

Mortgage Solutions Article 30 Oct 2008

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A Lack of precedents

We find ourselves in unprecedented times, with the necessary global intervention in the banking system to stop the downward spiral into oblivion that was sure to happen without it. Some argue that this intervention took too long and the delay has cost shareholders and tax payers many more billions to at least signal the beginning of the end. Others, perhaps on flakier ground may also argue that a more expeditious co-ordination of governments would have diluted, even prevented, the deep recession the globe and the UK are now officially about to experience.

However, although not sympathetic, I can understand our leader's procrastination in these decisions. I am not sympathetic because it is their role to take on the challenges of the most difficult times; however the sheer lack of precedents they have to guide them is bound to lead to more in-depth consideration, which in turn causes delay. I would rather the skipper of my metaphorical boat, takes it slow when navigating uncharted waters.

“What about other banking crises?” I hear you cry. Well all the major seismic events: Wall Street crash, UK 70's lifeboat, Japan in 90's were all national issues that were ultimately dealt with through their own jurisdictions with home-grown rescue packages. The proliferation of globalisation managed to tipped the balance, at some point after far east's troubles in the 90's, and for the first time a banking crisis is a global one. After decades of industry building cross border business, the authorities had only months to find a cross border solution with no previous precedents to lean on.

Closer to home there is another seismic event looming (albeit much further down the logarithmic Richter scale) that has a similar lack of precedents: mortgage misselling – an unpopular phrase up until now for borrowers, intermediaries, lenders and even the Regulator and Ombudsman. Never really a measurable problem whilst House Price Inflation continued to ascend as voluntary and formal regulation came to pass and during 16 long years positive economic growth complaints to the Ombudsman were as rare as a set of braces for the original hen's teenage offspring. The only real shouts of 'foul' came from the shared appreciation mortgage sector which itself was driven by HPI.

However, it is all too easy to predict a borrower, who was unconcerned about stretching themselves to secure a property with a quickly appreciating value, now may be very concerned about affordability with rising inflation, mortgage costs

and unemployment. How quick would this borrower be in blaming the adviser and the lender for allowing such a stretch of household income? As sure as night follows day, a falling economy breeds complaints if arrears and repossessions begin to threaten.

Add to this the sheer volumes of mortgage transactions since the last recession. They have shot up to unprecedented levels, increasing the statistical probability of rising complaints. In 1991 there were 723K* mortgages granted with 1.21m* being granted in 2006 an uplift of 68%. If we go back to when records began in 1974 there were only 444k* transactions, an astonishing 172%

There are a couple of other tell tale foreshocks, keeping to the earthquake analogy, that for those, like myself who are looking, clearly predict what is coming.

First is the number of lenders who have, in recent years, conducted eye watering amounts of business that are no longer around to deal with any alleged misselling. Never before has there been so much existing book business that does not have an originating lender backing it up. In the past matters of redress have usually been taken on board by those with the deepest pockets; the providers. This time without a lender in the frame either the Ombudsman or the legal representative will be looking for other sources of potential redress: the intermediary.

Secondly the FSA have raised their game in the scrutiny of mortgage advice. Gone are the thematic reviews, sample tens (maybe hundreds) of firms on a particular issue. Now following on from the Retail Enhanced Strategy we have the Small Firms Regional Assessments, which over a three year period are checking the compliance health of every firm. Larger firms are not immune to additional scrutiny either with the economic downturn revealing practices that might have been the norm a couple of years ago, now being found out as not meeting the due skill care and diligence standards of principle 2 or the suitability of advice under principle 9.

In one of the recent final notices the FSA made it quite clear it means business in the mortgage market. On fining a director of a mortgage business it said: "A financial penalty would deter [the director] from further breaches of regulatory rules and Principles. Equally, other senior managers will be deterred from following [these] practices and this will promote the message to the industry that the FSA expects senior managers to maintain high standards of regulatory conduct."

So why, if all the warning signs are here, does there seem to be complete apathy about doing anything about it? I think it is because there is such a lack of precedents to act upon.

Sure a few businesses have been shut down through enforcement after fraud investigations, but that's not indicative of the market place. And a few businesses have been identified as high risk under the thematic reviews, have gone or are going through supervision or enforcement, yet again it is only a handful. The mortgage market has so few precedents to rely upon it is easy to fall into a trance of denial.

But the danger is there and it is coming, so what can you do to prepare for the big event?

Ask yourself "Am I completely sure all my previous mortgage, GI and PPI business has met all the FSA principles and are my systems and controls robust enough to prove that it is so?" ...because this is exactly the question the Regulator is going to ask. If you know you have a problem or you are not sure, now is the time to get some expert help and do something about it.

Whilst doing that go the FSA web site and read PS08/9 and see if you match up, but that is a story for another day.