JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM

GENERAL SCHEME OF THE SALE OF LOAN BOOKS TO UNREGULATED THIRD PARTIES BILL 2014

PRESENTATION OF FREE LEGAL ADVICE CENTRES, 3 DECEMBER 2014

flac
promoting access to justice

Introduction

On behalf of FLAC, we would like to thank the Chair and the members of the Committee for the invitation to address you today. In response to the Public Consultation issued by the Department of Finance in July 2014, FLAC made a short submission which has been provided to the Committee. Our submission today reiterates any of the points made, with some adjustments in terms of developments and thinking that has taken place in the interim.

The intention of the proposed legislation is first that purchasers of loan books will become regulated as retail credit firms and will henceforth be covered by the relevant Central Bank codes, most particularly, the Code of Conduct on Mortgage Arrears (CCMA) and/or the Consumer Protection Code (CPC). In the case of owner-occupier mortgage arrears, this should at least ensure that the Mortgage Arrears Resolution Process (MARP) applies in all instances and that consistency of treatment will be the norm. Investment mortgage credit or unsecured credit is not covered by the MARP and arrears on these loans will fall to be dealt with under the arrears handling chapter of the Consumer Protection Code (CPC) 2012 – Chapter 8 – which does not provide as developed an infrastructure for attempting to resolve arrears cases for example.

Second, it is also intended that customers of these newly authorised retail credit firms will also have access to the complaints machinery of the Financial Services Ombudsman's Bureau (FSOB).

Will the proposed Bill achieve these objectives?

Before going on to consider whether this approach will in fact provided the required level of protection for borrowers whose loan have been sold on (our primary concern), we note that there some concerns have been raised as to whether the means chosen will actually achieve these objectives.

Notably, the submission of Mars Capital makes a number of points that may need to be carefully considered. It states, for example, that '*most of the acquirers of loan portfolios are securitisation special purpose vehicles'* and it notes the proposed exemption in the draft bill for SSPV's. It is suggested that this would appear to leave most of the acquirers of loan portfolios outside the terms of the new regulatory regime.

It also notes that the category of retail credit firm was originally introduced to apply to consumer lending (primarily sub-prime mortgage lenders) and that this '*would not really be relevant to acquirers of mortgage portfolios who do not intend to engage in further lending activities'.*

Ultimately, it proposes that these two deficiencies might be remedied by requiring '*entities that own Irish mortgage loans to be regulated as mortgage administrators'.* This, it says, is the approach taken in the UK where mortgage administrators are subject to a separate regulatory code. **These points should be carefully examined by the Committee and the Department in our view.**

Does the proposed approach provide appropriate protection for mortgage holders whose loans are sold on?

- **The lack of effectiveness of the CCMA**

On the broader issue of what constitutes appropriate protection for mortgage holders, however, we are of the view that the MARP/CCMA is increasingly revealing itself as an inadequate infrastructure for the resolution of mortgage arrears cases. As 2014 draws to a close, FLAC has been conducting a statistical analysis of the past 12 months of mortgage arrears, rescheduling and repossession activity (from the end September 2013 to end September 2014). This shows that applications to repossess family homes have risen substantially; that slow progress is being made on restructuring arrears cases and that there is genuine doubt whether some of the restructures that have taken place are sustainable into the future.

6,367 new repossession applications were brought in the first half of 2014. This contrasts with **3,321** applications in the second half of 2013 and **525** applications in the first half of 2013. Speaking at a recent MABS event, the Governor of the Central Bank suggested however:

> '*That the process of tackling unresolved arrears cases has been that lenders have not been allowed to neglect or long-finger the numerous cases of non-cooperating borrowers. This has had the undesirable side-effect of crystallising into legal proceedings cases of non-cooperation for which a negotiated cure could have been arrived at (and may still be achieved)'.*[1]

This could be interpreted to suggest that non-cooperation is the principal reason for legal proceedings and that if only borrowers had co-operated a solution would have been found. We do not know whether there are figures to back up this assertion but there are none officially available of which we are aware.

In any case, this is not our experience. We have seen a number of cases where co-operating borrowers who have been making agreed payments over a period of years have had demands made for increased payments following a financial review and, unable to meet these demands, have been issued with proceedings. This is not to say that there are not some borrowers who are not co-operative; but equally there are lenders who do not apply the rules in the CCMA properly and lenders who classify borrowers as not co-operating in order to short-circuit the MARP process.

We are of the view that the review of the CCMA leading to a new version in July 2013 was a very 'lender-friendly' exercise and a lengthy criticism of the approach taken is contained in our recent report, 'Redressing the Imbalance', published in March 2014.[2] In May 2014, the Central Bank provided helpful feedback on its view of our report and informed us that it was '*planning to undertake inspections of lenders in order to monitor the compliance of the CCMA **in the second half the year**'* (i.e. 2014). However, Governor Honohan, in the course of the same speech, recently said:

[1] 'Household Indebtedness – Rhetoric and Action', Address by Governor Patrick Honohan at MABS Management Forum Annual Conference, 8 November 2014.
[2] See, in particular, Pages 43 - 66

> '*We at the Central Bank cannot attempt to oversee each case – though we are shortly embarking on a further probe to detect any systematic deviations from this Code and we will continue to hold regulated lenders to account for any deficiencies in their policies and practices in this regard'.*

Is this the same review and is it possible that it has not started yet? And what of the holding regulated lenders to account for any deficiencies? In a Dail reply to Deputy Michael McGrath (FF) in July, the Minister for Finance confirmed that no bank has been sanctioned for failure to comply with the CCMA.

It is also now patently clear that there is no external appeals mechanism for borrowers against adverse decisions made by lenders under the MARP, as opposed to complaints of non-compliance with the process. From what we are experiencing, the (internal) Appeals Boards of lenders appear to be largely rubber stamping the decisions of their Arrears Support Units, though again it does not appear that there are any published statistics available from the Central Bank in this respect.

In turn, the Financial Services Ombudsman Bureau has made it abundantly clear that it will not interfere with the commercial discretion of lenders, both on its website and in discussions we have had with officials of that office. Thus, it will not therefore overturn any **substantive** decisions made under the MARP such as a declaration that a mortgage is not sustainable, regardless of whether the decision was rational and fair in the circumstances. It will on the other hand look at matters of **procedure** and it has upheld a number of complaints from borrowers in arrears.

It is also becoming clear that many lenders have understood this and have also therefore understood that as long as they comply with the rules of the MARP (which nonetheless some lenders continue to breach), there is little to be concerned about. In summary then, this approach may well be replicated by the newly authorised retail credit firms when the time to apply the CCMA comes for them.

This is leaving and will leave many borrowers who have cooperated with their lender facing repossession proceedings in their local Circuit Court, mostly without access to the necessary legal advice and representation to defend their position. A variety of advocacy groups and the Money Advice and Budgeting Service (MABS) are doing sterling work to try to avoid this kind of outcome through interventions at various steps along the way but this is no substitute for a properly integrated and comprehensive State system of financial and legal assistance for borrowers in mortgage distress.

We submit that the CCMA should be amended to provide for a proper appeal to a third party against the substantive decisions of lenders (whether the original creditor or the purchaser of a mortgage agreement) – failure to offer an alternative repayment arrangement, the offer of an unsuitable alternative repayment arrangement or a declaration of non-cooperation – and that borrowers should have access to state-funded assistance to help formulate and argue their appeal.

- **Access to the Financial Services Ombudsman Bureau (FSOB)**

The second objective that the proposed Bill is designed to achieve is access to the complaints processes of the FSOB for customers of the new category of retail credit firm. Again, FLAC's recent study provides a critical analysis of this service, in terms of access, outcomes, appeals and some perceived difficulties concerning the wording of the legislation establishing the service, though we stress that we are very much in favour of a Financial Services Ombudsman. A number of recommendations are made in the report for reform.

Many customers of the credit acquisition companies are fearful that now or in time the terms and conditions of their loan agreements may be varied to their detriment. A recent FSOB decision which was ultimately appealed to the High Court by the complainants will certainly give some pause for thought. In **Millar v Financial Services Ombudsman,** a couple who had originally taken out seven variable rate mortgages with National Irish Bank (six buy-to-let investment mortgages and one on their principal private residence) complained to the FSOB that Danske Bank (who had taken over the business of NIB) had increased the rate of interest on these mortgages even though European Central Bank rates were at an all-time low. The FSOB rejected the couple's complaint on the ground that Clause 3 of the mortgage agreement allowed for alterations in the rate of interest 'in response to market conditions' and not 'in line with general market interest rates'. The High Court overturned this decision finding that the clause was ambiguous and that the FSOB erred in finding that the clause was clear in its wording. The matter was to be remitted to the FSOB to be reviewed in a manner not inconsistent with the Court's judgment. However, we understand that the FSOB has indicated that it may in turn appeal this decision.

The holders of variable rate mortgages, whether in arrears or not and whether those mortgage loans have been sold on or not will be watching the outcome of this case very closely. In the long run, the obvious concern is that loans already sold on will further be sold again in a complex web of transactions that may mirror the packaging of sub-prime loans into investment vehicles and which contributed significantly to the debt crisis in the first place. There is a distinct danger that terms and conditions in both secured and unsecured loans will be exploited. Together with the lack of transparent information on the debt purchase process and the lack of state-funded access to assistance, this leaves consumers very vulnerable.

We require not just legally binding legislation that clarifies the status of the credit acquisition companies but also a regulatory regime and Financial Services Ombudsman service that is prepared to vigilantly monitor these companies and their activities and to deal with complaints in a pro-active and decisive fashion.

- **Consumers retain their rights under the consumer credit legislation?**

Section 40 of the Consumer Credit Act 1995 is not mentioned in the consultation paper and we have asked the Department to clarify what it believes the effect of this section and the parallel provisions in Regulation 20 of the European Communities (Consumer Credit Agreements) Regulations (SI 281/2010) are in relation to the assignment of credit rights to the new entity of retail credit firm or equivalent.

S.40 of the CCA 1995 reads as follows:

> *40. Where a creditor's or owner's rights under an agreement are assigned to a third person, the consumer shall be entitled to plead against that third person any defence which was available to him against the original creditor including set-off.*

Regulation 20 of SI 281/2010 reads as follows:

> *20. (1) If a creditor's rights under a credit agreement or the agreement itself are assigned to a third*

> *party, the consumer concerned is entitled to plead against the assignee any defence available to him or her against the original creditor, including set-off.*
>
> *(2) The consumer shall be informed of an assignment referred to in paragraph (1) except where the original creditor, by agreement with the assignee, continues to service the credit vis--vis the consumer.*

These provisions in our view mean that the purchaser of a debt steps into the original creditor's shoes from a legal perspective, not just from the point of view of enforcing the credit agreement, but also in terms of assuming any liability for breaches of legal requirements that may have occurred before that purchase.

We submit that the Bill should clarify that these newly regulated entities will be obliged to comply with other consumer protection legislation and that as part of the regulatory process, a list of such obligations be drawn up.

- **Status of existing arrangements under the CCMA?**

A related question which we believe requires clarification is what the status of alternative repayment arrangements agreed by a lender under the CCMA will be when that lender sells on the mortgage to a third party. For example, if the original lender agrees a payment of interest and part capital or a split mortgage with a borrower, can the purchaser of that loan deviate from this agreement even before the next review date set out?

We would suggest that the legislation provides that any existing alternative repayment arrangement agreed by the original lender under the CCMA/MARP is binding on the company acquiring that mortgage agreement.

- **Regulating hire purchase companies**

The choice of the retail credit firm route to achieve the regulation of previously unregulated entities illustrates that the State has the means at its disposal to bring providers of financial services under the Central Bank umbrella, should it so wish. It is notable that the retail credit firm category was first created, as acknowledged in the Consultation Paper, as far back as 2007 in the Markets in Financial Instruments and Miscellaneous Provisions Act 2007. This was done to ensure that non-deposit taking mortgage lenders, such as 'sub-prime' lenders and home reversion companies, were subjected to some kind of regulatory scrutiny. The principal regulatory consequence that followed from this new status was that the entity in question had to apply the rules and standards set out in the Central Bank's Consumer Protection Code 2006 and this was in turn provided for in an addendum to that code issued in May 2008.

It is in FLAC's view unfortunately ironic that the same addendum expressly removed Hire Purchase and related agreements from the ambit of the CPC, without any advance notice or consultation with consumer groups. Specifically, the addendum states that *'this Code does not apply to regulated entities when carrying on the business of entering into hire purchase agreements or consumer hire agreements'*. Subsequent discussions FLAC had with the Central Bank clarified that the Bank was of the view that the Code should never have applied to Hire Purchase in the first place, so that its subsequent exclusion was merely correcting a mistake. The Bank's explanation for this appeared to be that Hire Purchase was not and never has been a regulated activity.

However, it is notable that the definition of 'retail credit firm' in the 2007 Act includes a 'person who holds itself out as carrying on a business of, and **whose business consists wholly or partly of, providing credit directly to relevant persons'**. As we have seen, the proposed amendment in this Consultation paper proposes to amend this definition to include entities who have become owners of such credit. In our view, offering a Hire Purchase agreement is the provision of credit directly to consumers or to other persons acting in the course of their trade, business or profession. Hire Purchase agreements have always been regulated in Irish law, as far back as the Hire Purchase Act 1946 and are currently regulated by the Consumer Credit Act 1995. The definition of credit under the CCA 1995 includes **a deferred payment, cash loan, or any other form of financial accommodation.**

In our view HP agreements fit into this definition. That is why these agreements are regulated under the CCA in the first place and very specific information has to be provided in the written agreement by the Owner to the Hirer. The Hirer, often through the medium of a garage acting as a credit intermediary (who ironically has to obtain a credit intermediary's authorisation), borrows money from the Owner and is charged interest, and repays this loan in periodic instalments. If all instalments and charges are paid, s/he acquires ownership of the goods (i.e. a car) the subject of the agreement.

We have raised this issue with both the Central Bank and the Department on a number of occasions and yet nothing has been done to regularise the situation. The core problem here is that the agreement is regulated but the provider and the activity is not. Not only therefore does the Consumer Protection Code not apply to the agreement but it would appear that there is nothing to stop a garage offering car finance directly, without having to go through any regulatory hoops, with all the dangers in terms of consumer protection standards that may result.

During the credit boom, thousands of high-cost HP agreements were taken on by borrowers, many of whom did not properly understand the nature of the agreement and significant over-indebtedness resulted. We have urged that the opportunity be taken with this bill to clarify that Hire Purchase is the provision of credit and should therefore be a regulated financial service.

Hire Purchase providers, unless they are already regulated entities by virtue of other lending activity, should also have to apply and obtain an authorisation as retail credit firms, in order to lend money under HP and related agreements, and should have to apply the standards in the Consumer Protection Code to such transactions.