

Finalised guidance

FORBEARANCE AND PROVISIONS GUIDANCE THEMATIC – ‘MORTGAGES’ COST BENEFIT ANALYSIS

October 2011



COST BENEFIT ANALYSIS: Feedback

Only four of the respondents to the consultation commented specifically on the cost benefit analysis.

Two respondents pointed out that forbearance practices have been driven by external pressures that the government, the courts and the FSA has put on firms in recent years and therefore attributing it only to firms' incentives would be misleading.

One respondent said that the FSA did not provide evidence on the potential consequences of forbearance practices.

Two respondents pointed out that the additional scrutiny of forbearance practices may be reflected in an increase in arrears charges.

Three respondents argued that the compliance costs had been underestimated. In two cases this was attributed to higher system costs and in one case to costs incurred training staff so they are able to recognise the cases where forbearance measures may or may not be in the best interest of customers.

Our response

Regarding the drivers of forbearance measures, we acknowledge that, in addition to the incentives we identified in the original CBA, there are external factors that influence the firms' decisions. In some cases the external factors are likely to be considerably more important than the market incentives that are present nonetheless.

Regarding the consequences of forbearance practices, our thematic work showed that some firms were indeed using these measures to reduce their level of recognised impairment without giving sufficient consideration to the individual circumstances of the customer and the consequential impact for the customer as well as the impact on firm, regulator and market understanding of the loss risk and impairment of the book.

We also recognise that increased costs for firms could be reflected in higher arrears charges as long as they comply with the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)¹ rules.

Regarding the claim that the system costs have been underestimated, we have conducted additional analysis and provide some updated estimates below. However, we do not accept the claim that this guidance would result in material incremental training costs given that all firms, to comply with our rules (SYSC 3.1.6R², 5.1.1R³), must have existing processes in place to regularly update staff on changes to policy, procedure, products etc. and have teams in place conversant with individual customer and affordability assessment processes as well as training experience to support these tasks.

In the paragraphs that follow we summarise the additional analysis we conducted to provide updated compliance cost estimates. The other parts of the original CBA⁴ are unchanged.

COMPLIANCE COSTS

In order to take into account the feedback received on the compliance costs we have sought additional information on the IT costs associated with this guidance. We have therefore revised our assumption that 50% of firms would expand existing data depositories rather than develop a bespoke solution to the current assumption that all would create a bespoke database.

Based on actual costs from firms who have developed bespoke solutions to date, our revised estimate for the average IT development cost is £15,000 per firm (up from £10,000). Given our revised assumption that 100% of firms will create a bespoke solution rather than add to existing databases, to provide an upper limit to the compliance costs, the overall industry cost, across 300 firms, will be £4.5m. At £15,000 build cost, the investment could yield significant benefit for customers and firms through more informed knowledge on the effectiveness of various forbearances approaches, and statistically what in practice most aids effective support and long term recovery. This investment outlay would be covered by just one or two mortgages recovering onto sustainable terms and avoiding a loss situation.

¹ <http://www.fsa.gov.uk/pubs/hb-releases/rel61/rel61mcob.pdf>

² <http://fsahandbook.info/FSA/html/handbook/SYSC/3/1>

³ <http://fsahandbook.info/FSA/html/handbook/SYSC/5/1>

⁴ Which is available at http://www.fsa.gov.uk/pubs/guidance/gc11_10_cba.pdf