

Mortgage Market regulation

The FSA remains concerned that there is "little available evidence" to support the reasonableness of arrears charges and fees. Lenders should ensure that their arrears charges and fees are supported by cost-based evidence to show how they have been achieved. Lenders should also ensure that TPAs do not excessively benefit from arrears charges and fees and that high charges imposed on lenders by TPAs for this work are not, in effect, used to reduce administration costs more widely (of performing loans).

With credit cards, the OFT set a maximum fee of £12 for default letters, but there is no evidence that a similar approach will be taken by the FSA.

In addition regulation is becoming more intrusive. This will need to be a continuing focus for the Bank. If repossessions rise, it will inevitably lead to more complaints which will need to be dealt with.

The requirement for all mortgage intermediaries to become Approved Persons has now been delayed until 2012/2013. The Bank will need to ensure that any brokers it accepts business through are "Approved Persons" once this change takes place. Broker agreements may need to be updated to incorporate these changes.

There has been a significant decrease in the number of mortgage brokers (individually) and firms. There is consolidation in the broker market, with many having joined networks. The "bargaining power" of such networks is therefore likely to increase and this could raise commercial considerations for the Bank. Additionally, the FSA is concerned by the level of control over Appointed Representatives in network firms. The Bank will wish to ensure that networks who it does business with have appropriate controls and oversight processes in place, to mitigate the risk of non-compliance by individual brokers (in particular the risk of financial crime / mortgage fraud).

PPI replacements

There has been a significant rise in sales by banks (as a proportion of the market) of critical illness policies. The FSA considers this is likely to have resulted from banks needing to replace lost income from PPI sales.

New "PPI replacements" are on their way to market, some of which will be sold alongside mortgages. The FSA's Conduct Risk division will be scrutinising these carefully.

The Bank's processes for product design and approval need to be extremely robust as the FSA is likely to challenge firms where it has concerns about any PPI replacements that the Bank proposes to offer.

Regulatory shift from Principles-Based to Product Regulation

There is a recognition that principles-based regulation has not achieved the outcomes the FSA desired. Product intervention (through the FSA's Conduct Risk and Enforcement and Financial Crime Division) poses a particular problem for banks launching innovative products.

Having previously castigated "tick-box compliance", the FSA is moving back to that approach for product regulation. Detailed product rules are therefore likely to feature over the next few years, partly because these are easier to enforce.

As above, robust product design and approval processes will be particularly useful when responding to any challenges raised by the FSA under this new strategy.

Mortgage terms and conditions / KFI and sales documentation

Following HBOS / Lloyds agreement with the FSA to compensate customers who were unclear about whether an interest rate "cap" (above base rate) applied to their mortgages, a number of lenders in the market are re-reviewing their full range of documentation to evaluate any possible issues.

All lenders should focus on ensuring controls over the issuance of promotional material, in particular, are sufficiently robust to ensure the promotional material accurately reflects the legal features of the product.

Unfair Terms in Consumer Contracts

This remains a high priority for all regulators (note: the OFT has announced this week a market study into consumer contract terms).

Unfair terms in mortgage contracts are of particular regulatory interest, especially those that enable lenders to increase interest rates (or require immediate repayment) for minor breaches of contract. The FSA is also concerned (at a conduct level) about whether these terms are being applied appropriately, particularly for base-rate linked (variable) rate customers (whose loans are the most costly for lenders due to the low base rate).

Securitisation agreements

There is regulatory interest over whether the terms agreed in securitisation agreements are fettering firms' ability to TCF in arrears cases (for example, by not allowing for the capitalisation of arrears) or encouraging non-compliance in arrears and repossessions cases generally. Any new securitisations should ensure sufficient flexibility is built in to cope with these regulatory requirements (and possible changes) in this area.

The Treasury has recently announced that beneficiaries under securitisation agreements of first charge (FSA-regulated) mortgages will be subject to some form of regulation (to maintain consumer protection). Draft legislation has not yet been published, but we anticipate the FSA (or FCA) will become the responsible regulator. Securitisation agreements need to be capable of incorporating these legislative and regulatory changes and purchasers will need to become authorised.

Senior Management Responsibility

At a recent FT roundtable discussion Margaret Cole stressed that the FSA is committed to holding senior management responsible for wrongdoings, particularly in the retail sector.

The level of senior management control (requiring access to appropriate management information), the apportionment of duties and overall level of oversight within retail firms is of particular focus.

Second Mortgages

The Treasury has announced that the responsibility for second charge mortgages over residential properties will be transferred from the OFT to the FSA. A consultation document on the draft legislation (by the Treasury) and the conduct regime (by the FSA) is expected imminently. We anticipate these changes will not take effect until the second half of 2012.

These changes may impact corporate structures, particularly where first charge (FSA-regulated) lending is undertaken by a different entity to second charge lending.

These changes will also require a complete review of all second charge mortgage documentation against the new rules.

Interest only

An issue on the horizon for the industry as a whole are those cases coming towards the end of the term but with no repayment vehicle in place. This is of particular concern for those individuals who are reaching retirement. Consideration needs to be given to contacting those on interest only to ascertain whether there is a repayment vehicle in place and if not, what plans they have.

Unfair commercial practices

The European Commission is considering possible legislation on tying and potentially "unfair commercial practices" in the retail financial services sector. Although likely to be of limited application in the home finance market, if the bank offers "bundled products" (which include mortgages), the impact of this may need to be examined once any proposals are published.

What happens in America happens in the UK?

At a recent CML arrears conference a lawyer from a US firm spoke. He suggested that the US is 18 months ahead in the cycle of dealing with repossessions. The procedure is different from state to state. However, in Michigan, they now have a court imposed system whereby the lender, the borrower, and a state approved counsellor have to meet in a 3 month period between the LBA and any court proceedings being issued to see whether they are able to reach agreement. The lender is expected to consider debt forgiveness as part of this process within state set parameters. If no agreement is reached and the case proceeds to court, the court will consider whether the lender was reasonable in not reaching agreement and there are various measures that can be enforced.

If repossessions increase in volume, the question for lenders is whether the courts will be empowered to vary contracts terms and interfere to a greater extent in the process.

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