Consultation Response

Shelter's response to the Civil Justice Council consultation on the Mortgage Arrears Protocol

May 2008

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Shelter

Shelter is a national campaigning charity that provides practical advice, support and innovative services to over 170,000 homeless or badly housed people every year. This work gives us direct experience of the various problems caused by the shortage of affordable housing across all tenures. Our services include:

- A national network of over 20 housing aid centres
- Shelter's free housing advice helpline which runs from 8am-midnight
- Shelter's website which provides housing advice online
- The Government-funded National Homelessness Advice Service, which provides specialist housing advice, training, consultancy, referral and information to other voluntary agencies, such as Citizens Advice Bureaux and members of Advice UK, which are approached by people seeking housing advice
- A number of specialist projects promoting innovative solutions to particular homelessness and housing problems. These include 'Homeless to Home' schemes, which work with formerly homeless families, and the Shelter Inclusion Project, which works with families, couples and single people who have had difficulty complying with their tenancy agreements because of alleged anti-social behavior. The aim of these particular projects is to sustain tenancies and ensure people live successfully in the community.
- We also campaign for new laws and policies - as well as more investment - to improve the lives of homeless and badly housed people, now and in the future.

Introduction

Shelter warmly welcomes the proposed protocol. As mentioned in the consultation paper, it is a measure we have previously called for[1]. The number of possession actions being brought for mortgage arrears is increasing. Repossessions are also rising. Council of Mortgage Lenders (CML) estimates suggest that 45,000 households will lose their homes through repossession during 2008[2], a 50% increase over the levels for 2007[3].

Many mortgage lenders have good practices and policies in place for dealing with borrowers who fall into arrears. However, Shelter's experience as housing advice and County Court Duty Desk providers indicates that there are also many lenders who do not operate best practice in this area. This protocol would be a valuable tool in ensuring that

[1] *Policy Briefing – mortgages and repossessions*, Shelter, 2008
[2] Cunningham, J: *Housing and mortgage market forecasts 2008/7*, CML, 2007. See also Cunningham, J: *Repossession Risk Review*, CML, January 2007
[3] CML figures released February 2008 (Table AP4) showed there were 27,000 repossessions during 2007. This figure has risen from 8,000 in 2004, more than a threefold increase.

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best practice is replicated across the board, and that possession action is not taken other than as a last resort by any lender. In this way many homeowners can avoid the distress of possession proceedings and repossession, and court time and expense can be saved.

Summary of Shelter's recommendations

- Shelter is very much in favour of the introduction of this protocol and believes the proposed scheme and content are broadly correct. We look to the Government to back the urgent adoption of the protocol.

- We believe the key outcome of the protocol should be to improve practices in arrears management so that all lenders, particularly those in the sub-prime sector, conform to the best practice available, and to the FSA's Mortgage Conduct of Business and Treating Customers Fairly protocol. A secondary outcome should be the collation of meaningful information from the courts on the performance of each lender in this area.

- All lenders should be required to publish and make available their policies on arrears management and possession action.

- We would like to see lenders required to notify any tenants in the property at the start of the arrears process.

- We would like to see the provisions on referral for independent advice strengthened and relocated within the protocol so that the referral must take place at the outset of the process.

- We would like to see lenders entering into funding partnerships with advice providers so that the terms of the protocol as regards advice provision can be fully accomplished.

- As an extension of the move towards lenders ensuring that repossession is a last resort, of which this protocol forms part, we would like to see lenders expand their capacity to enter into purchase and rent back arrangements with borrowers who are facing repossession.

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Responses to consultation questions

Do you consider a protocol for mortgage arrears cases would be helpful? If so, what do you consider would be the advantages? If not, why not?

Yes, we believe a protocol for mortgage arrears cases will be extremely helpful. Shelter believes that there is too wide a range of policy and practice in place through individual lenders to protect borrowers adequately. We also believe that the Financial Services Authority (FSA) is not enforcing the terms of the Mortgage Conduct of Business (MCOB) or the Treating Customers Fairly (TCF) protocol to an adequate and universal standard, and so customers have for too long had to suffer a variable range of treatment if they fall into arrears, depending on who their lender is. We are also keenly aware that FSA regulation, and thus the MCOB and TCF standards, do not apply at all to buy to let lending and second charge lending. Although customers with second charge loans are protected by OFT regulations, we have made the point in our recent policy briefing[4] that this dual regulatory responsibility risks leaving these customers in confusion, uncertain as to exactly what their rights are and who they should turn to if they have been treated badly. Buy to let borrowers have no protection at all under existing regulatory standards. The proposed pre-action protocol needs to apply to all possession actions for residential property, regardless of whether the loan is a second charge loan, or a buy to let product, so that all customers are protected by this universal standard. Its universality will be of great benefit to the sector.

A pre-action protocol for mortgage arrears cases will make it more likely that all lenders comply with an agreed protocol of good practice in dealing with mortgage arrears and that the practice of all lenders is raised to an acceptable standard. It will allow judges to adjourn or stay a case if the lender has acted unreasonably or has not followed the protocol. This will be a protection for borrowers who have been subject to unfair treatment by the lender. It will also provide a strong incentive for lenders to improve their practices - if they do not, they face having cases adjourned and being prevented from passing on the costs of legal action to the borrower.

Will the protocol have any impact on your area of business or sector – particularly in terms of benefits or costs?

[4] *Policy: briefing – Mortgages and repossessions*, Shelter, 2008

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Shelter's housing advice services have seen an increasing number of clients who are in difficulty with mortgage arrears and possession actions over the past few years. Although this remains a small proportion of our overall advice work, it has doubled since 2004.

Some of these cases involve home owners being taken to court by mortgage lenders in circumstances where it is clear that the lender has not followed the FSA's MCOB rules, or the TCF protocol. Whilst the existence of these codes of conduct is valuable, they cannot be fully effective in protecting borrowers unless they are enforced rigourously and across the board. Shelter has questioned the effectiveness of the FSA's existing system of scrutiny and enforcement of mortgage lenders' conduct. It does not seem to be stopping lenders from bringing cases to court where they have not treated the borrower fairly.

Case study – County Court duty desk Feb 2008

Our client, Mrs P, was taken to court by her lender, a major player in the sub-prime market in February 2008. She had lost her job in October 2007, but immediately started up her own business. She had tried to contact her lender to ask for a 3-month payment holiday while her new business was getting up and running. The lender refused to negotiate terms, pursued court action and was awarded a suspended possession order on condition that Mrs D paid the full mortgage plus £250 per month towards arrears, plus court costs. Mrs D was not in long-term financial difficulty and it would have been easy for the lender to negotiate these terms or similar without proceeding to court, had they been willing to enter into discussions with her.

It would be very valuable to our advice and advocacy work with mortgage borrowers to be able to rely on a pre-action protocol which all lenders must follow before bringing a case to court. Even in cases where our advisers believe that the lender has not followed MCOB or TCF, the judge in the case cannot take this into account, as these codes do not have any legal weight and are not enforceable by a court. A pre-action protocol, on the other hand, would be something which the judge would be obliged to take into account in dealing with a case. We believe that its introduction would not only protect borrowers in individual cases, but over time would lead to an improvement in practice which would prevent unnecessary cases coming to court. This would enable Shelter's resources for advocacy to go further, as we would not have to deal with cases which should never have come to court at all. As some of our resources for this work come from public funds, this would also benefit the taxpayer.

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A pre-action protocol would also play a useful role in highlighting to the courts, regulators, and bodies such as CML and Shelter, which lenders are fully complying with existing codes and which are not. Through monitoring of court possession statistics and the way in which the protocol was used, the FSA might be assisted in targeting their regulation and scrutiny towards those lenders who are performing worst in the area of arrears management. This targeting of regulation where risk is greatest would be consistent with the general direction of regulation in government[5].

What sector of the mortgage lender market is likely to be affected by the introduction of the protocol? Can you give details of the size/significance of this sector?

Shelter is aware that most of the major lenders in the "mainstream" mortgage sector have thorough policies and procedures in place to ensure that the FSA's regulations are complied with. However there is a question mark over the extent to which this is so in the "sub-prime" sector. Whilst many lenders will make considerable attempts to contact borrowers in arrears and be willing to agree payment plans and other arrangements without taking legal action, others will be less flexible or approachable.

The recent CML study on Managing Arrears and Possessions did not have enough data to make definite claims about different attitudes and procedures in the sub-prime sector around arrears management[6], although it did find that the rate of repossessions in the sub-prime sector was 10 times that in the mainstream sector, while the rate of arrears was only 5 times higher. This seems to imply that borrowers who fall into arrears in the sub-prime sector may be twice as likely as those borrowing from mainstream lenders to end up being repossessed.

There is also evidence indicating this from a Citizens Advice analysis of mortgage possession actions listed in the court diary for Possession Claims Online (PCOL) during January 2007 and described in their recent report "Set up to fail[7]". This survey showed clearly that some lenders in the sub-prime sector were applying for many more possession orders than would be accounted for by their share of the market. Kingston CAB found a similarly worrying picture from a localised survey at Kingston County Court[8].

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[5] Hampton, P: *Reducing administrative burdens: effective inspection and enforcement* – the final report of the Hampton Review into regulation, HM Treasury, 2005
[6] Stephens, M and Quilgars, D: *Managing arrears and possessions*, CML, 2007
[7] Tutton, P and Edwards, S: *Set up to fail – CAB clients' experience of mortgage and secured loan arrears problems*, Citizens Advice, 2007
[8] Roof Magazine May/June 2007, p31-33 – *"Raging Bull", analysis of trends in possession actions in Kingston County Court* by Howard Springett of Citizens Advice Bureaux.

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It seems likely, therefore, that it will be lenders in the sub-prime sector whose practices are most challenged by the introduction of this protocol. It is difficult to quantify the size of this sector, as definitions are not particularly clear, however in a recent discussion paper published by Shelter, Professor Christine Whitehead[9] estimated that the sub-prime sector accounted for perhaps 5% of the total volume of lending. Although a small percentage of the total number of mortgages, it is likely that the customers in the sub prime sector are amongst the most vulnerable in the spectrum of home owners. They are likely already to have had problems with debt and financial management before they come to take out the mortgage. They are less likely than mainstream borrowers with a good credit rating to have been able to select between a range of products at the time of taking out the mortgage. Instead, it is likely to be the case that they were in a difficult financial position, needed the mortgage, and relied on the advice of a broker in directing them towards the product they took out[10]. They therefore need the protection of a pre-action protocol all the more.

The protocol will also be particularly valuable as an extra line of protection for borrowers of second charge loans, and buy to let mortgages. If this protocol will cover all mortgages cases including the above - and we certainly believe that it should - then it will ensure that lenders of these types of products, which are currently not covered by FSA regulation, will need to ensure that their standards in treating customers fairly are compatible with those required by the FSA for first charge lenders. If there are any cases where the differential regulation system through the OFT, or the lack of regulation by any body, has allowed lenders to develop unsatisfactory practices in advertising, sales, or arrears management, then these will be challenged and improved by the protocol.

Do you agree with the scheme of the protocol – i.e. early intervention when mortgage arrears begin; agreement of instalment payments; assistance to the borrower to gain benefits and manage debt; postponement of proceedings?

Yes, we agree with the scheme of the protocol. We would, however, make the following recommendations to improve the detail of the protocol's provisions.

1. Lenders' arrears policies must be publicly available

[9] Whitehead, C: *At any cost? Access to housing in a changing financial marketplace*, Shelter, 2007
[10] *Mortgage Effectiveness Review – Stage 2 report*, FSA, March 2008. This report identified a potentially problematic reliance by sub-prime mortgage borrowers on information given to them by their broker, and highlighted the inability of sub-prime customers to make free choices between different products, due to their constrained financial circumstances.

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On page 13 of the consultation paper, the protocol's aims are described thus – "The protocol is intended to ensure that lenders deal fairly with borrowers in arrears and to that end lenders must put in place and operate within a written policy (agreed by its respective governing body) and procedures for complying with the requirement to deal fairly with borrowers." We suggest that it is not sufficient for firms to have such a policy in place. The policy must be made publicly available so that any potential customers or other interested parties can see what it is and confirm that the firm is operating within it. Currently, it is extremely difficult to obtain details of lenders' policies or procedures for arrears management as many firms keep these confidential. We suggest that the first item of the protocol should be as follows: "All lenders should put in place and operate within a written policy regarding how they will deal with situations where borrowers fall into arrears with payments, and this policy must be made publicly available to any enquirers." This provision should precede the existing item 1 proposed in the consultation paper, perhaps under a separate heading entitled "General Requirements".

2. Extension of information provided to tenants in the property

Under current item 1 of the protocol (p13), lenders are to provide borrowers with a range of information about the arrears, sending this to each borrower where the mortgage is in joint names. Shelter has recently experienced a significant number of cases of tenants being made homeless because their landlord had fallen into arrears with the mortgage and been repossessed. Tenants are often unaware of the situation until a late stage of proceedings, which puts them in a very difficult position. They may be made homeless at very short notice through no fault of their own, when they have been making rent payments and have no reason to believe that their home is at risk. We therefore suggest that, at this very early stage, the requirements on lenders should include sending a letter to the mortgaged property addressed to "The Occupier", and indicating that the mortgage account is in arrears. This should be done in all cases, not just where the mortgage lender is aware that the property is let out; there are likely to be cases of lettings or sub-lettings which are unknown to the lender.

At each stage of the subsequent proceedings, a further letter should be sent, so that tenants in the property can be kept informed and can be prompted to seek advice as to their own housing rights, and to find out from the landlord what is going on. We recognise that there are confidentiality issues with doing this, and are not advocating that details as to the mortgagor's financial affairs, or of the arrears accrued, are passed on to the tenant. All that is needed is notification that the mortgage payments are in arrears, and what is happening at each stage of the process (dates of court hearings, orders granted etc). Including this requirement in the protocol will be of significant benefit to tenants and help further to reduce homelessness associated with mortgage arrears.

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The majority of cases where the borrower has let out the mortgaged property are likely to be where the mortgage taken out is a specialist buy to let product. Buy to let lending is excluded from FSA regulation altogether[11]. There are therefore fewer controls in place to stop potential buy to let purchasers from entering into unsustainable mortgage borrowing likely to lead to repossession. Including notification rights to protect tenants in mortgaged property within the terms of a pre-action protocol is therefore vital.

3. Referrals to independent advice

We do not consider that the provisions in the protocol for referral to independent advice are adequate. Obtaining independent advice is crucial for the borrower. The FSA's mortgage arrears information sheet which the protocol says must be given to borrowers in arrears does recommend that borrowers obtain advice and gives some contact details, and we welcome this. However the recommendation within the protocol of a referral to an advice agency needs to be strengthened and located at the beginning of the arrears process. There may be issues of confidentiality and consent in making such referrals. We recommend that these are covered for new mortgages through lenders requesting consent for the referral at the stage of granting the mortgage, and as a condition of granting the mortgage. For existing lenders, consent will need to be sought at the time when the account falls into arrears.

Shelter recommends that existing item 2 of the draft protocol becomes item 3, and that a new item 2 is inserted above it, worded as follows:
"Lenders shall, at the point of initial contact described in 1 above, make a direct referral for the borrowers to an independent advice service for advice on budgeting, debt and welfare benefits issues. Lenders should take steps to build up contacts and partnership working with one or more independent advice providers, and should refer each new arrears case to an advice agency directly, with a request that the advice provider wait for the borrower to make contact, and if this does not happen within 15 business days, that the advice provider directly contacts the borrower. The lender's initial letter to the borrower and occupier, described in 1 above, should include notification that such a referral has been made, and a request that the borrower make contact with the advice provider within 15 business days to discuss financial circumstances. Once the initial referral has been made, the precise arrangements for providing advice, or agreeing that it is not needed, can be made between the borrower and the advice provider. It will be open for the advice provider to become the borrower's advocate or representative in further dealings with the

[11] *Policy Briefing – mortgages and repossessions*, Shelter, 2008. Shelter recommends in this briefing that the FSA and the Government look again at the status of buy to let lending for regulatory purposes.

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lender, and subject to appropriate consent from the borrower, to share information on the borrower's financial position with the lender when negotiating terms for repayment of arrears."

This item 2 should replace the existing item 7 in the draft protocol.

We would like to see lenders providing funding towards independent advice agencies to facilitate agencies taking on this increase in volume of referrals. Clearly such funding would have to be provided on terms which do not prejudice the independence of the advice given. However, the example of what is already taking place in the social housing sector indicate that this is not a difficult thing to achieve. In the social housing sector it is not uncommon for housing associations to make funding grants towards the operating costs of the local Citizens Advice Bureau or other agencies. The housing associations are then in a better position to refer their tenants for independent advice to prevent rent arrears. If not-for-profit landlords in the social housing sector are able to justify such grant payments on a spend-to-save basis, then we consider that it is reasonable to expect mortgage lenders to do the same. Whilst requiring or recommending that this arrangement be put in place is outside the scope of the protocol itself, we take this opportunity to raise the proposal so that it can be considered by all parties interested in the protocol.

4. Communicating information in an appropriate manner

We are very pleased to see the provisions of item 5 included in this protocol. The requirement to provide information in a format which the borrower can understand is an important tool in protecting the vulnerable.

5. Range of options to be considered by the lender in arrears cases

We welcome the wide range of options which the protocol says lenders should consider. We are particularly pleased that the protocol acknowledges the principle established in recent case law that an acceptable time frame for paying off the arrears can include the lifetime of the mortgage.

6. Lenders assisting borrowers in claims for welfare benefits

Shelter has some concerns about the suggestion that lenders should be directly advising borrowers as to eligibility for welfare benefits. We consider that this is better done by independent advice agencies, who have the expertise to do this and who are in a better position to act as independent advisors, or advocates for the borrower in the area or

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welfare benefits. We have recommended above that a new item on referral to independent advice replaces the existing item 7 in the draft protocol, and is included at the point of initial contact, as a new item 2.

What should the sanctions for non-compliance be?

We consider that the sanctions indicated in the consultation paper - i.e. costs awarded against the lender (or at least lenders unable to recover costs from borrowers), stays, and adjournments - are all suitable sanctions for non-compliance.

We would, however, also like to see this protocol form part of a process of greater scrutiny of individual lenders' practices in bringing possession actions. We recommend that a central record is kept of all cases where failure to comply with the pre-action protocol has been a factor in the judge's decision, and that this information is compiled by the Ministry of Justice on a regular basis and made available to interested parties, broken down by lender and by court. Through such publishing of evidence, it should be possible for a picture to emerge of which lenders are operating poor practice in arrears management. It is also the case that the FSA regard the proportion of borrowers who fall into arrears as an indication of the suitability of the product which the borrowers have been sold[12], and therefore the compliance of lenders with MCOB rules on sale of mortgage products. Information on possession frequencies and practice by lenders collected as a result of the introduction of a pre-action protocol should be helpful in making a linkage back to whether the customer was inappropriately sold a product which they could not afford. This will be helpful to the FSA, who will be able to target their regulatory activity more accurately, and to potential borrowers and their advisers. It should also act as a strong incentive to encourage firms to improve their practices in sales as well as arrears management.

Any other comments?

We have mentioned under the section on referral for independent advice, above, that we would like to see lenders entering into funding partnerships with advice services in order to expand their capacity and facilitate referrals from the lender, so that all borrowers have full access to independent advice. Although outside the scope of this protocol, we strongly recommend that this is taken forward by the industry.

We welcome the provision in item 8 of the draft protocol saying that possession proceedings should not be started where the borrower has taken steps to market the property. However we are conscious that conditions in the property market may lead to

[12] *Mortgage Effectiveness Review – Stage 2 report*, FSA, March 2008.

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situations where selling the property may prove difficult. If there is a further significant slowdown in the property market, then it may become impractical for lenders to forebear on taking repossession action while waiting for a property to sell. We therefore recommend that lenders investigate expanding their existing provision for direct purchase and rent back arrangements with borrowers facing repossession. Shelter has made clear elsewhere[13] our concerns about sale and rent back arrangements currently proliferating amongst property speculators, which often offer very poor value for money and security for home owners. We would like to see a more sustainable model of sale and rent back in operation. We believe that lenders may be in a good position to purchase the property themselves and rent it back to the former owners, where sale on the open market within the required time frame is not likely. Clearly, such an option would have to be exercised only as a last resort in order to prevent repossession. It would also have to be carried out on terms which would incorporate best practice in this area[14]. This would include ensuring that the tenancy given to the former owner was a full assured tenancy rather than a shorthold assured tenancy which would offer only limited security; allowing for the former owner to buy back all or part of the property if their financial circumstances improved; rent levels set at affordable levels and increased only in line with increases in costs or inflation. Again, this is outside the direct scope of this protocol, however we raise the issue here for consideration amongst interested parties responding to this consultation.

Conclusion

This pre-action protocol as drafted is a very valuable step forward in protecting borrowers from variable practice across the mortgage lending sector, and in reducing the rate of repossession and homelessness. We warmly welcome it in principle, and have made a number of suggestions for areas where the draft version can be improved. We will be happy to discuss any of the points we have raised in further detail if that would be helpful.

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May 2008

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[13] In October 2007, Shelter wrote jointly with CML and Citizens Advice to the Economic Secretary to the Treasury, setting out concerns on sale and leaseback schemes and asking that such schemes be brought under FSA regulation.
[14] For Shelter's views on sale and leaseback arrangements, see our *Good Practice Briefing – Mortgage to Rent*, published in 2007 and available on Shelter's website.

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