FPC consults on withdrawing its Mortgage Affordability Test

AT A GLANCE

March 2022

What's new?

- The Bank of England's Financial Policy Committee (FPC) published a <u>consultation paper</u>, Withdrawal of the FPC's mortgage affordability test Recommendation, on 28 February 2022.
- The FPC is proposing to withdraw its June 2017 Recommendation on affordability testing, which requires mortgage lenders to apply an interest rate stress test to assess whether borrowers could still afford their mortgage in the event of a 3% rise in their interest rate.

What does this mean?

- The FPC introduced two Recommendations in 2014, aimed at constraining any loosening in mortgage underwriting standards.
- The first limited the number of mortgages that could be extended at 'loan to income' (LTI) ratios at or above 4.5. The second specified a stress interest rate for mortgage lenders when they assessed prospective borrowers' ability to repay a mortgage.
- In its latest review of these Recommendations, the FPC is concerned about how the affordability test has worked in practice. While average mortgage rates have fallen by 180 basis points since 2014, the stress mortgage rate adopted by most mortgage lenders has remained stable at around 7%.
- The FPC also notes that the LTI flow limit would be likely to play a

stronger role than the affordability test in guarding against wider financial stability risks (such as the level of household indebtedness).

 Therefore the FPC has assessed that the ongoing application of the LTI flow limit (without the affordability test), should deliver an appropriate level of resilience to the UK financial system.

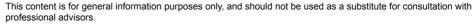
What do firms need to do?

- Firms should consider how the proposed withdrawal of the affordability test would influence their risk management practices. As set out in the its <u>supervisory</u> <u>priorities for 2022</u>, firms' management of credit risk will remain a key priority for the PRA.
- Firms should also consider whether the proposed change might impact their strategy for certain parts of the mortgage market (for example, potential lending at maximum LTI ratios).

Next steps

The consultation closes on 6 May 2022, and the FPC plans to issue a response later in 2022. It says it would formally withdraw the Recommendation within 12 months of making a decision.

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