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*"... this would focus increased regulatory attention on the demonstrable delivery of fair customer treatment..."*

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# THE MORTGAGE MARKET REVIEW – AN UPDATE

April 2010

## Overview

Since the publication of its discussion paper in October 2009, the FSA has followed through on its promise to act quickly in the areas that it sees as presenting the highest risk to the mortgage market. Since the start of the year we have seen a consultation paper on Arrears and Approved Persons and a feedback statement that summarises responses to the original discussion paper. Here we aim to provide an update on progress of the key regulatory areas of discussion.

### Strengthening of the arrears rules

Focus on arrears seems obvious given recent market conditions and the FSA has made it clear that it wants to ensure that firms do not profit out of mortgage customers who already find themselves in unfortunate circumstances. The FSA's draft rules will see particular change in a number of areas, including the following.

The FSA has made it clear that the **application of monthly arrears charges where a customer has entered into an Arrangement to Pay** the arrears is inappropriate. In order to strengthen the current MCOB requirements, a new evidential provision is proposed that will make it clear that firms should not levy an arrears charge where customers have a performing arrangement to repay the arrears in place. There remains an overarching requirement for charges in such circumstances to be a fair reflection of the additional administration costs faced by lenders, with further FSA review work being undertaken of charging and pricing structures in order that excessive practices may be better identified.

By **changing current guidance and evidential provisions regarding forbearance into rules** the FSA hopes to reduce the number of instances where firms move too quickly to take repossession action without reference to the borrower's individual circumstances. This would focus increased regulatory attention on the demonstrable delivery of fair customer treatment in such circumstances, rather than focusing on whether lenders have related documented policies and procedures in place.

Proposed guidance to make it clear that the **inclusion of arrears charges and accrued interest on these charges within Early Repayment Charges is prohibited** has also been published. Examples of current market practice have led the regulator to conclude that some firms are failing to meet this requirement in order to increase profits or offset costs from other parts of a firm's business.

Increased **record keeping requirements that would include the recording of all telephone conversations** between lenders, administrators and their customers have also been published. The relevance of these records will take on increased importance as firms seek to demonstrate real delivery of fair customer treatment, and for arrears cases the expectation will be that records should be kept for at least three years. The operational challenge that this may pose to some firms should not be underestimated.

The FSA also feels that it is necessary to add a rule to clarify that **payments from customers in arrears must be allocated to clearing missed monthly payments, leaving charges to be paid later**. This proposed rule will add weight to the current principle that consumers in payment difficulties should be treated fairly and should allow customers to recover from arrears positions more quickly.

### Extension of the Approved Persons regime

To date, the mortgage sector has benefited from a more relaxed application of the Approved Persons regime. As indicated in the original discussion paper, this is now set to change. These changes are likely to involve increased administrative burdens on firms and the regulator.

With a key objective of the regulator being the tracking of mortgage advisors through the industry, **a new customer function (CF31) will apply** to all current home finance advisors. However, also included within the proposed CF31 function would be those individuals that “bring about” home finance transactions. Whilst the consultation paper makes clear that customer service staff who only make arrangements, but stop short of bringing about a transaction, would be excluded from the proposals, it appears that the activities of a significant number of administrative staff would also be caught within the definition of the new function. Also, for the first time home finance firms will be required to have in place an individual approved to be responsible for compliance oversight.

### Most recent FSA feedback

Whilst the recent FSA feedback statement (FS 10/1, published in March) takes the opportunity to restate the regulator’s aims for the review, there are no new policy proposals included. Instead, the FSA outlines the feedback received from a wide range of respondents and clarifies the expected timetable for further work.

In respect of **prudential reform**, perhaps the most interesting comment concerns the prudential regulation of those lenders that are “non-banks”. The FSA notes that there is widespread support for more direct intervention in response to the risks posed by these firms, but there is still little clarity on what this will mean for non-banks in terms of their supervisory relationship with the regulator and whether there may be changes to their prudential regime.

Where **conduct of business reform** is concerned, the suggested prescriptive regulation of product features such as loan-to-value, loan-to-income, debt-to-income or any “toxic” combination of these ratios appears to have met little support from industry, and it seems that there would be much work to do in this area to achieve predictable regulation that does not disproportionately disadvantage some firms and borrowers.

The subjects of **income verification and affordability** appear to have been met with a wide range of reaction, which is to be expected given the wide diversity in firms, products and consumers in the marketplace. Many respondents will be eager to see further detailed proposals in the forthcoming consultations in order that they can fully assess the impact to their particular business models.

### What next?

A policy statement regarding arrears and approved persons is expected in June 2010, with two further consultation papers in Q3 and Q4 2010. An occasional paper setting out the FSA’s analysis of the causes of arrears will be published in Q3 2010. Firms should also note the continuing work of the European Commission regarding responsible lending and borrowing, which the FSA acknowledges could inform its own work in this area.

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