

Mortgage Lender Briefing

Issue 1 | June 2009

This is the first edition of the FSA's *Mortgage Lender Briefing*. We will publish further briefings periodically when we have project work or other items we need to bring to your attention.

In this issue:

- mortgage arrears project findings;
- issues in the low interest-rate environment;
- FSA mortgage market review; and
- sale and rent back regulation.

Mortgage arrears – four specialist lending firms referred to enforcement for poor treatment of customers in arrears

We have identified continued weakness in the way some firms are handling mortgage arrears and repossessions – particularly for consumers with impaired credit histories.

Focusing on specialist lending firms who are no longer lending and third-party administrators, we reviewed the following areas:

- arrears handling;
- the application of arrears charges; and
- the treatment of customers in arrears whose mortgages have been securitised.

Our enforcement team are investigating cases against four of the firms we looked at, and several more firms are being assessed for investigation.

In many cases we found a high incidence of mortgages moving straight into arrears and potential breaches of responsible lending rules. All firms investigated will be required to take action to remedy failures identified in the arrears review.

Although our project looked at specialist areas of the mortgage market, all lenders and administrators should review our findings.

High-level findings

We found some specialist lenders are still not treating customers fairly or meeting our rules, in particular:

- not taking account of borrowers' individual circumstances;
- focusing on getting arrears back quickly rather than considering other options;
- not treating court action for repossession as a last resort;
- applying charges unfairly; and
- having insufficient oversight of third-party administrators.

We also found that some terms in securitisation covenants could lead to unequal treatment of borrowers in arrears by reducing the options available to resolve arrears.

Areas for firms to consider

All firms should take note of the areas we identify below to see if they meet the standards we expect. We set these out in more detail on our website, which also includes good and poor practice examples.

This is particularly important as our data on mortgage lending shows the numbers of consumers facing arrears and reposessions continues to increase.

Arrears handling

Three key things we expect all firms to remember are:

- consider the individual circumstances of borrowers falling into arrears;
- tailor your approach to the situation to customer circumstances; and
- take court action only as a last resort.

These are some of the areas firms may need to review:

- staff training – to ensure that arrears-handling staff are trained to an appropriate standard and monitored to ensure they can treat customers fairly;
- reward schemes – schemes that drive the wrong behaviour can lead to unfair treatment of customers and firms should consider ways of rewarding staff for the fair treatment of customers;
- management information – some firms are still not collecting enough management information to be able to effectively assess the fair treatment of customers; and
- ‘debt counsellors’ – firms should not give the impression they provide debt advice or counselling if they do not, particularly in the job titles they use to describe staff or agents who visit customers to discuss arrears and repayment plans.

Arrears charges

We identified poor practice in how firms apply arrears charges and fees. Firms must remember that arrears fees should reflect no more than the cost of administering the arrears, and must be applied in a way that treats customers fairly.

We had particular concerns around:

- monthly arrears charges;
- charges for unpaid direct debits;
- double-recovering charges for administering arrears (for example, charging for tasks already covered in a monthly arrears charge);
- court-related fees, where cases are adjourned due to the lender’s omissions; and
- ‘debt counsellor’ fees.

Third-party administrators (TPAs)

We found shortcomings with TPAs carrying out arrears-handling on behalf of specialist lenders and dealing with potentially vulnerable customers.

In many cases TPAs do not have the systems and controls in place to treat customers fairly. They must ensure they meet our requirements and not rely on the argument that they are simply acting on behalf and instructions of the lender.

Lenders must also ensure that they exercise the necessary level of oversight of TPAs to ensure the fair treatment of their customers.

Fair treatment of customers with securitised mortgages

We found that fewer tools are usually available for resolving arrears for securitised loans.

For example, securitisation covenants could prevent borrowers being offered the option of extending their mortgage term or switching to interest-only for a short period.

We expect all customers to be treated fairly and to be offered a relevant range of options for resolving arrears.

New securitisation should not contain provisions that could lead to less fair treatment of borrowers.

Next steps

Arrears handling will continue to be a high priority for us until the necessary progress is made. This is part of our ongoing work to monitor the effectiveness of legislation of mortgage lending, to address key issues in the mortgage sector and to ensure consumers are treated fairly and can make informed decisions. We will include the issues we identified in our mortgage market review.

On our website:

Arrears and repossessions practical examples and good and poor practice examples:

www.fsa.gov.uk/Pages/About/What/thematic/mortgage_arrears/index.shtml

Responsible lending good and poor practice examples:

www.fsa.gov.uk/Pages/About/What/thematic/resp_lending/index.shtml

Data on mortgage lending for the first quarter of 2009:

www.fsa.gov.uk/pages/Doing/Regulated/Returns/IRR/statistics/index.shtml

Issues in a low interest-rate environment

We have found a number of mortgage-related issues in the current low interest-rate environment, where some lenders have proposed or taken action that we believe does not meet their responsibility to treat customers fairly.

Firms may have prudential reasons for taking these actions, but they need to carefully consider their legal and regulatory responsibilities when deciding what steps to take in response to the current economic climate.

Tracker mortgages with collars

Lenders using ‘collars’ that set a point at which a firm will not pass-on any further reduction in the Bank of England Base Rate (Bank Rate) need to be aware of potential concerns around disclosure and fair contract terms.

Disclosure

Firstly, firms need to ensure that if they intend to rely on a collar in their tracker mortgage portfolio, the collar needs to have been correctly disclosed in line with our requirements (see chapters 5 and 6 of MCOB) in both the pre-application key features illustration (KFI) and the offer KFI. It is also important that firms ensure all financial promotions relating to the tracker mortgage contain appropriate disclosure of any collar.

Failure to comply with these disclosure requirements is a breach of our rules and would be met with the appropriate regulatory response, which may include preventing the firm from relying on the collar.

Fair contract terms

Secondly, if firms have a collar in their tracker mortgage, they need to ensure that the terms explaining the collar are drafted both fairly and in plain intelligible language, as required under the Unfair Terms in Consumer Contracts Regulations 1999 (the Regulations). Firms also need to be mindful that under the Regulations unfair terms are unenforceable and therefore may pose wider risks, such as:

- a legal risk of not being able to enforce a particular term because it has been deemed to be unfair;
- a prudential risk if, for example, a term setting out a collar is drafted unfairly so it is unenforceable, the firm may be left exposed to the full interest-rate fall;
- an operational risk of spending management time in redrafting new contract terms and providing consumers with new contracts; and
- a reputational risk that consumers may not trust a firm that tries to rely on unfair terms.

Recently we found that one firm had included a term that aimed to give them a right to change the up-front tracker margin under certain conditions, including if the Bank Rate fell below 3%. The clause empowered the firm to change the tracker margin by any amount it desired and allowed it to maintain the new margin even if the Bank Rate rose back above 3%. We felt that this term was unfair and the firm agreed not to rely on it.

Wide interpretation of contract terms

This is where a firm seeks to widely interpret a contractual provision, with the aim of introducing changes that the contract had clearly not envisaged and that had not been disclosed to the consumer.

For example, one firm suggested to us that it would rely on a term that allowed it to vary existing charges or introduce a new charge to effectively alter the interest rate payable on the mortgage. The firm wished to introduce a charge for its customers that had a tracker mortgage without a collar, in such a way as to effectively create a collar. We were unhappy with the firm's suggestion and the firm subsequently agreed that it would not introduce the proposed charge.

Describing the linked interest rate

Generally speaking, tracker mortgages are perceived (by consumers in particular) as tracking an external benchmark, such as Bank Rate or LIBOR. However, some firms' products track their own internal interest rate that they control, as opposed to an external rate that falls outside the firms' control.

Although it is acceptable to call such products 'trackers' firms need to ensure that it is clear in advertising, mortgage literature, pre-application KFI, offer KFI and general communications with consumers that the product is tracking an internal interest rate. Failure to make the appropriate disclosure could otherwise leave a consumer with a reasonable expectation that the tracker is linked to an external benchmark rate.

We think it would be helpful, where a product tracks an internal rate, for firms to take extra steps to explain to consumers that the firm has control over an internal interest rate and that such a rate may

not always reflect changes in an external rate, such as Bank Rate.

Offering customers alternatives to their tracker mortgages

Where a firm decides to offer existing customers an alternative mortgage product, it needs to ensure that the consumer is given sufficient information to make an informed decision about whether to switch.

We are aware of at least one firm that has contacted its existing mortgage customers, where the product does not have a collar, to offer alternative mortgage deals (such as tracker mortgages with a collar). Communications of this nature are financial promotions and so should be balanced, enabling consumers to make a proper comparison of their existing mortgage and the proposed alternative product.

Any failure to make clear the key features of the consumer's existing mortgage and the one being proposed is likely to be a breach of our clear, fair and not misleading requirements and is in contrast to treating customers fairly.

Considerations for firms in the current low interest-rate environment

Are interest-rate collars properly disclosed in both your pre-application KFI and offer KFI?

Do you adequately disclose the existence of an interest-rate collar in your financial promotions?

Are your mortgage terms and conditions drafted fairly and in plain intelligible language, as required under the Unfair Terms in Consumer Contracts Regulations 1999?

How do you describe the interest rate that is being tracked? Are you clear, fair and not misleading in promotions, general communications, KFI and offer documents?

Are you planning to write to your tracker mortgage customers to offer them alternative products and, if so, are you satisfied that these communications are balanced, clear, fair and not misleading?

Mortgage market review

Thank you to all who attended our mortgage sector conference last month. We were pleased to have the opportunity to speak directly to the industry about our review.

We will publish our proposals for changes to mortgage regulation in a discussion paper in September.

The review aims to help achieve:

- a sustainable market for all within it; and
- a flexible market that works for consumers.

We are still developing our ideas, but Jon Pain's speech from the conference includes some of our early thinking on the way forward:

www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0512_jp.shtml.

Sale and rent back regulation

We have published details of the regime we plan to introduce on 1 July 2009 to tackle immediate problems for customers in the sale and rent back market.

We are taking a two-stage approach to regulating the sale and rent back market. We will bring in an interim regime as soon as any statutory changes come into force (expected to be 1 July) in order to address the most immediate problems for consumers, followed by a more comprehensive regime that will start on 30 June 2010.

Our Policy Statement sets out the regime we plan to introduce for sale and rent back firms:

www.fsa.gov.uk/pages/Library/Policy/Policy/2009/09_09.shtml.