



New FSA proposals on the fair treatment of customers in arrears

This briefing summarises two recent publications by the Financial Services Authority (FSA) in which the FSA proposes that certain changes be made to the Mortgage Conduct of Business Rules (MCOB). The publications are *Discussion paper 09/3: mortgage market review* and *Consultation paper 10/02 – mortgage market review: arrears and approved persons*. We discuss the implications of some of the main changes put forward, with a particular focus on how the proposed amendments to MCOB will affect firms' obligations in respect of the fair treatment of mortgage customers in arrears.

Introduction

Regulation of the UK mortgage market, and in particular the need to ensure that customers in arrears are treated fairly, is proving to be a key priority for the Financial Services Authority (FSA) in 2010. Partly in response to political pressure to the effect that – in the present climate – the current regulatory framework is ineffective in protecting struggling home owners, the regulator has now proposed a range of amendments to the Mortgage Conduct of Business Rules (MCOB) that are likely to affect firms' future policies and procedures.

The proposed amendments and the background to them are set out in two FSA papers:

- a discussion paper released in October 2009 (*Discussion paper 09/3: mortgage market review*; DP 09/3), which outlines key issues arising from the FSA's review of the mortgage industry and its thematic work with firms in 2008 and 2009; and
- a follow-up consultation paper dated January 2010 (*Consultation paper 10/02 – mortgage market review: arrears and approved persons*; CP 10/02), which sets out the FSA's specific proposals for regulatory change.

Recent commentary on the regulatory framework has also come in the form of a report produced by the House of Commons treasury committee in July 2009 entitled *Mortgage arrears and access to mortgage finance*, which contains strong criticism of the FSA's regulation of the mortgage market to date, and a consultation paper produced by HM Treasury in November 2009, which makes a number of proposals in relation to the regime

governing lending permissions and second-charge mortgages.

Together these documents provide a road map for where regulation of the mortgage market is likely to go in the next few years. The proposals on arrears management and repossessions handling, summarised below, could be particularly significant for firms.

Lender flexibility and forbearance

In its July 2009 report the treasury committee expresses particular concern about a lack of flexibility and forbearance by those lenders operating within the sub-prime and specialist lending sectors. In DP 09/3 and CP 10/02, the FSA also picks up on this issue, suggesting that it thinks lenders have to date focused too narrowly on recovering arrears and have been moving too quickly to repossession proceedings without first considering all other available options.

To deal with this, the FSA is now proposing to replace the existing framework, which is essentially based on general principles, with a prescriptive and more comprehensive list of actions that lenders will be obliged to take in relation to customers experiencing financial difficulties. For example, guidance on MCOB 13.3.4 will, under the proposals, be converted into a set of rules prescribing what a lender must do in seeking to reach an agreement with customers in arrears over the method by which those customers will repay any shortfall. If the FSA's proposed amendments are implemented lenders will in future have clear obligations to:

- give customers a reasonable period to consider any proposals for payment that are put to them;
- give customers adequate information about any applicable government schemes to assist borrowers in payment difficulties; and
- consider whether it would be appropriate to do one or more of the following to help the customer in paying off the arrears:
 - extend the term of the loan;
 - change its type (eg switching capital to interest only);
 - defer payment of interest due;
 - treat the payment shortfall as if it were part of the original amount provided (notwithstanding that capitalisation of a shortfall should never be automatic); and/or
 - make use of any government forbearance initiatives in which the lender participates.
- lenders must not apply a monthly arrears charge to borrowers who are complying with the terms of an agreed repayment arrangement between the borrower and the lender (for example, if the lender has agreed to accept a series of reduced payments to help the customer out of arrears) unless that fee genuinely represents the cost of additional administration work by the firm.

In addition, the FSA is carrying out further detailed review work in relation to arrears charges to ensure that fees reflect the underlying costs of arrears administration and to identify and challenge further practices that it considers may be unfair. The review is part of a wider piece of ongoing supervisory work into the levels of lender product charges and lender charging models, and the FSA has stated that its eventual findings may lead it to establish baseline figures for charges, something it has previously resisted doing.

Mortgage arrears charges

The treasury committee has been highly critical of what it considers to be excessive charges levied on borrowers in arrears, expressing concern that some lenders have been using these charges as an alternative profit stream rather than to recoup the additional administrative costs incurred in dealing with customers in arrears.

In DP 09/3 and CP 10/02, the FSA also demonstrates a renewed focus on this topic. Whereas previously the FSA has relied on guidance such as the ‘good and poor practice’ examples on its website to flesh out the requirements of MCOB 12 in relation to charges, it has now announced an intention to follow a more interventionist approach to regulating charging practices. This is to be facilitated by a number of proposed amendments to MCOB set out in CP 10/02. If implemented, these amendments will make clear that – among other requirements – firms have a regulatory obligation to ensure that:

- payments from customers in arrears must be allocated first to clearing missed monthly payments and only after such arrears are cleared should monies go to paying off charges;
- lenders must not add early repayment charges onto arrears charges; and

Record keeping

In CP 10/02 the FSA has also indicated that it is planning to introduce amendments to the record keeping regime set out in MCOB. The principal proposals are that:

- lenders be required to record all telephone calls with their customers; and
- such recordings, and all other records of dealings with customers in arrears or with a mortgage shortfall debt, be retained for at least three years from the date on which the relevant payment or sale shortfall is cleared.

These changes reflect the FSA’s belief that telephone calls are a crucial record of the way front-line staff interact with customers and that call records are therefore essential to understanding whether the customer has been treated fairly.

The amended regime could have a significant effect on some firms’ record keeping practices, particularly those that had until now been meeting – but not going beyond – the express requirements of MCOB 13. To date these requirements have allowed firms to rely purely on the retention of ‘adequate’ records (which has been interpreted by some firms as requiring only the retention of written call notes and correspondence) and have specified a minimum retention period of only 12 months.

In a continuation of the existing rules, firms will still be expected to keep all records readily accessible for inspection by the FSA. Firms will also still need to consider the FSA's Dispute Resolution: Complaints rules when recording information about customer complaints.

Potential implications for the industry

The FSA's consultation on the above measures is due to close on 30 April 2010, after which it plans to finalise its proposals for regulatory change with a view to publishing a policy statement in June 2010. Some feedback from the market on the proposals in DP 09/3 has already been gathered and has been set out in *Feedback statement 10/1: mortgage market review*, released on 23 March.

The key proposals move away from regulation primarily based on principles (which inevitably leads to uncertainty over the exact regulatory requirements) to a focus on specific rules. They serve to emphasise that the FSA is seeking to tighten its grip on the mortgage market and the FSA's business plan for 2010-11, published on 17 March 2010, indicates that mortgage arrears handling will continue to be a key priority. Against this backdrop, it is increasingly important for firms to have rigorous systems and controls in place to ensure adherence to arrears and repossessions-handling policies.

In areas such as record keeping, where it appears some firms may need to make significant revisions to policy and procedure when the current proposals (subject to any amendments resulting from the consultation process) are put into place, the next few months will afford valuable time to pave the way for those revisions and ensure that the firm's record keeping infrastructure can cope with what could potentially be a significant increase in the volume of data firms need to retain.

Recent FSA statements have emphasised that the regulator is willing to use the full range of powers available to it to protect customers in arrears and expects firms to be able to demonstrate that they regularly review and critically appraise their procedures for treating customers fairly. There are risks of enforcement action against firms that are found to have weaknesses in their arrears-handling and repossessions practices and, as demonstrated by the recent case of GMAC – which in October 2009 was fined £2.8m and ordered to pay

redress to customers of up to £7.7m plus interest – the potential effects of such enforcement action can be severe.

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