

FSA Mortgage Market Review
Arrears Consultation CP 10/2
Response by the Building Societies Association

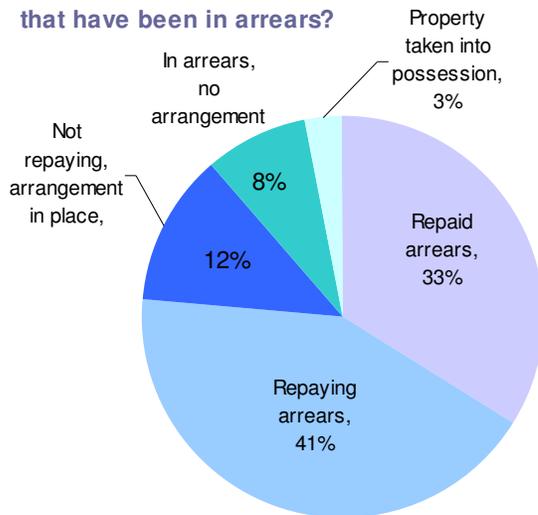
FSA Mortgage Market Review: Arrears Consultation CP 10/2

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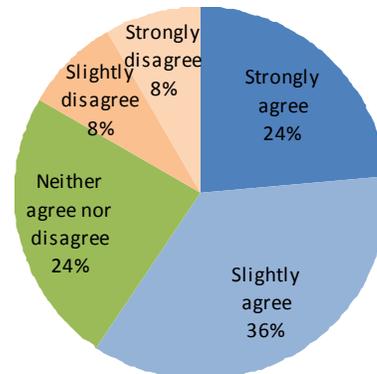
Introduction

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 51 UK building societies. Mutual lenders and deposit takers have total assets of almost £375 billion and, together with their subsidiaries, hold residential mortgages of almost £240 billion, 19% of the total outstanding in the UK. They hold over £245 billion of retail deposits, accounting for just under 22% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.
2. The BSA is supportive of the consistent outcomes that the FSA aims to achieve. However, we do not believe that the poor practices¹ identified in some lenders are indicative of the industry as a whole. Building societies, mutual lenders and the vast majority of high street lenders abide by the current rules as required by the FSA. They adopt approaches that are fair and meet the needs of the both the borrower and the lender.
3. BSA research *Understanding Mortgage Arrears*², published in 2009, found that 86% of borrowers surveyed had come to an agreement with their lender regarding their arrears and only 16% believed they had been treated unfairly.

What is the current situation of borrowers that have been in arrears?



Borrowers agreeing that their lender treated them fairly



4. The recent enforcement against GMAC RFC and Kensington does not demonstrate a failure of existing MCOB rules and guidance, but a failure of supervision and enforcement of the rules. Without effective supervision, the proposals detailed in the consultation paper will not prevent such behaviour from occurring again in the future. The consumer detriment

¹ FSA Thematic review findings <http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/080.shtml>

² *Understanding Mortgage Arrears* August 2009 http://www.bsa.org.uk/docs/publications/understanding_mortgage_arrears.pdf

identified in these firms will be more effectively dealt with through better supervision, rather than wholesale changes to the conduct of business rules.

5. We recognise the steps the FSA has taken recently to enhance the supervisory teams, to ensure supervision is targeted and effective. We believe that it would be sensible to assess the full impact of the supervisory changes prior to making changes to the conduct of business rules. This will ensure rule changes are targeted in areas where consumer detriment remains.

6. We are very supportive of the aim to increase standards of compliance within firms, but do not believe that all of the proposals are proportionate to the scale of the issue. They will impose substantial costs on the industry which are disproportionate to the consumer benefits. For building societies and mutual lenders these costs will ultimately be borne by their members.

Executive Summary

7. The BSA supports the proposal to prohibit monthly arrears charges, where the customer is maintaining an arrangement to repay the arrears. This practice is already widely adopted by building societies and mutual lenders.

8. Whilst we appreciate the reasons for amending the guidance into rules, we maintain that rules alone will not be sufficient to ensure high standards of compliance. The proposed rules must be supported by robust supervision and where failings are identified, appropriate enforcement must be swift to minimise further detriment to customers.

9. In the context proposed, and on the basis of the draft wording provided in the CP, we do not oppose the inclusion of Government schemes as a forbearance option.

10. We support the FSA's objective with regards to the charging of an ERC on arrears charges and accrued interest, we recognise the concerns that customers in this situation are being charged twice. However, we have concerns with the practical implementation of the proposals and believe that further work is required to ensure that firms have a suitable implementation timeframe and the proposals are clear to allow firms to treat all customers fairly.

11. We do not agree with the proposals to require every firm to record telephone calls. The impacts of the proposals are disproportionate to smaller firms and place further burdens on larger lenders, for little additional customer benefit. In addition, there are practical difficulties, resulting in the proposals being problematic to implement.

12. The BSA recommends that the FSA gives further consideration to the impact on smaller firms, before pressing ahead with the proposals. We believe there is sufficient evidence, backed by adequate controls, to exempt smaller societies from being required to record telephone calls.

13. The BSA recommends that further consideration is given to the impact on larger firms and considers the issues identified, before pressing ahead with the proposals. We believe that further work is required to determine the full extent of call recording which is required, to ensure the proposals are practical and proportionate, as well as deliver benefit to customers.

14. We support the overall proposal to maintain records for longer. However, we do not believe the proposal to require arrears calls, paper, and electronic records to be held for three years from the date the payment or sale shortfall has been cleared is proportionate. We believe that holding records for three years from the date the record was made results in sufficient consumer protection.

Question 1. Do you agree with our proposals to clarify our requirements to prohibit lenders from levying an arrears charge where customers have a performing arrangement to repay the arrears?

15. The BSA supports the approach of prohibiting monthly arrears charges, where the customer is maintaining an arrangement to repay the arrears. This practice is already widely adopted by building societies and mutual lenders.

16. The wording of the proposal currently excludes arrangements involving the contracted monthly payment only and arrangements or concessions allowing reduced payments. In these instances the lender and the customer will have made an agreement to allow the arrears to remain outstanding, or even to increase in the short term.

17. It is unclear whether this outcome is intentional, therefore clarification is required. If these situations are also to have monthly fees prohibited, this needs to be explicit in the rules.

18. It is vital that the rules are clear in order for the lender to be fully compliant and to ensure that supervisors can enforce the regime effectively.

Question 2. Do you agree with our proposals to convert current MCOB guidance to rules?

19. We support the proposals to convert MCOB guidance into rules. In our response to DP 09/3, we raised concerns that the drafting of the rules must not restrict the ability for lenders to apply flexible forbearance.

20. The draft wording of the rules as stated in CP 10/2, does not cause this situation to arise and will still permit lenders to offer flexible forbearance, based on the individual circumstances of the borrower.

21. Whilst the FSA and lenders may be clear that the intention of the change to rules is to result in better outcomes for the customer, this may not be clear for the judiciary. We therefore urge the FSA work closely with the Civil Justice Council to ensure that MCOB 13 and the pre-action protocol do not result in conflicting requirements upon firms.

22. We appreciate the reasons for amending the guidance into rules but maintain that rules alone will not be sufficient to ensure high levels of compliance. The proposed rules need to be supported by robust supervision and where failings are identified, appropriate enforcement must be swift to minimise further detriment to consumers.

Question 3. Do you agree that regard to Government schemes should be included as a potential forbearance option?

23. In the context proposed and on the basis of the draft wording, we do not oppose the inclusion of Government schemes as a forbearance option.

24. As we highlighted in our response to DP 09/3, it would be inappropriate to mention the schemes by name. Currently Homeowner Mortgage Support (HMS) and Mortgage Rescue (MRS) are temporary schemes. HMS in particular is also a voluntary scheme that many lenders are not formally participating in.

25. It is of utmost importance that voluntary Government schemes remain as such and that regulation takes account of this. We agree with the draft wording of the proposed rules, which will ensure that lenders are not forced into participating in voluntary schemes.

26. We also believe it is vital that the wording allows for changes in Government policy and avoids the need for a concurrent consultation to amend MCOB rules each time a new scheme is introduced.

Question 4. Do you agree with our proposal to use guidance to clarify our current requirements prohibiting the inclusion of arrears charges and accrued interest on the charges within ERCs?

27. We support the outcome that the FSA aims to achieve and recognise the concerns that some customers in this situation are being charged twice. However, we are concerned with the practical implementation of the proposals. We believe that further work is required to provide clarity in the rules to enable firms to implement the proposals consistently. We also believe that firms should be provided with a suitable implementation timeframe.

(i) Using guidance to clarify the application of ERCs

28. The proposal to use guidance rather than an evidential provision, does not, in our view, appear to be consistent with the approach to other fees detailed in the CP.

29. The FSA recognise that a minority of firms did not accept that the application of a monthly arrears charge where an agreed arrangement was in place was inappropriate. We believe there is a risk that some firms will also fail to understand the FSA position regarding ERCs on arrears charges and interest.

30. The majority of lenders will work to ensure that guidance is followed and amend systems and processes accordingly, which may involve substantial financial investment. As a result, firms that strive to achieve the highest standards of compliance will incur a financial impact, whilst other firms may continue to benefit financially by continuing to charge an ERC on the full balance. Not only is this unfair to lenders, it will result in inconsistent treatment of customers and will not result in any improvement to the current situation.

31. We believe that to ensure the highest standards of compliance and to ensure that all customers are treated fairly the proposal, if implemented, should be an evidential provision rather than guidance.

(ii) Definition of arrears charges

32. The CP does not provide a clear definition of what constitutes an arrears charge. Clarification is required to enable lenders to comply with the proposals.

33. It is not accurate to define an arrears charge as *all charges applied to a customer in arrears*. Some charges may relate to other services, for example changing the account to interest only, or for a returned Direct Debit. These charges will also be payable by customers who do not fall into arrears. For example a returned Direct Debit may be paid on representation or by another payment method before the end of the month.

34. There is also the issue of unpaid ground rent and service charges, which the lender may pay to avoid forfeiture of lease. Many lenders treat this payment as arrears and take relevant steps to arrange repayment with the borrower. We do not believe that these charges should fall under the scope of the proposals, but the lack of a clear definition makes the lender position unclear.

35. Leaving the definitions unclear may inadvertently extend the scope of the proposal to include all charges payable, whether the customer is in arrears or not. This would not be proportionate and any such proposal would need greater analysis and a more detailed consultation.

(iii) Capitalisation of arrears balance, charges and accrued interest

36. Capitalisation can consist of the arrears balance, charges and accrued interest or arrears charges only.

37. Capitalising the arrears balance and charges is usually offered to customers who are recovering their situation and have been maintaining an arrangement with the lender. Capitalising the remaining balance will improve the customer's credit file, whilst still enabling an affordable monthly payment.

38. Capitalising the arrears charges only, results in the charges being added to the capital balance and not the arrears balance. Fees may be capitalised monthly, quarterly or annually depending on the individual firm. Capitalising arrears charges allows the lender to allocate payments to the arrears balance first, without having separate system flags or sub accounts, therefore provides a practical solution to enable compliance with the proposals regarding allocation of payments.

39. Capitalisation in either form creates issues with complying with the ERC proposals. The nature of capitalisation means that it is not possible to determine each individual element of the capital balance, therefore when applying the ERC, it would be applied to the total amount outstanding.

40. We believe that capitalisation in both forms should remain as an option to customers during an ERC period, especially for customers on long term fixed rate mortgages. However, this will only work if the ERC proposals are not applied to capitalised balances.

41. The strengthening of capitalisation rules and more robust supervision of firms will ensure that the exemption would not result in any consumer detriment.

(iv) Systems and documentation

42. We recommend that a realistic implementation timeframe is given to allow firms to make the required system and documentation changes to comply with the new requirements.

43. The current timeframes result in a policy statement being issued in June 2010, with firms expected to be compliant immediately. We are concerned that this proposal is classified as clarification of an existing requirement, when for many lenders this proposal will require changes to processes and systems. In order to comply, firms will need to begin the process of amending systems and documentation before the policy statement is issued and therefore pre-empt the final requirements.

44. This carries potential risks, especially if the requirements in the policy statement vary from those stated in the CP.

45. It is also important to note that even if firms did commence work now, it is still a very ambitious timeframe. There is also the added pressure of budgetary and financial constraints, resulting from additional expenditure mid way through the year. This could place considerable pressure on firms, in what is still a fragile financial environment.

46. Whilst some firms may be prepared to operate manual workarounds, this will not be suitable for all. Manual workarounds can lead to human error and mistakes with regards to calculations, record keeping and management controls. For larger firms in particular, this will not be practical due to the scale of operations, therefore would not work at all as an interim solution.

47. The potential for errors with manual workarounds, could potentially be more detrimental to the customer if the ERC is calculated incorrectly and would leave the firm open to complaints and redress, increasing costs further.

(v) Cost implications

48. The BSA has undertaken a cost benefit analysis in relation to the ERC proposals, using data provided from our members. A cross section of our members have provided details of the average fees charged to a borrower in arrears. For the purpose of the analysis we have assumed the borrower is 6 months in arrears.

Scenario 1			
Loan:	£100,000		
Interest Rate:	6%		
Term:	20 years		
Loan type:	Interest Only		
Contractual monthly payment³:	£500		
Arrears of 6 months⁴:	£3,000		
Average Total Arrears Charge⁵:	£215		
Outstanding Balance⁶:	103,000		
Outstanding balance including arrears charges and accrued interest⁷:	£103,222		
Impact of an ERC			
ERC	Outstanding balance including arrears charges and accrued interest	Outstanding balance only	Customer saving
5%	£5,161	£5,150	£11
4%	£4,129	£4,120	£9
3%	£3,097	£3,090	£7
2%	£2,044	£2,060	£4
1%	£1,032	£1,030	£2

³ The monthly payment has been calculated on an annual rest basis

⁴ The arrears balance is 6 months missed payments

⁵ The average arrears charge is the total charges accumulated up to the point of reaching 6 months arrears. The figure does not include any fees relating to litigation and possession. The average is based upon information from six societies of varying sizes from a top 10 society to a very small society.

⁶ The outstanding balance includes the arrears balance, but assumes it has not been capitalised and that additional interest is not being charged.

⁷ This balance includes arrears charges and interest charged at 6%.

Scenario 2

The same loan amount, interest rate, term, loan type and arrears balance as per scenario 1 have been used in scenario 2.

Highest Total Arrears Charge⁸:	£325
Outstanding Balance:	£103,000
Outstanding balance including arrears charges and accrued interest:	£103,335

Impact of an ERC

ERC	Outstanding balance including arrears charges and accrued interest	Outstanding balance only	Customer saving
5%	£5,157	£5,150	£7
4%	£4,133	£4,120	£13
3%	£3,100	£3,090	£10
2%	£2,067	£2,060	£7
1%	£1,033	£1,030	£3

Scenario 3

The same loan amount, interest rate, term, loan type and arrears balance as per scenario 1 have been used in scenario 3.

Lowest Total Arrears Charge⁹:	£140
Outstanding Balance:	£103,000
Outstanding balance including arrears charges and accrued interest:	£103,144

Impact of an ERC

ERC	Outstanding balance including arrears charges and accrued interest	Outstanding balance only	Customer saving
5%	£5,157	£5,150	£7
4%	£4,125	£4,120	£5
3%	£3,094	£3,090	£4
2%	£2,063	£2,060	£3
1%	£1,031	£1,030	£1

49. Our analysis shows that the financial benefits to consumers are minimal. Using the FSA assumption that an ERC is charged at 3% on average, this would save the customer between £4 and £10, with the average being £7. We do not believe this justifies the costs of amending IT systems, which are detailed below.

⁸ The highest total arrears charge is the highest fee used in the analysis

⁹ The lowest total arrears charge is the lowest fee used in the analysis

Cost Implications to firms

Society 1 - This is a top 15 building society as defined by the BSA Year book 2009/10

Society 2 - This is a 20 to 30 building society as defined by the BSA Year book 2009/10

Society 3 - This is a 30 to 40 building society as defined by the BSA Year book 2009/10

The following figures are the estimated costs for amending IT systems to ensure an ERC is not charged on arrears fees and accrued interest. The cost per customer demonstrates the impact of the change based on the number of customers each lender has in arrears (rounded to the nearest whole number to protect commercially sensitive data) as at Q3 2009. Further information can be provided to the FSA on a confidential basis.

	System Costs	Cost per arrears customer
Society 1	£20,000	£50
Society 2	£10,000	£250
Society 3	£5,000	£200

50. The estimated costs highlight that the financial impact of the proposed changes far outweighs the benefits to the customer. Some larger lenders have estimated costs far higher (several million in some cases). We therefore believe further work is required to establish the overall financial impact.

51. The analysis used by the FSA is very much focussed on the findings of the thematic work, which highlighted firms who levy excessive charges. We strongly believe that this is not widespread practice.

52. We believe a more proportionate response would be to review the impact of the proposals to ban monthly arrears charging for arrangements and the requirement to allocate payments to the arrears balance, to ascertain the overall impact this has upon the total charges levied against borrowers in arrears.

53. Furthermore we believe that the FSA should consider implementing a maximum level, where an ERC could be charged on the total balance, as the overall impact on the customer would be negligible. This would result in only those firms who charge excessive fees being required to make the necessary system changes to avoid applying the ERC.

54. We also believe it that it would be more cost efficient for firms to assess the system implications for all aspects of the MMR, rather than in isolation. An implementation timeframe involving enhancements to systems should therefore take account of all the necessary changes which result from proposals in the forthcoming CPs.

55. We strongly urge the FSA to consider the overall practical difficulties of the proposal and to recognise that an implementation period is required.

(vi) Retrospective application of the proposed rules.

56. We are concerned that the proposals could leave a firm open to complaints from past customers, which could lead to claims for refunds. This could impose significant costs on firms in terms of administration and compensation.

57. We recommend that the implementation of the proposal commences from a specific date, therefore ensuring firms are not open to retrospective action. This is important, we do not believe that this change is a clarification of existing requirements, but is a new requirement upon firms. As such, it would be inappropriate to require firms to implement the proposal retrospectively.

Question 5. Do you agree with our proposals to implement call record keeping requirements for telephone calls?

58. We do not agree with the proposals to require every firm to record telephone calls. The impacts of the proposals are disproportionate to smaller firms and place further burdens on larger lenders, for little additional customer benefit. In addition, there are practical difficulties, resulting in the proposals being problematic to implement.

59. We have not recommended a definition of larger and smaller firms. For the purpose of our analysis we have defined smaller as firms with mortgage assets less than £1 billion and larger with assets equal to or greater than £1 billion. We believe further work is required to define smaller and larger firms to ensure the definitions result in appropriate regulation.

The impact on smaller firms

60. Many smaller building societies do not use call recording in any form. These societies have very low levels of arrears compared to the industry average.

Arrears by sector			
Balances in arrears of 1.5% or more of the outstanding balance expressed as a % of total loan balances outstanding			
	Building societies*	ALL lenders*	Building societies <£1 billion mortgage assets**
2009 Q2	0.92%	2.98%	0.90%
2009 Q3	0.96%	2.90%	0.89%
2009 Q4	-	2.78%	0.90%

*Source: FSA
 Regulated and non-regulated non-securitised loans
 Building societies' figures do not include subsidiaries
 From Q4 2009 the FSA no longer report sector statistics

**Source BSA
 Data represents 20 societies with mortgage assets under £1 billion

61. Due to the size and nature of smaller firms, staff have very close relationships with their customers and work very closely to help them resolve their situation. As a result, implementing call recording is very unlikely to add any significant additional benefits to customers.

62. Smaller firms do recognise that a close relationship with their customer is not sufficient on its own to ensure that the customer has been treated fairly and appropriate information has been given regarding their mortgage. Therefore smaller firms have additional controls in place to monitor arrears cases, with audits in place to challenge decisions and ensure TCF, which are explained in more detail below:

- (i) Setting up an arrangement

63. When agreeing an arrangement with the customer, the details of the arrangement are sent to the customer as a record of the agreement. The customer may also be asked to return a signed declaration, acknowledging the terms of the arrangement.

64. This process also allows the customer to make queries or to request an amendment to the arrangement, should they disagree. If the customer does not return the declaration,

the lender will contact the customer to ascertain the reason why. This could result in an amended arrangement being agreed.

(ii) Monitoring arrangements

65. All arrangements are monitored on a regular basis to ensure they are maintained as agreed. If an arrangement is broken, a review is undertaken to ascertain the reason for the non payment. On average 84%¹⁰ of arrangements by smaller societies are maintained.

66. If it is identified that the arrangement is unaffordable, this is fed back to relevant members of staff and will feed into staff training and competency.

(iii) Independent audits

67. Regular audits of all arrears cases are undertaken by managers and/or compliance personnel and some firms use a TCF Committee. Audits are also undertaken by external agents, such as Mutual One or by the firm's appointed auditors. These audits consist of reviews of all written correspondence, file notes and the status of the arrears. This includes a review of the forbearance options offered to the customer, ensuring they were appropriate based on the information collected from the customer.

68. All audits will look to challenge decisions to ensure there is appropriate justification and evidence to support the options given to the customer. If the audit highlights an alternative solution, this is fed back to relevant staff and contact is made with the customer.

69. If issues are identified with how the customer was treated or with the information provided to the customer, steps are taken to swiftly resolve the situation.

70. Should it be necessary to commence possession action, a review is undertaken prior to action commencing to ensure all other options have been considered and the commencement of the action really is a last resort.

71. We believe that these controls are sufficient to ensure that customers are treated fairly, we therefore fail to see where call recording would add further benefits.

Practical implementation for smaller firms

72. There are also a number of issues specifically with smaller societies in relation to practical implementation of the proposals, such as the lack of a dedicated arrears department and the disproportionate costs.

(i) Arrears department

73. Smaller firms do not have dedicated arrears departments, as seen in larger firms. The structure of smaller firms is vastly different, due to the scale of operations.

74. In practice this means that arrears calls are received into head office via the general contact numbers, there is no dedicated arrears contact number. A call may be handled by any member of head office staff, although often there is one person who will handle the majority of the calls.

75. In theory this could mean that arrears calls could be recorded by connecting recording equipment to the individual's telephone. However, in practice it is not as straightforward. Should that member of staff be absent, or is unable to take the call for capacity reasons, the call will be dealt with by another member of staff and therefore will not be recorded.

¹⁰ Information taken from a cross section of societies with mortgage assets under £1 billion.

76. The alternative solution would be to record all telephone calls received or to connect recording equipment which is activated manually when an arrears call is received. These two options have significant cost implications.

(ii) The cost of call recording

77. The average cost for implementing a call recording system, for smaller societies is £8,000. For some there will be additional support and maintenance costs, which average at £2,000 per annum. We therefore recognise that the costs to set up recording are not necessarily prohibitive, but they are disproportionate based on the cost per customer as demonstrated below:

The costs have been calculated using data from 7 societies with mortgage assets under £1 billion. The cost per customer is calculated using the total number of borrowers with arrears of 1.5% or more of the mortgage balance, as at Q4 2009.

Average cost to implement call recording	Average cost per customer	Lowest cost to implement call recording	Lowest cost per customer	Highest cost to implement call recording	Highest cost per customer
£8,000	£172	£5,000	£50	£20,000	£333

78. Although these figures are based on a small sample of firms, they support the need for a more detailed cost benefit analysis before pressing ahead with implementation.

Recommendation for smaller firms

79. The BSA recommends that the FSA gives further consideration to the impacts on smaller firms, before pressing ahead with implementation of the proposals. We believe there is sufficient evidence, backed by adequate controls, to exempt smaller societies from being required to record telephone calls.

The impact on larger firms

80. Many larger societies and mutual lenders have existing call recording arrangements in place in various parts of the business, including the arrears department.

81. In larger firms, call recording provides some benefits due to the scale of operations and is therefore more appropriate. The number of staff employed and the potential for a higher turnover of staff requires different types of checks to be put in place to monitor training and competence, including TCF, which call recording supplements. Larger firms therefore see a benefit in having call recording in place, which smaller firms would not.

82. In addition to call recording, firms rely on audits of file notes, information and performance of arrangements to ensure customers are offered appropriate forbearance and are provided with relevant and accurate information. These processes are used to promote high standards of customer service and to minimise the potential for detriment.

(i) Staff training

83. Arrears staff are trained to work with the borrower to resolve their situation and to offer payment arrangements taking account of the individual circumstances of the customer. Staff are not trained solely as collectors to obtain payment at all costs, regardless of the customer's circumstances.

84. Staff are given mandates that reflect experience and knowledge. These mandates are not designed to constrain the options offered to customers and instead encourage staff to escalate situations outside of their mandate to a more senior or experienced member of staff, therefore ensuring customers are treated fairly and consistently at all times.

85. This is supported by a high level of performing arrangements, indicating that customers are not forced into a position of agreeing unsustainable payments as seen in the recent enforcement against GMAC RFC and Kensington.

(ii) Audits

86. Within larger firms staff performance is regularly reviewed and case audits are undertaken to ensure correct procedures are followed and adequate, accurate information is provided to customers. These audits may include a review of recorded telephone calls. However, firms do not rely on call recording as the primary tool to monitor staff.

87. If the audit identifies any concerns, this is fed back to relevant members of staff and steps are taken to enhance training and competence. If the customer has potentially suffered detriment, steps are also taken to swiftly rectify the situation.

88. Regular audits of arrears cases are undertaken by managers and/or compliance personnel and some firms use a TCF Committee. These audits consist of reviews of all written correspondence, file notes and the status of the arrears. This includes a review of forbearance options offered, ensuring they were appropriate based on the information collected from the customer.

89. All audits will look to challenge decisions to ensure there is appropriate justification and evidence to support the options given to the customer. If the audit highlights an alternative solution, this is fed back to relevant staff and contact is made with the customer.

Practical implementation for larger firms

90. Although larger firms have existing call recording arrangements in place, the proposals create issues specifically for larger firms in relation to the practical implementation.

(iii) Capturing all relevant calls

91. The technology used by some firms is not infallible and therefore results in the potential for inbound and outbound calls not to be recorded. For example some firms report issues with mobile telephone numbers not being picked up by the call recording equipment.

92. The CP takes a very simplistic approach, as it appears to assume all arrears calls are received directly into the arrears department every time, which in practice is not always the case. If a call is made directly to a member of the arrears team (such as a manager), or is transferred internally, the recording of the call will not be activated.

93. Internal transfer of calls is a common issue amongst firms. The telephone systems do not differentiate between a customer call and a call transferred from another part of the business. To overcome this, all internal calls would have to be recorded. However, this would add significant costs and would be disproportionate to the resulting benefits.

94. Both situations create issues of non compliance, as the record of the call will be held on the file notes, but the recording will not have occurred. We therefore recommend that further analysis is undertaken to determine a suitable 'drop' rate. For example, similar rules are in place in relation to 'silent calls'. Ofcom¹¹ regulations allow a 3% silent call rate

¹¹ <http://www.ofcom.org.uk/media/features/callsfine>

(supported by additional requirements such as a recorded message). We believe a similar approach to call recording should be considered.

(iv) Managing arrears calls in other parts of the business

95. Larger firms often manage capacity by utilising other parts of the business. This practice results in processing efficiencies, resulting in cost savings. For example, firms may use the new business call centre to conduct outbound and receive inbound arrears calls at times when capacity in the arrears department is under pressure.

96. In this situation arrears calls would be stored within the new business archive, making the retrieval far more costly and time consuming. Finding relevant calls could require searching all calls by the contact centre at a specified time of the day, and playing them back to identify the customer.

97. We do not believe this is a proportionate solution and therefore recommend the FSA take account of these situations and undertakes further analysis. It is important that the call recording proposals are proportionate to the practical issues and potential costs.

Recommendation for larger firms

98. The BSA recommends that further consideration is given to the impact on larger firms and considers the issues identified, before pressing ahead with the proposals. We believe that further work is required to determine the full extent of call recording which is required, to ensure the proposals are practical and proportionate, as well as deliver benefit to customers.

Practical issues for both smaller and larger firms.

99. In addition to the specific practical impacts on the different sizes of firm, there are common issues which would impact all firms.

(i) Definition of an arrears call

100. The consultation does not provide a clear definition of that constitutes an arrears call. It is not as simple as '*a customer in arrears*', as this would exclude pro-active arrears management by the customer or the lender, but would include a call from a customer in arrears enquiring about branch opening times or the interest rate on their savings account.

101. This creates the situation where the lender may be required to record every call by that customer irrespective of the purpose. We therefore recommend that the FSA ensure the definition of an arrears call is clear.

(ii) Payment Card Industry (PCI) data security standards

102. The draft proposal appears to conflict with the requirements of the PCI Security Standards¹² Council which directs the non-retention of card payment information. It is a violation of requirement 3.2 of the standards to store any sensitive authentication data, including card validation codes and values, after authorisation even if the data is encrypted.

103. It is therefore prohibited to use any form of digital audio recording (using formats such as wav, mp3 etc) for storing CAV2, CVC2, CVV2 or CID codes after authorisation if that data can be queried.

104. In order to comply with the standards firms would be required to erase the payment information from the recording. We believe further work is required to ensure the proposals take account of PCI standards.

¹² <http://selfservice.talisma.com/display/2n/ index1.aspx?tab=faq&r=0.7662217>

(iii) Retrieval and notice period

105. The current timescales for production of records to the FSA is 48 hours. We do not believe this is a sufficient time period in which to gather all relevant calls for the required mortgage accounts.

106. In order to comply with the data protection act in relation to the storage of the data, only a limited number of staff will have access to the records. It is therefore not feasible to assume that a large number of staff will be mobilised to action the FSA request. This would require the firm to potentially grant access to sensitive data to junior or temporary staff, which we do not believe is a reasonable expectation on firms.

107. For consistency we believe that the timescales for the production of the call records should be brought in line with the prescribed timescales for a Data Protection Act Subject Access request, which is 40 days.

(iv) Branch Calls and third parties

108. The consultation does not clarify how arrears calls handled by branches or other third parties would be captured by the proposals.

109. All building societies and mutual lenders operate branches. These range from a single branch also housing a head office to a network in excess of 900 outlets. Many customers use their local branch regularly and enjoy good relationships with the staff. For this reason some customers may feel more comfortable telephoning their branch to discuss their arrears rather than head office.

110. The lender may have trained their branch staff to handle the call and to discuss the account with the customer, including the agreement of appropriate forbearance. Details of the agreement would be noted on the customer's file as it would if the call had been handled by head office.

111. Other firms do not permit their branch staff to discuss forbearance and instead redirect the customer to speak to head office. This also includes situations where the customer visits the branch and is connected to the arrears department via a telephone in branch.

112. The use of branches in respect of arrears management provides a valuable service to customers. Recording telephone calls from branches results in those difficulties highlighted previously. We believe that branch calls should be exempt from the proposals.

113. Firms often use a range of third parties at different stages in the arrears and possessions process, most common are the use of field agents and solicitors. It is unclear from the proposals as to whether these firms are also required to record telephone calls as they are acting on behalf of the lender. We do not believe that calls made by third parties should be captured by the proposals and therefore clarification is needed in this respect.

Question 6. Do you agree with the extension of the period for all arrears records from twelve months to three years?

114. We support the overall proposal to maintain records for longer. However, we do not believe the proposal to require arrears calls, paper and electronic records to be held for three years from the date the payment or sale shortfall has been cleared is proportionate. We believe that holding records for three years from the date the record was made results in sufficient consumer protection.

115. A customer continually dropping into and out of arrears, selling at a shortfall, perhaps agreeing a shortfall payment then lapsing, may result in lenders being required to

hold these records for an indefinite period. This creates issues regarding storage capacity and associated costs, as well as staffing costs for record retrieval.

116. This goes beyond what should be reasonably expected of firms. Furthermore the proposals may conflict with the requirements of the Data Protection Act, particularly in relation to storing data for a reasonable period of time. Holding data indefinitely is unlikely to be viewed as 'reasonable'.

117. It would be far more appropriate to retain records, for three years from the date of the record. For telephone calls this would be three years from the date the call was made. For paper or electronic records, this would be from the date the record was made.

Question 7. Do you agree with our proposal to clarify our current requirements for borrower payments to be allocated to paying off arrears before charges?

118. We understand the outcomes the FSA aim to achieve with the proposals. However, the ability for firms to comply with this proposal, may be hindered by the issues of capitalisation and the charging of an ERC, as we outline in our response to Question 4.

119. We recommend the FSA undertakes further analysis to ensure that the proposed changes overall do not result in any conflicts with regards to the ability of the lender to comply with the proposals.

Question 8. Would our proposals to change the rules affect firms' ability to improve customer understanding of the arrears statement?

120. We do not believe that the proposals would affect the customer's understanding of the arrears statement. The proposed changes are likely to have a neutral impact at best and would be unlikely to enhance a customer's understanding.

Question 9. What should the timescales be for implementing call recording and retention?

121. It is very difficult to recommend a timescale due to the need for clarification and further analysis in relation to the issues identified in Question 5. The final requirements will therefore dictate the development involved by individual firms. As a starting point we recommend the FSA consider a minimum period of 18 months.

122. As highlighted previously in our response to Question 4, we strongly recommend an implementation timeframe is provided for firms to comply with the ERC proposals. This is again dependant on the final requirements and as a minimum we recommend a period of 18 months, but would encourage the FSA to work with the industry to agree a suitable period.

Question 10. Do you have any comments on our CBA?

123. We agree with the analysis in relation to monthly arrears charges, converting MCOB guidance into rules and the reference to Government schemes.

124. Our own analysis does not support the findings of the CBA regarding ERCs. As we state in our response to Question 4, we believe that the overall impact of charging an ERC is negligible compared to the costs required to amend systems.

125. As stated previously we believe the FSA should consider implementing a maximum level, where an ERC could be charged on the total balance. This would result in only those firms who charge excessive fees being required to make the necessary system changes to avoid applying the ERC.

126. As also highlighted in our response to Question 4, we do not believe the costs for smaller firms are proportionate to the number of customers in arrears. The FSA should conduct a more detailed CBA specifically for smaller firms and consider an exemption for those where the costs far exceed the benefits to the customer.

127. We believe that the CBA needs to be reworked in respect to the allocation of payments. The numbers provided in the CBA do not appear to be correct. The CBA assumes a monthly payment of £250 on a loan of £100,000, interest only at 6%. The monthly payment on this loan would be double that at £500, therefore the assumptions made in the CBA are not necessarily correct.

Question 11. Do you agree with the compatibility statement?

128. We agree with the compatibility statement, subject to our comments raised previously where we believe some of the proposals are not proportionate to the issues identified.

Contact

129. This response has been prepared by the BSA in consultation with its members. Comments and queries in the first instance should be addressed to Victoria Barnard, Mortgage Policy Adviser (victoria.barnard@bsa.org.uk).

29 April 2010