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Dear Sir

Consumer Focus response to OFT consultation on second charge lending: OFT guidance for brokers and lenders

Consumer Focus welcomes the opportunity to comment on this consultation. Consumer Focus is the new statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, in Northern Ireland. We will be the voice of the consumer, and work to secure a fair deal on their behalf. We were created through the merger of three consumer organisations – Energywatch, Postwatch and the National Consumer Council (including the Welsh and Scottish Consumer Councils). The new approach allows for more joined-up consumer advocacy, with a single organisation speaking with a powerful voice and able to more readily bring cross-sector expertise to issues of concern.

Introduction

We are pleased that guidance which deals specifically with practice in relation to second charge lending is going to be issued. In our view, given the seriousness of a loan secured on the borrower's home, guidance of this nature is long overdue. The Financial Services Authority (FSA)'s current Mortgage Conduct of Business Rules (MCOB) have been in place with respect to first charge mortgages since 31 October 2004.

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According to figures provided by the Finance and Leasing Association 1,558 properties were taken into possession by their members on the basis of second charge lending in 2008, an increase of 33 per cent on 2007. This figure only represents cases where the borrower was forced to leave their home. This does not include the number of homes where a possession order has been made on an outright basis, but possession has not yet been taken (as an arrangement has been reached with the lender) or where a suspended possession order has been made on terms of payment. The degree of distress caused to individuals and their families in these circumstances cannot be underestimated. There is a perception among some advice providers that second charge lenders pursue repossession more forcefully than first mortgage lenders.

Overall, the spirit and intentions of the guidance seem appropriate, but we have concerns around the detail and implementation of the proposals. Before responding to the specific questions within the consultation, we would like to make the following general comments on the guidance:

Level of detail

In the document as a whole, we find that the provisions of the guidance lack detail. There may be a difficulty in holding any individual or company to account under such guidance, as a result of which the level of protection given to the consumer is weakened. We appreciate that the sums borrowed on second charges are generally lower than the sums borrowed on first mortgages, but that is not a justification for a lower standard of practice for second charge lenders. People borrowing under a second charge may be more vulnerable than those borrowing under a first charge, as they may be borrowing as a result of pre-existing financial problems. Furthermore, when a person is repossessed due to default on a second mortgage, this is likely to be for a much lower outstanding debt than where default on a first mortgage has occurred.

Monitoring and complaints

Clearly, it is essential that effective mechanisms are in place for ensuring compliance with the guidance and responding to complaints. While the guidance refers to sanctions that might be

applied in the case of non-compliance, it does not deal with monitoring requirements and how non-compliance will be established.

In addition, the guidance does not include any references to the requirements for record-keeping during the process. A good standard of record keeping is vital in order for a regulator to satisfy itself that a lender has complied with its obligations under the guidance.

Furthermore, the guidance fails to include any requirement for lenders to advise their customers about making complaints or to have robust complaints procedures in place. We consider that this omission in the guidance needs to be addressed.

Enforcement

The consequences of breach of the guidance appear to be either revocation of a lender's licence or withholding of a licence. Alternatively, a 'requirement' may be imposed on the lender, breach of which will result in a financial penalty of up to £50,000. However, this does not have any impact on the contract between the lender and consumer and the borrower's home will remain at risk, even where the lender's conduct has been found to be in breach of the guidance.

In our view, there should be scope for a lender's failure to comply with the guidance to be taken into account in any ensuing court proceedings, by limiting the lender's ability to repossess the borrower's home. This is particularly important if lending has been irresponsible but an 'unfair relationship' under s140A Consumer Credit Act 1974 has not been found (as an unfair relationship finding would give the court considerable scope to intervene in the contract). We would add that we consider irresponsible lending to be a strong basis for finding that an unfair relationship existed between the lender and borrower in any court proceedings.

We are also aware of the recent pre-action protocol in mortgage arrears cases. However, under this protocol it is only the conduct of the lender once the borrower is in default that is taken into account. Therefore, the lender's conduct – in relation to pre-contractual, contractual and post-

contractual matters, apart from when the client is in arrears – is not covered by the protocol. We consider that the court rules should be amended so courts consider whether, and the extent to which, the lender complied with this guidance in relation to the entire transaction when determining a second charge lender's claim for possession of a property.

Separate regulation

We are concerned that having the FSA and OFT as separate regulatory bodies for first and second charge mortgages is confusing for consumers. We feel that it may benefit consumers for all charges secured on residential homes to be regulated by the same body and under the same guidance, as the potential consequence of losing their home is the same in each instance.

Scotland

It is important to be aware that the laws and procedures are different in Scotland. This will need to be taken into account when drafting the guidance, both in terms of content and terminology used. A key area of difference is in relation to the pre-action protocol in mortgage arrears cases, which does not apply in Scotland. As paragraph 6.4 indicates, it is imperative that consumers in Scotland are not disadvantaged by this in terms of the application of the guidance. We understand that a pre-action protocol is one of the issues being considered by the Scottish Government's Mortgage Repossessions Group and pre-action protocols are also being considered as part of the current civil courts review.

2: General Principles of Customer Care

Q1: Are the draft guidelines on general principles sufficiently clear?

Q2: Are there any substantive aspects of the draft with which you disagree?

Q3: Do the draft guidelines on general principles have any significant omissions?

Q4: Do you have any other suggestions for improvement?

In answer to questions 1-4, as we have indicated, we do not disagree with the substantive proposals, but we feel they should be more detailed. Some elements of the guidance on general principles that would benefit from further clarification include:

- The definition of 'high-pressure selling'
- An indication of what would be considered 'an adequate time' for the borrower to reflect on the agreement and take independent advice
- A proper assessment of the ability of the individual to repay this debt must be a priority. The position in relation to self-certification mortgages is of particular concern.
- The statement that 'repossession should only be used as a last resort' is evidently very broad in its terms and allows a very wide range of interpretations as to its meaning. In our view the definition of 'as a last resort' should include as a minimum that the arrears should exceed a minimum of six months' payments and the equity in the property should be insufficient to safeguard the lender's capital. The lender should not be able to reject any reasonable offer to repay the debt by instalments and a reasonable offer should be considered as one which will pay off the debt in full over the remaining lifetime of the mortgage (in line with *Cheltenham and Gloucester BS v Norgan* [1996] 1 All ER 449). Moreover all other possible options should have been explored and exhausted with the borrower, including the possibility of freezing interest and other charges, extending the mortgage term or agreeing a payment holiday without the accrual of further interest during the break in payments. The borrower should also have had a full opportunity and been advised to claim all possible welfare benefits and have no outstanding benefit claims (or appeals) prior to a possession claim being taken. Once proceedings have been taken, the lender should be willing to adjourn the case without obtaining a possession order indefinitely on the basis of a reasonable offer of payment or for a fixed period sufficient to allow the resolution of any benefits matters.

Clearly we await the OFT consultation on the definition of irresponsible lending, but as already stated, we consider that where a lender is found to have lent irresponsibly they should not be entitled to repossess the property concerned.

3 Pre-contract issues

Q5: Are the draft guidelines on pre-contract issues sufficiently clear?

Q6: Are there any substantive aspects of the draft guidelines on pre-contract issues with which you disagree?

Q7: Are there any significant omissions?

Q8: Do you have any other suggestions for improvement to this section?

Paragraph 3.10 states that the existence of commission should be disclosed at an early stage and the amount should be disclosed on request. We consider that a broker should be required to inform the borrower of the existence and amount of any commission or any other payment both orally and in writing at the outset of the transaction.

Lenders' salespeople may also be in receipt of commission, payments or other incentives in respect of the sale of particular products. This may influence their approach to certain products. We consider that transparency requires that any such commission, payments or incentives should also be disclosed to borrowers at the outset of the transaction.

In paragraphs 3.11 and 3.12, the guidelines place a number of obligations on brokers and salespersons in relation to the borrower in terms of not encouraging borrowers to take on more debt than they have requested or can afford to repay and giving advice in the best interests of the borrower, including not taking out a secured loan. The OFT must be prepared to take robust steps to ensure that brokers and lenders meet these obligations in full in the future. Ensuring compliance requires stringent record-keeping requirements and rigorous monitoring procedures, but the guidance does not refer to this nor give any indication of how this will be carried out.

We also consider that lenders should be required to demonstrate that they have complied with these obligations in any subsequent possession proceedings. If they are unable to do so, they should not be able to repossess the property in question.

4 Contract issues

Q9: Are the draft guidelines on contract issues sufficiently clear?

Q10: Are there any substantive aspects of the draft guidelines on contract issues with which you disagree?

Q11: Are there any significant omissions?

Q12: Do you have any other suggestions for improvement to this section?

The contract documentation must comply with all legislative requirements. We agree that the borrower should be encouraged to read all the contract documentation, and that the lender should provide the information in the contract documentation as set out in the guidance. We also consider, however, that the lender should be required to inform the borrower orally of certain key information, setting out clearly and fully the borrower's rights and responsibilities under the agreement. This key information should include the total amount to be repaid under the loan, the amount of each repayment (and if this is variable, this should be made clear) and when it is due, an accurate APR (including if the APR is variable and the potential consequences of this), the amount and basis of calculation of any early settlement charges and the amount, nature and purpose of any default fees or charges or any other fees or charges. The lender should also be obliged to advise the borrower to seek independent legal advice before entering into the agreement.

5 Post-contractual issues

Q13: Are the draft guidelines on post-contract issues sufficiently clear?

Q14: Are there any substantive aspects of the draft guidelines on post-contract issues with which you disagree?

Q15: Are there any significant omissions?

Q16: Do you have any other suggestions for improvement to this section?

In relation to paragraph 5.2, we agree that default charges should be reasonable and only cover necessary administrative costs. We consider it should be further clarified that lenders should

never impose penalty charges for late payment, default or any other breach of the agreement. Lenders should be required to justify the imposition of any charge for default or any other reason and should demonstrate that any charge made covers no more than the lender's necessary administrative costs. Further, additional charges should not be incurred where a borrower makes their payment by a method other than direct debit.

6 Possession Actions

Q17: Are the draft guidelines on possession action sufficiently clear?

Q18: Are there any substantive aspects of the draft guidelines on possession action issues with which you disagree?

Q19: Are there any significant omissions?

Q20: Do you have any other suggestions for improvement to this section?

We welcome the guidance that where a borrower falls into arrears, repossession should only be sought as a last resort. However, we reiterate that last resort should be given the meaning set out in our comments above in relation to the General Principles of Customer Care (Section 2).

The guidance should state clearly that, despite the lack of a pre-action protocol in mortgage arrears cases in Scotland, lenders are expected to apply the same practice and principles in relation to mortgage arrears cases in Scotland.

In addition, the guidance should state that a lender must only seek to exercise a power of sale in relation to a residential property after a possession order has first been obtained from the court. The need for a possession order against the borrower in order to exercise a power of sale and proper judicial scrutiny should not be circumvented by the appointment of a receiver as recently happened in the case of *Horsham Properties v Clark and Beech*.

Finally, we wish to restate our view, as set out in our introductory comments, that it should be possible for failure to comply with the guidance to be taken into consideration within court

proceedings to repossess the borrower's home. In this way, the lender's conduct throughout the entire transaction could be considered and not just their conduct after the borrower had fallen into arrears (as required by the pre-action protocol in mortgage arrears cases).

7 Regulatory Compliance and Enforcement

Q21: Are the draft guidelines on regulatory compliance and enforcement sufficiently clear?

Q22: Are there any substantive aspects of the draft guidelines on regulatory compliance and enforcement with which you disagree?

Q23: Are there any significant omissions?

Q24: Do you have any other suggestions for improvement to this section?

As stated above, we feel that the guidance regarding monitoring, complaints and enforcement procedures lacks detail and clarity. In the first instance, it is unclear how lenders will be monitored for failure to comply with the guidance. Secondly, the issue of complaints and complaints procedures is not dealt with within the guidance. We consider this omission should be rectified, as complaints are an important part of monitoring the performance of any organisation or agency.

Finally, we should like to say that we are supportive of guidance being issued in this area, but we consider that it is important that such guidance is purposive and effective and results in better protection for consumers.

Yours faithfully,

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