

## The impact of changes to the social security safety net for mortgagors

In October 1995, restrictions were introduced to the State safety net provisions for mortgagors who lose all income through accident, sickness and unemployment. Research by Janet Ford and Elaine Kempson examines whether private insurance has bridged the gap left by the withdrawal of State support and looks at the consequences of the changing relationship between State and private safety net provision.

-  Borrowers have little knowledge or understanding of the nature of the changes. Those who claimed to be knowledgeable often had an inaccurate picture of their likely entitlement under different conditions.
-  Few new private insurance products have been developed to mirror the cuts to State provision. There has been a change from excluding whole categories of borrowers (such as the self-employed) to accepting most applicants but attaching specific conditions to their policies.
-  At most, only 21 per cent of borrowers have private insurance. Take-up amongst post-October 1995 borrowers (those most affected by the changes) is higher at 30 per cent. Overall, take-up grew by three to four percentage points between 1994 and 1996.
-  Three-quarters of people at greatest risk are not insured and could wait up to nine months for help with mortgage interest costs. This group make up a quarter of all borrowers.
-  There was no evidence that those at greatest risk were more likely to insure. Take-up was more linked to borrowers' attitudes to insurance and/or the date of their mortgage, suggesting that private mortgage payments insurance is sold rather than bought.
-  Take-up of private insurance has been unaffected by falls in its price. The level of take-up also reflects the fact that half of new mortgages are arranged by intermediaries which limits lenders' ability to discuss and sell insurance.
-  Despite relatively low take-up of private insurance, the predicted rise in arrears and possessions has not occurred. This is largely due to tight lending policies, to relatively low interest rates, to falling unemployment and to more cautious borrowing. Lenders believe that the situation will worsen if interest rates rise and the economy slows.

## State and private provision for mortgage payments protection

In 1987, the Government implemented a number of restrictions on the help available with their mortgage interest payments for those in receipt of Income Support. In October 1995, a further set of restrictions was introduced. From that date, borrowers who took out their mortgage prior to October 1995 have received no assistance with eligible mortgage interest payments for two months, 50 per cent of eligible payments for a further four months and only thereafter up to 100 per cent of interest payments. Borrowers taking loans after October 1995, with just a few exceptions, receive no assistance with eligible interest for the first nine months, and then full eligible interest. The presumption was that the private insurance market would increasingly provide a replacement safety net, able to meet the mortgage payments of Income Support claimants during these 'ISMI (Income Support for mortgage interest) gaps'.

At the time the changes were announced, approximately 12 per cent of borrowers had private mortgage payments protection insurance (MPPI). The market was criticised over restricted eligibility for insurance, poor provision of information and mis-selling and difficulties with respect to claiming. Private insurance for mortgage payments was also judged expensive. Notwithstanding these comments, there were views that the market was likely to expand to around 3.5 million policies, although the time period of the predicted expansion was unclear.

Currently there are only two direct insurers for mortgage payments insurance. More typically, it is offered as a block policy: lenders charge all borrowers accepted on a particular policy the same rate per £100 of repayments insured, and risks are not individually assessed. This raises the possibility of 'adverse selection', whereby those at greatest risk of making a claim will be most likely to insure. The contract is usually a monthly one which allows insurers to change the terms and conditions of policies as economic circumstances change: insurers providing mortgage cover relating to unemployment cannot be certain about the probability of unemployment, certainly in the longer term, and individual risks are influenced by the economic cycle.

## Perspectives on Income Support help with mortgage costs

The study showed that borrowers' knowledge of ISMI was very poor. Only one in five borrowers knew exactly what help they could expect to receive, with those *most* likely to be eligible for ISMI if they lost their job having the *least* knowledge. Both lenders and insurers believed borrowers had very low levels of knowledge and understanding.

Lenders responded to the ISMI changes by ensuring that their lending policies, which most had tightened in the early 1990s, remained cautious. A third of lenders revised their arrears policies and practices as a result of the proposed cuts to the State safety net, but for different reasons. Some were concerned to protect borrowers on Income Support, but without private insurance, through their 'ISMI gap' and these borrowers were not typically at risk of possession proceedings. Others sought to identify those in the 'ISMI gap' in order to ensure that arrears did not mount, and here borrowers could be at risk of litigation. The typical response from lenders, however, was to apply one standard arrears management policy to all borrowers, irrespective of individual circumstances.

Without a marked increase in the take-up of private insurance, lenders expected the changes to ISMI to result in further arrears and possessions. To date this has not happened, in part because of the subdued housing market, the tight lending regime, the relatively limited upward movement in interest rates and falling unemployment. However, lenders reported that the pressures towards arrears were still significant and that the predicted interest rate rises along with the next economic downturn would reveal the seriousness and full impact of the ISMI changes.

## The development of mortgage payments protection insurance (MPPI) products

Private insurance cover for mortgage payments has been available since the early 1980s, but the 1990s have seen substantial changes in the number, nature and cost of products. The predominant form of cover, however, remains the traditional accident, sickness and unemployment (ASU) policy, although more lenders are now allowing borrowers to insure for just some of these risks. There have been few innovative products, and few that mirror the 'ISMI gap' by offering nine months' cover.

Lenders have expanded the categories of borrowers who can *routinely* obtain MPPI. While cover now looks to be more accessible, this has been accompanied by a process of attaching specific conditions to the acceptance of members of particular groups. There is evidence that those with unstable employment histories still face the greatest difficulty in obtaining a policy.

The terms and conditions of MPPI vary in response to the level of claims and profitability of the products. Most recently there has been a reduction in the deferral periods associated with many policies. Some lenders have added services such as unemployment counselling services, help lines and hospitalisation or total disability benefits. The price of MPPI has also fallen, but the impact on take-up as a whole has been negligible. Some lenders have

adopted a policy of providing free insurance, for unemployment only, typically limited for a period of time. One expectation is that borrowers will then take out full ASU insurance on their own account, but there is no evidence as yet to assess the success of this policy.

### Marketing and take-up of mortgage payments protection insurance

The take-up of MPPI grew by between three and four percentage points between 1994 and 1996. Currently, between one in six and one in five borrowers are covered. The estimates of take-up vary depending on whether borrowers or lenders are the source of the information. Borrowers are likely to overstate take-up, due to a tendency to confuse different forms of insurance, while lenders' statistics tend to understate take-up, because they may be unaware of the extent to which borrowers that are introduced to them by intermediaries have insurance.

Take-up varies between lenders, but there are some clear influences at work that account for these differences. Post-October 1995 borrowers are more likely to have MPPI than pre-October 1995 borrowers and direct borrowers are more likely to be insured than those gaining a mortgage through an intermediary. Lenders differ on both these dimensions, as some have been more active lenders over the last two years than others. Lenders also differ in the amount of resources they have invested in training and marketing.

An important issue is whether the borrowers most likely to be at risk from the cuts in ISMI (those with less than £8,000 savings and no partner in employment) are the ones taking MPPI. Unless these borrowers have insurance, they will have to wait up to nine months for any assistance with their mortgage payments and clearly must be at risk of payment default. Overall, the research indicates a poor alignment between risk and taking insurance. Thirty-two per cent of borrowers surveyed would be eligible for Income Support (and subsequently ISMI) if they lost all income. Of these, three out of four have no private insurance. Grossing up the figures, this indicates a potential 2.5 million borrowers without insurance and at risk of the 'ISMI gap'. Although private insurance is often discussed in the context of a replacement for ISMI, the safety net issues extend beyond this. There are a further one million borrowers (nine per cent) ineligible for Income Support yet with no obvious means to maintain their mortgage payments on the loss of all income. These people do not have insurance, nor a partner in employment, nor savings that would enable them to redeem their mortgage.

The characteristics of those who take private cover for mortgage payments  
The study shows that the personal characteristics of borrowers (and particularly their financial characteristics) are not significant factors in accounting for take-up. Rather, the date of their taking out a mortgage was important, reflecting the fact that lenders have been actively canvassing post-October 1995 borrowers. Borrowers' attitudes to insurance, and so their responsiveness to marketing, were also important. This leads to the conclusion that MPPI is sold rather than bought.

A small number of borrowers were 'risk averse' and when risks associated with their mortgages were pointed out, they decided to insure. Others felt that they had no option but to take insurance when the policies were in fact not compulsory. Only a minority weighed up the costs of insurance and the cover offered against their likely circumstances and decided pragmatically. Amongst the majority without insurance, most seemed never to have considered the issue seriously, although a small number believed they were probably uninsurable because of their health or employment circumstances. Where people had considered a policy, more than decided against insuring than had taken out a policy.

One issue of concern to the private insurance market is the potential for 'adverse selection', whereby those at the greatest risk, and so with the greatest likelihood of making a claim, will dominate take-up. There is no evidence to date to suggest that this is an issue for MPPI. Rather, as noted earlier, three-quarters of those at known risk are not insured. Further, those who took out insurance were not a higher risk group than those who did not.

### Experiences of mortgage payments protection insurance

The proportion of policies triggering a claim varies with the overall state of the economy. The number of claims has fallen recently and, in 1996, four per cent of policy holders made a claim. There is variation in the level of claims between lenders which is, in all probability, a reflection of their lending policies.

About half of all claims currently relate to unemployment, a reduction since the recession in the early 1990s. There has, however, been a long-term increase in the number of health-related claims, reflecting the increase in the number of people claiming Invalidity (now Incapacity) Benefit.

Around 80 per cent of claims are accepted and, on average, payments last around six months. Claims may be rejected for a range of reasons; the

main ones being evidence of pre-existing medical conditions or job insecurity, or because claims are submitted too early (during the deferral period). A significant number of claims fail because the borrower does not meet the criteria for the policy which suggests a level of mis-selling. About five per cent of all claims are fraudulent.

Currently between 10 and 12 per cent of borrowers seem to cancel policies each year, many during the first month the policy is in force. This suggests that borrowers have second thoughts about the nature of the cover or its cost. A proportion of cancellations are due to mortgage redemption, and others result from house moves and the fact that, currently, most policies are not portable.

### Conclusions

The development of the private market for mortgage payments protection has been relatively slow, given that the changes to ISMI were thought likely to stimulate the market. On the whole, policies have been *sold* to borrowers and not *bought by them*. There is no evidence that those with the greatest potential risk are the most likely to insure, and so currently no evidence that the market is characterised by adverse selection. There are approximately 2.5 million borrowers who might in the past have qualified for (some) ISMI at the start of a claim for Income Support who have no MPPI as yet and who will now have no assistance for up to nine months of any IS claim. Borrowers' understanding of the ISMI changes and of MPPI is either absent or often incorrect.

### About the study

The research is based on depth interviews with 31 borrowers, nine lenders and five insurers, a quantitative survey of almost 900 borrowers and a survey of 28 lenders. The fieldwork took place in the summer and autumn of 1996.

### Further information

The full report, *Bridging the Gap? Safety nets for mortgage borrowers* by Janet Ford and Elaine Kempson is published by York Publishing Services (ISBN 1 874797 79 X, price £10.00).

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