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Dear Ms Bunce

Mortgage Market Review: Mortgage Arrears

This is the Financial Services Consumer Panel's response to the FSA CP 10/2: proposed changes to current mortgage arrears rules.

The Panel is supportive of the FSA's proposals to strengthen its approach to firms' arrears management practices. This is an area with significant risk of detriment and hardship for consumers, especially in the current economic climate. It is very disappointing that the unfair treatment of consumers has persisted within the mortgage market; strong and decisive action by the FSA is required to remind firms of their duty to treat customers fairly and signal the FSA's commitment to identify and take action against firms who are non-compliant.

The Consumer Panel believes that a central aim of the FSA's rules for firms' handling of arrears should be that borrowers are given sufficient time and guidance to enable them to decide whether they will be able to regularise their arrears situation within a reasonable time. Mortgage customers experiencing financial difficulty should be treated constructively positively and sympathetically, with solutions to managing arrears being developed on an individual basis, within a clear and transparent policy on arrears-handling. Borrowers who have a reasonable chance of regularising their repayments should not be hindered from doing so by their lender, nor penalised with unfair charges that perpetuate the cycle of debt. The equitable forbearance of temporary financial problems that we expect the industry to show should however not be misused to licence consumer choices that result in excessive long-term indebtedness.

Overleaf, the Panel has responded to the questions in the consultation paper. Within its response, the Panel suggests the FSA should bring into regulation best practice already outlined in the Council of Mortgage Lenders' (CML) industry guidance on mortgage arrears and possessions and the Civil Justice Pre-Action Protocol. We would welcome the opportunity to discuss this proposal in further detail in the coming months.

Yours sincerely

Adam Phillips
Chair, Financial Services Consumer Panel

Financial Services Consumer Panel's response to FSA CP 10/2***:

Mortgage Market Review: Proposed changes to current mortgage arrears rules

Question One: *Do you agree with the FSA's proposal to clarify requirements to prohibit lenders from levying an arrears charge where customers have a performing arrangement to repay the arrears in place?*

- 1) The Consumer Panel believes that when a customer has agreed to follow a performance arrangement, this shows a real willingness to repay their mortgage and get out of arrears. It is unacceptable that lenders continue to add arrears charges to a debt when a repayment plan is being kept to. Likewise, it is unacceptable that where a performance arrangement is in place lenders continue to add arrears charges because payments are a few days late. Both of these approaches only perpetuate the cycle of debt.
- 2) We would also question some lenders' approach to charging administrative fees to those who cannot, or do not wish to, repay using direct debits. For consumers in financial difficulties, the ability to have control of their finances is vital. A recent report by the Financial Inclusion Taskforce provided evidence of problems arising for financially vulnerable consumers when direct debits payments are taken from their accounts. Not only does it cause detriment in respect of bouncing unpaid direct debits and any authorised overdraft fees that may be incurred, but it also stops the consumer having control over their bank balance. Those on a tight budget need to have total control of their bank accounts and direct repayments (i.e. cheque or bank transfer) give this to the customer. Therefore, the Panel calls on the FSA to ensure mortgage lenders do not penalise those customers wanting to keep tight control of their finances and not use direct debits.
- 3) The Panel believes it is essential that arrears charges genuinely reflect the additional costs of handling arrears, rather than being used as a profit stream. Reflecting on the issues around unauthorised overdraft bank charges, one could draw comparisons that as with bank charges, there can be no justification for such high arrears charges hitting consumers when they are most vulnerable. If firms are serious about treating customers fairly they should accept that it's not fair to fund their retail operations through excessively high charges to one section of their customers.

Question Two: *Do you agree with the FSA's proposals to convert current MCOB guidance to rules?*

- 4) In the Consumer Panel's submission to the Treasury Select Committee's inquiry into mortgage arrears in July 2009, it called for the FSA to ensure firms were complying with MCOB 13. We support the FSA's proposals to convert MCOB forbearance guidance into rules but believe there is an opportunity here to join up several recent initiatives to provide for more effective consumer protection.

- 5) In comparison with the response seen in the early 1990s to mortgage arrears, there has been a welcome raft of recent initiatives that aim to help struggling homeowners. In particular, we note:
 - a) the FSA review of MCOB rules pertaining to arrears;
 - b) the mortgage pre-action protocol¹
 - c) the CML Industry Guidance on mortgage arrears²
- 6) Some very good practice has been suggested in all three initiatives, but they are not joined up. This presents difficulties for homeowners and advisers in knowing what they can expect or require from mortgage lenders and just how much they can rely on the protection of regulation. The difficulty is most noticeable where some of the initiatives mandate practices whilst others leave it to the discretion of the individual lender whether they follow good practice. We can best illustrate our point through two examples:
- 7) The Civil Justice Pre-action Protocol describes the behaviour that the court will normally expect of the parties prior to the start of a mortgage possession claim. It aims to ensure that lenders (and borrowers) act fairly and reasonably in dealing with mortgage arrears. Section 6.1 of the protocol states that:

A lender should consider not starting a possession claim for mortgage arrears where the borrower can demonstrate to the lender that the borrower has:

 - (1) submitted a claim to an insurer under a mortgage payment protection policy and has provided all the evidence required to process a claim;*
 - (2) a reasonable expectation of eligibility for payment from the insurer; and*
 - (3) an ability to pay a mortgage instalment not covered by the insurance.*
- 8) The Panel believes this, and other provisions of the protocol, give too much discretion to lenders in their 'consideration' of what they can do. In this example if a borrower has paid for a mortgage payment insurance protection policy, and expects the insurance to pay out, and can also meet any shortfall in the mortgage payment that will not be covered by the insurance, then the appropriate and balanced regulatory response is to provide that a lender will not take possession action. We recognise that safeguards may be needed for lenders if a borrower has deliberately accumulated arrears, however the Panel believes that in reality falling into arrears is not a choice the vast majority of consumers would make.
- 9) Similarly the CML best practice guidance contains a wide range of measures which we readily endorse as being a genuine attempt by the trade association to deal fairly with borrowers in mortgage arrears. But, as the CML states in the introduction to its paper, their guidance 'has no regulatory status and some of the examples of good practice given may not be appropriate for all lenders'. This reduces the impact of the guidance. A borrower facing mortgage arrears should surely be able to expect that this recommended 'best practice' will not vary depending on the company with which they have their mortgage.

¹ http://www.civiljusticecouncil.gov.uk/files/Mortgage_Arrears_Pre-Action_Protocol.pdf

² <http://www.cml.org.uk/cml/policy/issues/1629>

- 10) As part of its guidance, the CML explains how its members should agree a plan for the repayment of mortgage arrears. The CML sets down that the lender should:
- a) *assess income and expenditure, using a combination of existing information on file (perhaps from the original application), updated using revised income and expenditure statements. This could also be done through any third party that you have agreed to liaise with (e.g. an independent free debt adviser). Income and expenditure might need to take into account other priority debts like council tax, etc;*
 - b) *check this information to see how reasonable it is, for example, by using recent payslips/bank statements;*
 - c) *suggest that customers seek independent advice before accepting an agreement;*
 - d) *compare your agreements to pay with any decided by the court. You may need to review your procedures if courts are arranging lower payments*
- 11) This guidance, set out above, seems to be sensible and appropriate, akin to what a regulator should require of a mortgage lender. Yet, it should not be left to the discretion of a lender whether it follows this guidance. This is another example of best practice that should be included within FSA rules so that borrowers know exactly what lenders are required to do and what steps the borrower also needs to take.
- 12) The Consumer Panel believes the FSA should enter into discussions with trade associations, firms and consumer groups on how best to ensure that best practice is enshrined within the FSA rules.
- 13) The Panel would also like to raise concerns over how FSA rules interact with the Ministry of Justice's legislation. Where a consumer has mortgage arrears, MCOB lays down the requirements (rules) and expectations (guidance) of the FSA. But where the arrears lead to a possession hearing, the District Judge has to have regard to the relevant provisions of the Administration of Justice Act. Put simply, the Administration of Justice provisions provide that the borrower has to be able to convince the Judge that s/he can repay the mortgage arrears within a 'reasonable' time period. Any failure by the lender to abide by MCOB provisions may be of interest to the judge in deciding how to interpret the 'reasonable' period but otherwise there is no connection between the regulatory provisions and the statutory provisions.
- 14) The November 2008 pre-action protocol on mortgage arrears was an attempt to help judges by setting down requirements on lenders to help ensure that possession action was preceded by meaningful attempts to negotiate an arrangement that would allow the borrower to keep their home. Yet, the protocol does not even mention MCOB. The only point where the protocol refer to regulatory protection is where it states:

8.1 The lender should consider whether to postpone the start of a possession claim where the borrower has made a genuine complaint to the Financial Ombudsman Service (FOS) about the potential possession claim.

8.2 Where a lender does not intend to await the decision of the FOS it should give notice to the borrower with reasons that it intends to start a possession claim at least 5 business days before doing so.

- 15) Note that the obligation on the lender to consider the role of the FOS is discretionary and that it's the lender's call as to whether the complaint is genuine. Therefore, the Panel calls for:
- a) A joined up regulatory and statutory approach would provide that district judges would at least be able to consider whether a lender was in breach of fundamental consumer protection regulations. Whilst the judiciary may be reluctant to act as a back-stop to the FSA (judges may reasonably consider that it is up to the FSA to make sure that mortgage lenders follow FSA rules) there should be some provision whereby a borrower who has made a claim to the FOS can bring this to the attention of the judge and that the statute allows the judge to adjourn for the FOS to make a decision. But this interaction of the regulatory and statutory provisions requires discussion and collaboration between the FSA, Ministry of Justice (MoJ) and the FOS.
 - b) We suggest that the FSA should meet with the MoJ and the FOS to discuss ways in which the protection to borrowers offered by MCOB, the Administration of Justice Act and the FOS provisions can be better joined together.
- 16) We also note that in Scotland, the Home Owner and Debtor Protection (Scotland) Act 2010 requires lenders to comply with the pre-action requirements, failing which, an action can be dismissed. It is understood this Act is being brought into force from September 2010.

Question Three: *Do you agree that government schemes should be included as a potential forbearance option?*

- 17) The Consumer Panel supports the FSA's proposals to include government schemes as a potential forbearance option. We believe it is important that customers in arrears are made aware of the Government schemes.
- 18) However, we would urge the FSA to go further than just the government schemes as forbearance option. For example, the rules should remind lenders of their obligations under the Mental Capacity Act and arrears recovery should reflect any relevant reported determinations or guidance provided by the FOS. This builds on our substantive point that the FSA regulation on mortgage arrears should bring together all relevant statutory requirements and best practice guidelines.
- 19) The Panel also supports Shelter's suggestion that the FSA should require firms to take into account both available state help (i.e. benefits) and/or insurance (such as mortgage payment protection insurance or income protection insurance).

Question Four: *Do you agree with the FSA's proposal to use guidance to clarify our current requirements prohibiting the inclusion of arrears charges and accrued interest on the charges within ERCs?*

20) Following the logic of lenders wanting customers to get back to regularising their repayments rather than continuing a cycle of arrears, the Panel believes early repayment charges (ERCs) should not include arrears charges or any interest levied. As the FSA's consultation paper states [paragraph 4.19], the regulator found there were firms including arrears charges and the interest levied on these charges in their ERC calculations. This effectively means the customer is: charged; made to pay interest on that charge; and then on top of that subjected to an ERC.

21) We wholly support the FSA's approach; it is contrary to the Principle of treating customers fairly that any mortgage lenders would want their customer to remain in a cycle of debt, rather than enabling them to regularise their repayments at the earliest opportunity. The Consumer Panel believes mortgage companies should be allowed to recoup costs incurred, but lenders should not seek to profit from consumers' misfortune. It is in the financial services industry's interests that consumers resolve financial difficulties and become active players in the market.

Question Five: *Do you agree with our proposals to implement record-keeping requirements for telephone calls?*

Question Six: *Do you agree with the extension of the period for all arrears records from 12 months to three years?*

Question Nine: *What should the timescales be for implementing call recording and retention?*

22) The Consumer Panel supports the FSA's raft of proposals on record keeping. We believe that compliant firms should see the benefit of having a record of interaction with customers, both in case of a customer complaint or FSA review.

Question Seven: *Do you agree with the proposal to clarify our current requirements for borrower payments to be allocated to paying off arrears before charges?*

23) We support the FSA's clarification over payment allocation and believe consumers should be paying off the largest debt first (i.e. the mortgage), with any 'fair' arrears charges being paid off either after the customer has begun regularising their payment, or repossession has taken place and the loan is cleared.

Question Eight: *Would the proposals to change the rules affect firms' ability to improve consumer understanding of the arrears statement?*

24) No, we believe the changes will not confuse consumers. As the FSA's own research found, currently some arrears statements are difficult to understand, and we would imagine consumer awareness about arrears statements is likely to be low anyway. The FSA gave a clear steer to firms in August 2008 to what it

considered to be good and bad practice in the information provided to consumers in arrears.

Question Ten: *Do you have any comments on our CBA?*

25) Perhaps inevitably, regulatory costs may be passed on to consumers. It is a sad reflection on the financial services sector as a whole that firms still need intrusive (and sometimes costly) regulation to ensure customers are treated fairly and that consumers often end up bearing the costs of this.

26) Paragraphs 6.44 and 6.58 of the consultation paper note that industry may recover the income losses and extra costs that arise from regulatory changes by charging consumers more. The point is central to the calculation of welfare seen from a consumer point of view and should be highlighted in the main body of the consultation paper.

27) It is regrettable that the CBA makes no attempt to quantify the extent of such claw back. As a result, it is not possible to gauge using the information provided the impact to consumers as a whole from any of the five proposals. The Panel regards this omission as a serious weakness in the CBA. In addition, it would be helpful for a summary of the CBA to be included in the consultation paper.

Question Eleven: *Do you agree with the compatibility statement?*

28) The Panel agrees with the statement.