Finalised guidance

Sale and Rent Back Review 2011

July 2012

Contents

INTRODUCTION

1.1 In March 2011, we undertook a thematic review of the sale and rent back (SRB) market. This report explains the findings from that review. The background and methodology that we used are contained in the Annex.

1.2 22 authorised SRB firms were reviewed. Of those, nine firms have been active in the SRB market since our full regulatory regime began in June 2010. The other 13 firms are regarded as inactive, as they have not been involved in any SRB transactions under the full regime.

Overall assessment

1.3 The review identified widespread poor practice among SRB firms. The main conclusion is that the majority of SRB sales were either unaffordable or inappropriate. This means consumers have entered into agreements that have either already led to a detrimental outcome, or are highly likely to in the future. This is unacceptable, and we are taking immediate action to address this.

1.4 The review found that even though senior management at SRB firms were aware of their regulatory obligations, the majority of authorised SRB firms were not adhering to the requirements of our full regime, particularly the conduct of business requirements set out in our Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).[1]

1.5 The most common failings identified by the review, together with the relevant MCOB rules, can be summarised as follows:

- **Appropriateness and affordability** were not assessed correctly (MCOB 4.11.3R and 4.11.5E).
- **Disclosure** did not follow the correct order, was insufficient and was not given at the right time (MCOB 4.11.1R and 5.9.1R).
- **Record keeping was inadequate** to confirm that our requirements had been met (MCOB 4.11.8 R).
- **SRB agreements** contained incorrect information and did not meet our requirements for tenancy agreements (MCOB 2.6A.5B R).
- **Financial promotions** were not compliant with our rules (MCOB 3.8B).

[1] MCOB can be found at http://fsahandbook.info/FSA/html/handbook/MCOB

- **Sales processes** did not follow the structure set out in our rules, or allow firms to gather enough information from the customer to assess appropriateness (MCOB 4.11.3R, 4.11.4E, 4.11.5E and 4.11.7G).

- **Customers were not given enough time to consider the SRB** (MCOB 5.9.1R).

1.6 In addition, **Training and competence** and **compliance monitoring** were found to be inadequate.

Immediate outcomes

1.7 Due to the seriousness of these findings, five active SRB firms have voluntarily varied their permissions and have ceased to conduct SRB business. A number of active SRB firms have also agreed to complete past business reviews, which may lead to further action being taken, and one has already been referred to Enforcement. Due to the prominence of these firms in the sector, the market for regulated SRB has in effect been temporarily halted.

1.8 One firm has agreed to stop 'entering into' transactions until remedial action is undertaken, and two have informed us that they do not intend to use their permissions going forward. Another will only 'enter into' SRB transactions on the secondary market, i.e. buying existing SRB contracts. Three firms may enter into SRB transactions in the future, but have not done so yet.

1.9 Our intervention has identified and mitigated widespread poor practices and met our objective to protect vulnerable consumers.

ANNEX

DETAILED FINDINGS

Appropriateness and affordability testing

2.1 The sales processes adopted by the SRB firms displayed the following deficiencies, which are all potential breaches of our appropriateness rule in MCOB 4.11.3R[2]:

(a) Other options that may have been available to the consumer were not considered, such as negotiating with their lender, debt restructuring, open market sales, government benefits, rescue schemes or not selling the house.

(b) Where the customers were aged 55 or above[3] and equity release may have been an available option, a few firms had considered lifetime mortgages, but none had assessed whether a home reversion product would have been a better option.

(c) Some firms did not fully assess appropriateness and allowed the customer to enter into an SRB agreement because they expressed a desire to do so, not because it was necessarily appropriate to do so. These firms felt that appropriateness was met by satisfying the customer's desire to enter into the SRB agreement, regardless of whether or not the benefits outweighed the adverse effects.

(d) The fact-finding process was in general pitched at a high level and did not encourage firms to delve deeper into the customer's circumstances. For example, many files detailed the customer's desire to repay unsecured debts, but not the reasons behind the need to repay debts.

(e) Some firms based their affordability assessment on what appeared to be unreasonable figures for income and expenditure without supporting evidence (e.g. payslips, bank and benefit statements). Firms assessed affordability using only short-term income. For example, one SRB provider did not take into consideration a possible future reduction in income (for example on retirement) and entered into SRB contracts where they knew the contract would be unaffordable at some point during the tenancy. In some cases there was no affordability assessment carried out at all.

(f) Some firms had based affordability on housing benefit income even though there was no evidence on file to confirm that a successful claim could be made.

[2] See http://fsahandbook.info/FSA/html/handbook/MCOB/4/11
[3] The minimum age at entry applied by most equity release providers is currently 55 for lifetime mortgages, 65 for home reversions.

(g) Some firms were entering into SRB agreements with unemployed customers and relying on the lump sum released, or the income from the lump sum, for the affordability check. In some cases the lump sum was retained by the provider to pay the rent.

Disclosure

2.2 In all cases involving an authorised provider entering into an SRB contract, the pre-sale disclosure did not meet our requirements, or was not being given to the consumer at the right time. Our pre-sale disclosure requirements are clearly set out in MCOB 5.9.1 to 5.9.4R .[4] For example, one firm did not supply all of the required legal documentation in a timely fashion to allow customers to benefit from the statutory 14-day cooling-off period.

2.3 Some of the disclosure documents were misleading or inaccurate. For example, information relating to buy back options, rent rises and fees was often unclear or incorrect.

Agreement from lenders

2.4 Where SRB firms were using a mortgage or other borrowing facility to fund their purchases, most files did not show that the lender or finance provider had agreed to the letting under the SRB agreement. Where this was obtained from the lender or finance provider, a copy was not always given to the seller. This is a requirement under MCOB 2.6A.5B R.[5]

Valuation

2.5 In many cases it was not clear from the file that the surveyor owed a duty of care to the SRB seller. This is a requirement under MCOB 2.6A.12A R[6] It was therefore not clear if these customers received an offer that was based on a fair assessment of the value of the property.

SRB agreement, including the tenancy agreement

2.6 The contract documents used by the firms were reviewed against the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) and our requirements under MCOB. We found the following issues with some of the documents:

- Some of the contract documents had not been written in plain and intelligible language. Legal jargon was frequently used.
- A number of the documents were not up to date. For example, in some of the tenancy agreements, there were references to the landlord retaining a deposit, whereas the requirement is now to place a deposit in an authorised tenancy deposit scheme.

[4] http://fsahandbook.info/FSA/html/handbook/MCOB/5/9
[5] http://fsahandbook.info/FSA/html/handbook/MCOB/2/6A
[6] http://fsahandbook.info/FSA/html/handbook/MCOB/2/6A

- Several of the firms had information in their sales literature that contradicted the contents of their contracts.

- Firms were not sufficiently aware of our rules that limit the grounds for termination. Some tenancy agreements contained a term that gave the landlord a broad discretion to terminate the agreement if the tenant breached of any of the terms. In our view, such a broad discretion may indicate that a term is likely to be unfair and could mislead consumers about their rights.

- A number of tenancy agreements contained a term that gave the landlord a broad discretion to vary the level of rent. We consider the variation provisions to be too wide and likely to be unfair under the UTCCRs, as the terms did not provide any 'valid reasons' for unilateral variation. It was not clear to consumers if or when their rent could be varied and/or whether they could challenge such a variation.

- Terms in some of the tenancy agreements could amount to financial penalties under the UTCCRs, in particular those imposing charges and/or interest for a late payment of rent. Such terms are likely to be unfair under the UTCCRs.

- There were examples of 'read and understood' terms, where consumers were requested to confirm that they have read and understood the contents of an agreement, whether or not the consumer had, in fact, had the opportunity to read the document. We consider such terms are likely to be unfair.

- There were also tenancy agreements that were in breach of our rules, as they did not allow the tenant to terminate the agreement with three months' notice and with no other conditions attached. Some required the tenant to pay the remaining rent due under the agreement.

Financial promotions

2.7 11 firms were actively promoting SRB business. A detailed review of their websites found the majority to be non-compliant with the financial promotions rules set out in MCOB 3.8B.[7] The main issues were the lack of required risk warnings or failure to present them prominently. A number of sites presented the advantages of SRB without highlighting the potential downsides. In addition, we were concerned about the use of emotive language that often exploited the vulnerable nature of SRB customers. Discussions at firm visits confirmed our concerns about the general lack of understanding of the financial promotions rules in MCOB.

Sales processes

2.8 Although the majority of the firms had a written sales process in place, six of the firms' processes were considered to be inadequate. Deficiencies identified included:

[7] http://fsahandbook.info/FSA/html/handbook/MCOB/3/8B

- no procedures in place describing the requirements to issue a pre-offer disclosure document to the client; and
- inadequate procedures relating to the assessment of appropriateness and affordability.

Know your client

2.9 A number of firms had fact-finding processes that were inadequate, in that they did not collect enough information to demonstrate the SRB transaction was appropriate for the seller.

Treating customers fairly

2.10 Where consumers were in arrears and at risk of repossession, the majority of files showed that SRB firms were helping sellers explain the SRB process to their mortgage lender and were encouraging sellers to discuss further forbearance with the lender until the SRB contract had completed.

Fees

2.11 Some SRB arrangers and advisers were charging fees of thousands of pounds, while others did not charge a fee at all. Those not charging a fee may have offered sellers a larger discount (equivalent to the fee). However, given the nature of the SRB market, we believe it is unlikely that most consumers would have compared the overall value of one scheme against others. Most of the SRB customers were vulnerable due to their age, financial position or need to move fast and therefore may not fully understand the impact of fees being charged.

2.12 The advising/arranging firms that do not charge fees generally receive commission from the provider. The average commission paid by the providers is 5% of the purchase price, which in most cases is over £4,000. Although one firm reported a maximum fee of 5% of the purchase price, there was evidence on file to suggest that they had charged clients up to £40,000.

High-pressure selling

2.13 Some high-pressure selling techniques were being used. All firms said that they understood their obligations with respect to high-pressure selling. However, some firms committed the customer to unnecessary and high charges early in the sales process, before the customer had time to consider the terms of the SRB. Some firms required an excessive number of, or unnecessary, signatures, or asked the customer to sign declarations about 'being bound by terms and conditions' when in fact the customer is not bound by any term or condition.

Training and competence

2.14 Seven of the firms did not have a training and competence scheme in place and the remaining firms had schemes of varying complexity, of which we considered five to be inadequate. The majority of the larger firms had no systems in place to ensure competence was maintained (for example, through

regular testing), nor were they recording continual professional development or documenting meetings in a consistent manner.

Compliance monitoring

2.15 Most of the active firms had their files reviewed by a compliance consultant and in many cases 100% of the customer files were checked. High levels of good quality files were reported by the compliance consultants. However, the quality of this checking was inadequate, as shown by the high levels of inappropriate or unaffordable SRB transactions that we identified. Three of the active firms did not monitor the quality of their advice post-sale, including one of the larger adviser firms and one of largest providers.

Management information (MI)

2.16 Three of the firms reviewed did not collate MI. The majority of the remaining firms collated inadequate MI that was restricted to a new business register. Only three firms used key performance indicators to analyse the data collected and the majority of firms did not commit to regular trend analysis.

2.17 The majority of firms did not collect information on cases that did not proceed, thereby making it difficult to accurately analyse trends associated with poor sales practices.

Unauthorised business

2.18 Two firms arranged deals with unauthorised private investors. At the time of review there was nothing to prevent this, as we had no control over the actions of the unauthorised private investors – we found that this practice could expose consumers to additional risks. We liaised with the Treasury and legislative changes have been made (see paragraph 2.22) so that anyone who provides an SRB agreement has to be authorised by the FSA, unless they are providing it to a relative.

2.19 Examples of risks we had identified included that firms:

(a) Did not make clear to sellers the involvement of the private investor, did little due diligence on the investor and exercised little control over how the tenancy was handled by the investor.

(b) Arranged for the property to be sold at full market value to an unauthorised investor and encouraged the seller to repay the investor's deposit money from the proceeds of the sale. This fraudulent behaviour could result in the investor's mortgagee taking the house into possession in the future, which in turn could lead to the seller having to move out.

(c) Claimed to be a provider but did not intend to buy the property and arranged for an unauthorised private investor to enter into the agreement instead.

(d) Sold on SRB agreements to unauthorised private investors after a relatively short period of time (six to 12 months).

2.20 The risk to consumers was that agreements from unauthorised investors could be unaffordable, or include a tenancy shorter than the minimum five years required under our regime.

2.21 While the firms had done some due diligence on the investors and followed our high-level rules (e.g. regulatory disclosure to the customer of the status of the investor), this fell short of the protection afforded by authorised firms. The scale of unauthorised business to authorised business suggests that there was limited consumer protection on a number of sales.

2.22 We worked with the Treasury to address this risk. Legislative changes have been made to the 'by way of business' test under FSMA.[8] The changes, effective from 16 September 2011, mean that anybody who provides a SRB agreement – even a single transaction – must be authorised by us unless they are providing it to a relative.

[8] http://www.legislation.gov.uk/ukdsi/2011/9780111513088/article/2

BACKGROUND AND METHODOLOGY

Background

3.1 In March 2010 we received a report from a lender (via the Information From Lenders Scheme) that SRB transactions were being arranged as normal buy-to-let mortgages where the properties were sold at below market value and the lender was defrauded because the purchase price declared on mortgage application forms was inflated. Their report suggested that this was a widespread issue. Following our own investigations, one firm has been referred to Enforcement. This case also raised concerns about consumers being treated unfairly under the contracts being used in SRB agreements.

3.2 In March 2010 we carried out a piece of work that identified firms using financial promotions to attract vulnerable consumers. This work highlighted instances of financial promotions relating to quick sales that often led to an SRB being entered into.

3.3 Which? carried out a consumer survey on SRB and published their findings in February 2011.[9] They suggested that the advice to SRB consumers was 'woefully inadequate'. Which? Said that 'out of the 17 researchers who contacted nine firms about SRB, only two were offered acceptable advice'. Their findings can be summarised as follows:

- Out of the nine firms it contacted, two were not registered with the FSA to offer SRB. Despite this, they both gave quotes to researchers.
- Seven advisers failed to discuss whether SRB was the right option for a customer, with six of these going on to give a quote.
- On only two occasions were other solutions fully explored, and on both of these the adviser suggested the customer consider these options before proceeding with SRB.
- Only one firm did a thorough affordability check to see if SRB was suitable for the customer, with others asking basic questions about income and what might be affordable as rent, while some did not cover the issue at all.

3.4 In response to the concerns above, we began a thematic project in March 2011. At the start of the project, 27 SRB firms were authorised under the full regime. Many of these firms were also carrying out regulated activities in regard to SRB from the start of the interim regime in July 2009. The aim of the project was to:

- investigate the quality of advice that was being given by the firms and what impact this had on the fair treatment of customers;

[9] http://www.which.co.uk/news/2011/02/which-exposes-sale-and-rent-back-firms-245640/

- test the fairness of the firms' financial promotions;
- understand the risks associated with the contractual documentation being given to consumers;
- ascertain whether risks were the same across all firm types that have SRB permissions, or if there were risks that are specific only to standalone SRB firms; and
- ascertain whether the same risks applied to established larger firms in comparison with the smaller new firms.

The intended outcomes of the project were to:

- ensure that consumers are being treated fairly regardless of whether they are vulnerable to the current market conditions;
- ensure that firms found to have inappropriate systems and control arrangements/compliance procedures adapt their behaviours accordingly through firm education, communication or regulatory (including enforcement) action;
- ensure that firms found to have disadvantaged consumers due to poor sales processes offer appropriate redress; and
- communicate our findings to the industry.

Methodology

3.5 The data collected from the project spans both the interim regime from 1 July 2009 to 30 June 2010 and the full regime from 1 July 2010 to 1 April 2011. At the start of the project, 27 SRB firms were authorised under the full regime. Many of these firms were also carrying on SRB-regulated activities from the start of the interim regime in July 2009.

3.6 Firms were assessed using a mixture of firm visits and desk-based reviews (DBRs). Firms were selected for either visits or DBRs based on the number of SRB agreements they had entered into, advised on or arranged. We started with an outbound calling exercise that reduced the number of firms to 22, as some firms cancelled their authorisations as a result of our contact. We conducted visits to the top 12 firms and did desk-based reviews on the remaining ten firms.

3.7 Since the full regime came into force, of the 22 firms reviewed:

a. only nine had entered into, arranged or advised on a regulated SRB contract – four acted as providers of SRB (for 42 SRB agreements) while the other five acted as advisers only;

b. two of the active firms advised on 19 SRB contracts that were entered into by unauthorised providers (taking the total number of regulated SRB contracts to 61); and

c. the other 13 firms (inactive firms) were either not going to transact any new business or intended to become active at some point in the future.