



## MORTGAGE...MORTGAGE...MORTGAGE...MORTGAGE...MORTGAGE...MORTG

### Welcome to Mortgage Target...

Welcome to the winter edition of Mortgage Target; the newsletter tailored for Paradigm Mortgage Firms that will cover the important issues arising in the regulatory world. Each quarter we will aim to provide you with the most relevant articles, written in an easy manner and more importantly highlighting the potential impact on your day-to-day business.

We begin this winter edition of Mortgage Target with a look at the Crosby Report, backed by the Chancellor of the Exchequer, which sets out a number of recommendations in relation to the options for improving mortgage finance markets.

Also inside this issue, we provide useful case studies published by the Financial Services Ombudsman in relation to complaints to them regarding Equity Release Schemes. We also have a round up of the latest enforcement action by the FSA plus other interesting articles.

We provide an overview of a speech by the FSA about challenges facing the Mortgage Intermediary Sector in addition to a summary of the proposals set out in a white paper published by the Association of Finance Brokers on the future of regulation of the secured loans industry.

If you have any comments or constructive feedback regarding Mortgage Target, please e-mail [suecaughtry@paradigm mortgages.com](mailto:suecaughtry@paradigm mortgages.com)

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## The Crosby Report

On 9<sup>th</sup> April 2008 the Chancellor of the Exchequer announced that Sir James Crosby would provide advice to the government on options for improving the function of mortgage finance markets.

The interim analysis report was published on 29<sup>th</sup> July 08 in which Crosby reviewed the importance of these markets for the UK mortgage market. The report highlighted the level to which continued disruption in these markets had contributed to higher funding costs for mortgage lenders, and the consequences of higher prices and reduced access to finance for many borrowers.

The final report was published together with the 2008 Pre-Budget Report on 24<sup>th</sup> November 08 and sets out Crosby's recommendations which are as follows:

- The government should encourage the banking industry to adopt new standards of transparency and standardisation in the market in mortgage-backed securities;
- The government should encourage the International Accounting Standards Board to rethink its principle of "fair-value accounting", which has caused banks to reduce the value of their assets and inter-bank lending to seize up. Crosby stresses that transparency should not be compromised.
- And Crosby believes that there is a "strong case" for the government to intervene in mortgage finance markets by guaranteeing £100bn of new issues of mortgage-backed securities in 2009 and 2010.

Crosby believes this intervention kick start the housing market which would be of huge benefit to the economy whilst providing some relief to existing and potential homeowners.

## Challenges Facing the Mortgage Intermediary Sector

Lesley Titcomb, Director of Small Firms and Contact Centre and Retail Intermediaries & Mortgage Sector Leader, spoke at the Mortgage Business Expo on the challenges facing the mortgage intermediary sector.

The FSA has already seen many intermediaries heavily reliant on the subprime business cancelling their FSA permissions. In these difficult times, the FSA accepts that firms may look for ways to diversify their income but is concerned where firms switch to selling products outside their area of expertise or that are riskier; one such product being equity release. The FSA expects all FSA authorised firms to exercise a duty of care to their customers when advising on sale and rent back - even though this market is not regulated by the FSA yet.

The FSA has begun to see evidence of the revival of 'phoenix firms', this is when the directors of one firm seek to close down the firm and transfer the assets to a new firm, leaving the liabilities behind, to be met by the Financial Services Compensation Scheme (FSCS). The FSA is asking firms to let it know if they suspect this is happening and to be extra careful in their due diligence on new appointed representatives.

The five key risks the FSA sees for the mortgage intermediary sector are:

- inadequate standards of competence and professionalism;
- unsuitable advice;
- inadequate financial resources and business model sustainability;
- inadequate management oversight; and
- inadequate fraud systems and controls to prevent and detect mortgage fraud.

Lesley concludes her speech with a clear message about how the FSA want to offer mortgage intermediaries a more tailored service including a better quality service and greater level of support.

This new service model will include:

- More technical specialists to help answer queries on first call;
- More emphasis on helping firms with principles-based regulation queries; and
- The provision of more firm specific tailored answers to queries to help firms meet their regulatory outcomes.

## Financial Ombudsman Service - A clear and open approach

**Following a review by Lord Hunt in April 2008 the Financial Ombudsman Service (FOS) announced its plans to publish information on the complaints it handles about named individual firms.**

In September 2008 the FOS disclosed the type of information it plans to make public. This includes the number of complaints referred to the ombudsman service in relation to the 150 or so financial businesses that produce between 85% and 95% of all cases and the percentage of 'upheld' complaints – where the outcome changed in favour of the consumer, after the involvement of the ombudsman service.

Earlier this month Tony Boorman, Principal Ombudsman, at the ABI's complaints management seminar explained that the FOS has now published over 800 case studies in ombudsman news in addition to dozens of articles on FOS practice in handling complaint cases. Tony stated that this would continue. This is something Lord Hunt recognised in his report however he asked the FOS to do more to help consumers and businesses resolve matters without the need for disputes to be referred to the Ombudsman.

Lord Hunt said in his report "I do not, however, see how the ombudsman can become more transparent without significantly more decisions being published, and those decisions being published in full, rather than in summary form."

In his speech, Tony Boorman emphasised how the FOS aims to go further. He explained that in addition to the Ombudsman News the FOS also publish technical notes and guides on major complaint issues such as mortgage endowments and payment protection insurance. In addition the FOS has plans to produce a digest of its practice, illustrating its approach with examples, but this will take time.

Whilst we appreciate that for Paradigm Partner firms complaints handling is very much the exception rather than the norm, we thought it would be useful to highlight this topic in order to provide an insight as to how FOS aim to achieve greater transparency in complaints handling and what information may be made publicly available about how an individual firm deals with complaints.

## FOS Case Studies involving Equity Release Schemes

In issue 72 of the Ombudsman News the FOS examine some of the complaints seen which are made after the death of someone who signed up to an equity release scheme.

The FOS specifically focuses on the effect these schemes have on the value of the estate that the homeowner wishes to pass on when they die. The Ombudsman expresses concern about the fact that in one instance the only time the family member found out that a firm has an interest in the property was when the relative had died. The family member was under the illusion that they would inherit the property in its entirety.

The FOS acknowledge that firms offering equity release schemes do generally advise homeowners to share their intentions with family members before taking any action however it is down to the individual as to whether they do this or not.

Please find below a few of the more pertinent case studies (more of which can be found at <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/72/72-mortgages.html>):

### **Complaint - next-of-kin complain about advice given to their late sister to take a home reversion plan**

Mrs C named her three younger sisters as beneficiaries in her will. However, she did not tell them that, after seeking financial advice, she had entered into a home reversion plan. When Mrs C died, some years after the plan had been set up, her sisters found out about the arrangement from the executor of her will, a local solicitor.

They were shocked to discover that the firm that had given the financial advice was now entitled to most of the proceeds from the sale of Mrs C's house. When that firm refused to consider their complaint that it had wrongly advised their sister, they referred the matter to us.

### **Complaint out of our jurisdiction – and better suited to the courts**

Under our rules, we can only consider complaints brought by 'eligible complainants'. Executors are 'eligible complainants' but beneficiaries are not, so the complaint did not fall within our jurisdiction and we were unable to look into it.

However, even if the complaint had been within our jurisdiction, we would probably have decided it was more appropriate for the courts to deal with it. This is because as well as disputing the advice provided by the firm, the sisters were in dispute with each other and with the executor about how much of Mrs C's estate they should each be entitled to.

### **Complaint - whether elderly homeowner was appropriately advised to take a home reversion plan in order to pay for property repairs**

Mrs B had been finding it increasingly difficult to afford essential repairs to her house, which she owned on a leasehold basis. The firm advised her to take a home reversion plan. This would provide her with a modest income for the rest of her life – and she would be able to use part of the money for property repairs.

The arrangement gave the firm a 90% interest in the value of Mrs B's house. She retained the remaining 10% and the firm lent her a certain amount of money against this. The loan attracted interest, but enabled Mrs B to buy the freehold of her house (since it was one of the conditions of the plan that the property was freehold).

After Mrs B died, the executor of her estate – her sister Mrs M – complained to the firm. She thought the plan had been inappropriate for her late sister's needs, as she considered its terms extremely onerous. She also thought the firm should have ensured that Mrs B obtained independent advice and consulted her family before agreeing to take the plan. When the firm rejected the complaint, she referred it to us.

**Complaint upheld** The firm had stressed that Mrs B's estate had benefited through her purchase of the freehold. It noted that Mrs B had signed all the relevant documentation and it said this indicated that she had been responsible for her own actions in taking the plan.

After investigating the complaint, our adjudicator upheld it. He accepted that Mrs B had signed the firm's documents, agreeing to take out the plan. However, he noted that she had consulted the firm for professional advice and had been heavily reliant on the firm's guidance. He considered that the firm should have investigated any alternative means of paying for home repairs – such as state benefits or local authority grants – rather than simply recommending the home income plan.

## FOS Case Studies involving equity release schemes

The adjudicator did not agree with the firm's view that Mrs B, or her estate, had received any material benefit as a result of obtaining the freehold. There was no reason to believe Mrs B would have wanted or needed to buy the freehold, if it had not been a condition of the home income plan. And Mrs B had funded the entire cost of buying the freehold, even though her estate would receive only a nominal benefit from it when the property was sold, after her death.

The firm refused to accept the adjudicator's view. It asked for the case to be referred to an ombudsman, for an independent review. After fully examining the case and considering all the evidence and arguments afresh, the ombudsman decided that the complaint should be upheld.

The firm was required to pay Mrs B's estate an amount comprising the proceeds of the sale of her house, together with the sum she had paid in legal fees when she entered into the agreement for the plan. However, the ombudsman agreed that the firm could deduct a certain amount in recognition of the fact that the plan had provided Mrs B with some financial benefit.

### **Complaint - whether elderly couple were wrongly advised to take home reversion plan**

Mrs J's complaint concerned the home reversion plan that she and her husband had been advised to take some years earlier. This provided the couple with a cash lump sum and an income for life, together with the right to continue living in the house. After both of them had died, the house would be sold and the firm would take a specified percentage of the property's value. The remaining value would pass to the deceased's estate.

Following her husband's death, Mrs J asked the executors of her late husband's estate – the family solicitors – to complain to the firm that provided the plan.

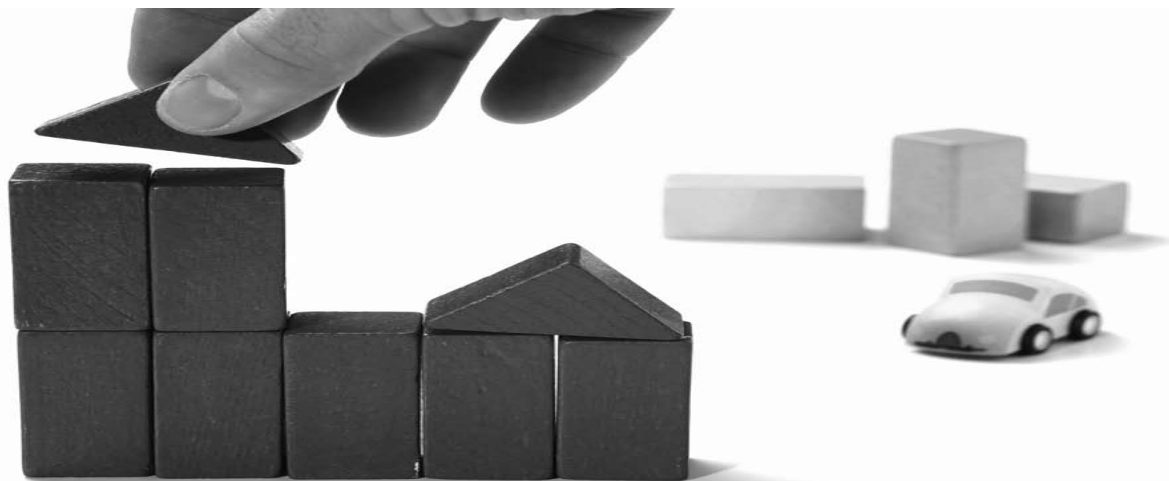
The solicitors told the firm that they considered its advice to have been inappropriate, in view of Mr and Mrs J's financial objectives at the time. They added that it was doubtful whether Mr J would have understood the complexities of the arrangement, as his mental health had started to fail at around the time he took the plan. The solicitors also thought it curious that they had not been asked to provide legal advice. The terms of the contract required the firm to ensure the couple took independent legal advice before signing up to the plan.

### **Complaint not upheld**

There was evidence to show that, at the time they received the firm's advice, Mr and Mrs J had been living beyond their means and were looking for ways of increasing their income. They had no assets that they could have used to generate additional income, other than their home. We considered that, in the circumstances, the firm's recommendation had been suitable.

The information we obtained about Mr J's mental health showed that there had been some deterioration in later years. However, we saw nothing to suggest that his judgement would have been impaired in any way at the time the advice was given – and neither Mrs J nor the firm's adviser had expressed any concerns about this at the time.

Although he had retired some years before he took out the plan, Mr J had formerly been a senior partner at the firm of solicitors that was now bringing the complaint. We thought it unlikely that he would not have understood the implications of the agreement he was entering into. And he had, in fact, taken legal advice about the plan – but not from the solicitors now bringing the complaint. It did not seem to us unreasonable that he would have wanted to keep his personal affairs separate from the family practice. We did not uphold the complaint.



## FSA Enforcement Action

### **Orchid Financial Ltd fined for advice failings**

In October the FSA fined Doncaster mortgage broker Orchid Financial Limited £34,500 for failing to ensure it provided suitable advice which exposed over 900 customers to the risk of being sold an unsuitable mortgage.

This was the second enforcement case to arise from the FSA's thematic project looking into the quality of advice processes by mortgage brokers.

According to the FSA, between October 2005 and March 2008 Orchid failed to obtain and record from customers all information likely to be relevant to the suitability of its advice, including financial information.

The firm also failed to record how or why recommended mortgage contracts were suitable, implement adequate arrangements for supervising and monitoring its advisers and make and retain adequate records to demonstrate how it carried out training, supervision and monitoring of its advisers.

Jonathan Phelan, head of retail enforcement for the FSA, said: "Orchid's failings meant they could not demonstrate that their mortgage advice and sales were suitable. This fine sends out a clear message to brokers that their advice must be of good quality - otherwise there is a likelihood that they will not be treating customers fairly."

### **Mortgage Brokers banned for advice failings**

The FSA bans two Tyne & Wear mortgage brokers, Edward Allen and Ronald Allen for exposing customers to unsuitable mortgage advice.

The Directors of Homeplan failed to:

- Implement adequate systems and controls to ensure quality of mortgage advice was up to standard.
- Gather relevant customer information and ensure recommendations were suitable.
- Adequately monitor sales of mortgage contracts and produce adequate management information.

It also found Edward Allen failed to ensure his roles for direction and oversight of the firm were delegated effectively when he was off sick for an extended period of time. Jonathan Phelan, head of retail enforcement at the FSA, said:

"Both directors lacked the competence and capability needed to make sure their firm delivered good quality mortgage advice.

The failings were particularly serious because the FSA first identified problems with the firm's systems and controls during a visit in 2006 and no steps were taken to remedy the situation by the time of the FSA's visit in 2008."

"The failings warranted a fine of £15,000 for each director but as they have provided verifiable evidence that they would suffer serious financial hardship if this financial penalty was imposed, we have issued a public censure instead."

The trading permission of Homeplan has also been cancelled.

The FSA's report said Edward Allen demonstrated "a lack of competence and capability" and posed "a serious risk to lenders and customers."

It added he had failed to ensure there were adequate systems and controls regarding the quality of mortgage advice given that the firm collected the right information from customers and that information handed out was relevant and clear.

"Customers were exposed to the risk that the advice they received was unsuitable," said the FSA.

"The lack of clarity in Homeplan's letters led to customers being exposed to the unacceptable risk that they did not understand the advice they had received and/or that the recommendation made was not suitable."

## FSA Enforcement Action

### **Asim Hussain banned for Mortgage Fraud**

Asim Hussain, trading as Lifestyle Mortgages (Ealing), was found to have submitted false mortgage applications to lenders on behalf of himself and customers.

The 36 year old broker was found out when the FSA received information from a lender highlighting their concerns regarding inconsistencies in relation to mortgage applications submitted by Mr Hussain, which suggested they were based on false and misleading information.

In addition the broker was also found to have submitted 18 mortgage applications on behalf of clients containing income and employment details which did not match with information they had reported to HM Revenue & Customs.

He failed to carry out appropriate checks when verifying customer details for at least six applicants, and applied for a mortgage through his company Lifestyle Mortgages (Ealing) based on a heavily inflated declaration of his income received from the firm, the FSA found.

“Mr Hussain used his business to commit mortgage fraud, and his actions posed a risk both to lenders and to his customers who were put at risk of receiving mortgages beyond their ability to finance, potentially leading to indebtedness and repossession of the property acquired” said Jonathan Phelan, head of retail enforcement at the FSA.

### **Two Sole Trader mortgage brokers banned for failing to comply with FSA rules**

Andrew David Bowden, trading as Scott Jarrett Bowden and Partners (SJB), and Shaun Lawrence were found by the FSA to have misled the regulator, thereby displaying a lack of honesty and integrity. The regulator found Mr Bowden submitted false and unverified information on the firm’s regulatory reports to the FSA, while Mr Lawrence removed documents from files before sending them on to the regulator.

Furthermore the banned brokers failed to ensure that their work reached the appropriate regulatory standards and were therefore deemed not to be sufficiently competent and capable to conduct regulated activities. Amongst other issues, both brokers failed to keep a record of all customer files and failed to keep documents secure – neither was aware exactly where all customer files were. The FSA pointed out that this was particularly serious as it could lead to the risk that a customer complaint or enquiry could not be followed up, and that personal and confidential customer information could fall into the wrong hands and possibly be used for the purposes of financial crime.

Jonathan Phelan, FSA’s head of retail enforcement, said:

“The FSA will not tolerate firms who fail to understand and comply with our rules. The actions of both brokers amply illustrate that they lacked not only the competence and capability to follow our rules, but also demonstrated a failure to act with honesty and integrity.

We have now ensured that both Mr Bowden and Mr Lawrence are unable to work in the regulated industry again and this sends a message to firms that we take failures to comply with relevant standards extremely seriously.”

Although the FSA did not uncover any actual customer detriment in these cases, if any customers of Shaun Lawrence or Mr Bowden’s firm SJB have concerns, then they should get in touch with the FSA’s customer contact centre on 0845 606 1234.



## The AFB launches consultation on regulation of secured loans

In September the Association of Finance Brokers (AFB) published a white paper on the future of regulation of the secured loans industry.

The AFB sets out the options which include remaining under the Office of Fair Trading (OFT) and Consumer Credit Act control, or moving across to the Financial Services Authority.

It says that with the implementation of the European Consumer Credit Directive, a change to the regulatory landscape is inevitable.

Commenting on the new proposals, Robert Sinclair, director of the AFB, urged intermediaries to act in a progressive manner to ensure that new regulatory instruments protect the interest of brokers, loan providers and the consumer. He added that the public need to be put at the heart of any new legislation governing the secured loans market. Robert Sinclair said that "Consumers and consumer groups are likely to see a move to FSA regulation as positive. An improved perception of second-charge lending could lead to increased interest in products, and increased awareness of the sector. Secured lending has a part to play in debt financing but it is vital consumers are treated fairly and well protected. We have already been in discussion with government and the regulators and they are keen for the industry to reach its own conclusions. If not, we will have that power taken from our hands" A secured loan may be of interest to people who plan on making large purchases, or who intend to carry out home improvements. However, a report published by Moneyfacts published in July warned homeowners that they may find their ability to get a secured loan is diminished due to poor market conditions. It noted that seven major secured loans providers have exited the marketplace as the credit crunch tightened its grip on the industry.

The AFB was calling for comments from intermediaries by 30th September 08.

## The FSA provides further clarification on the ICOBS requirement to disclose the total premium

The FSA has reminded firms of their responsibilities in enabling customers to make an informed decision when purchasing Mortgage Payment Protection Insurance (MPPI) as well as other general insurance and protection products.

In July this year the FSA sent letters to various trade bodies setting out their expectations of firms selling MPPI in relation to the disclosure of total premium. The FSA has discovered that a number of firms selling MPPI only disclose the monthly premium and their interpretation of total premium falls short of the regulator's expectations that sufficient information should be provided to customers to enable them to make an informed decision about products.

In the statement the FSA reminds firms that in accordance with ICOBS 6.1.5R firms must take reasonable steps to ensure that a customer is given appropriate information about a policy in a comprehensible form and in good time. The guidance (in ICOBS 6.1.6G) sets out that the price of the policy should be set out. The FSA states that a disclosure of monthly premium alone will not be adequate to enable customers to make an informed decision.

The FSA draws attention to the previous rule in ICOB 5.5.14R which required firms to provide customers with a statement of price which included the total amount of the premium or at least the basis upon which premium would be calculated. The move to principles-based guidance does not change what needs to be disclosed.

The FSA has examined MPPI contracts described as "monthly renewable" and states that these policies are not contracts of a month's duration as the customer cannot in effect opt in or out each month and the terms of the policies are clearly linked to events over longer periods of time. For these reasons disclosing a monthly premium is insufficient for consumer's ability to make an informed decision.

The FSA considers that with annually renewable contracts where the customer is offered the opportunity to renew or opt out at the appropriate intervals, disclosure of the total annual premium is sufficient. However for "monthly renewable" contracts where renewal is automatic, the FSA does not consider the disclosure of the monthly premium amount to be sufficient as it does not represent the likely total amount payable by the customer over the duration of the contract.

For these contracts the FSA has suggested the following possible ways of disclosing information which would comply with the rules:

- Disclosing the total premium over a period defined by reference to the list of events which the insurance contract says will cause the cover to cease, e.g. the customer reaching age 65;
- An illustration of the cumulative cost of the policy for milestone durations, for example 1,5 and 10 years; and
- For reviewable premium policies, disclosure of the total premium as set out in the first point above, or an illustration of cumulative costs as set out in the second point, noting that it is subject to review.

## CP 08/15: Financial Services Compensation Scheme - review of limits

The FSCS began operation in December 2001, and has paid compensation where authorised firms have been in default. The FSA has decided to review the FSCS compensation limits, in conjunction with the Treasury and the Bank of England. The FSA has also been working with the British Bankers Association together with external consultants, the proposals include, but are not limited to:

- Payment of compensation on a per account or per brand basis instead of per deposit per authorised firm basis.
- Moving to gross rather than a net payment (where previously loans or mortgages were offset and the net amount paid).
- The introduction of a single customer view.

The authorities are committed to a payout within seven days and a consultation paper on their proposals will be issued early in the New Year.

This Consultation Paper reviews the limits of compensation payable by the FSCS re:-

- Deposits
- Life and general insurance
- Investment business
- Loan finance mediation (mortgage arranging and advice)

The FSA, however make it clear that the FSCS does not provide any cover for investment risk. The FSA also reiterate their view that consumers should have a degree of responsibility for the decisions they take.

The FSA was due to review the FSCS compensation limits in 2009, however due to current market conditions the FSA Board has agreed to raise the deposit compensation limit to £50,000 (this took effect from the 7<sup>th</sup> October 2008). The FSA are also considering the FSCS investment and home finance limits of compensation, currently 100% of the first £30,000 and 90% of the next £20,000 giving a total coverage of £48,000. In each case the FSA are proposing to increase the cover to 100% of the first £50,000.

Current life and general insurance cover is 100% of the first £2,000 and 90% of the remainder (no upper limit). The FSA are proposing to remove the 100% of the first £2,000 to 90% of the total claim (no upper limit).

As well as reviewing the current limits for the various existing FSCS sub-schemes the FSA have:

- looked again at the exclusion of mortgage lending and administration from the scope of the FSCS, the FSA felt it was appropriate that it should remain outside the scope of the FSCS,
- considered possible solutions for protecting temporary high deposit balances held with a failed deposit taking firm; it will be carrying out further research and evaluation,
- reviewed the method used for the distributing of recovered assets from failed firms between claimants and the FSCS, they concluded that the existing basis should continue.

We will provide further information to you once firm policy has been established.

## Increase in FOS fees

Paradigm Partner firms should be aware that in the 2009/10 financial year it is expected that FOS case fees are to rise from £450 to £500. The proposal is for the first three cases to continue to be free and for subsequent disputes referred to the ombudsman during the year there will be an increased fee.

FOS forecast pension and investment complaints to increase by 41% to 24,000 cases and mortgages complaints to increase by 78% to 16,000 in the 2009/2010 financial year.

## PARADIGM REGULATORY CONSULTANCY



The regulatory environment is evolving quickly with a seemingly constant flow of new regulation and guidance being produced for firms to understand and implement within their businesses.

At Paradigm we understand the difficulties facing firms in not only finding the time to understand these changes and how they may affect their business, but also in successfully ensuring that these changes are implemented with the minimum effort and impact.

Our experienced team has a wide and varied knowledge that enables us to provide comprehensive guidance and also helps us to understand how this impacts on your business.

**Through Paradigm Group we can provide regulatory consultancy support which includes:**

- Financial Promotions
- Technical queries
- Remote File Reviews
- RMAR completion
- FSA Applications + Change of Entity/Variation of Permissions/Approved Persons
- Complaints Guidance
- Risk assessment and mitigation plans
- Monitoring plan design and audit,
- Treating Customers Fairly (TCF) and much more...

**To find out how you can take advantage of our regulatory consultancy service please contact Sue Caughtry on 0845 688 1344 [Suecaughtry@Paradigmmortgages.com](mailto:Suecaughtry@Paradigmmortgages.com)**

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