CAPSTONE Mortgage Services

3 September 2010

Consumer Protection Codes Department
Financial Regulator
PO Box 9138
6 – 8 College Green
Dublin 2

By Post and by Email

Code of Conduct on Mortgage Arrears

Dear Sir/Madam

We are writing in respect of Consultation Paper CP 46 which was issued in August 2010, in which you sought views and comments on the proposed amendments to the Code of Conduct on Mortgage Arrears (CCMA).

Introduction

Capstone Mortgage Services Limited ("Capstone") is a third party mortgage servicer operating in the UK and Irish markets with offices in the UK and in Dublin. Capstone currently has over 450 people servicing more than 80,000 mortgage customers in the UK and the Republic of Ireland. Capstone has proven experience in dealing with customers in arrears, having worked with such customers in the UK since 2006. Our arrears management team averages over 15 years experience in working with mortgage customers in an arrears situation.

Capstone is currently servicing a portfolio on behalf of Stepstone Mortgage Funding Limited ("Stepstone"), an Irish lender that originated residential mortgage loans in 2007 and 2008.

As a mortgage servicing specialist with a depth of experience in working with customers in arrears, Capstone welcomes the opportunity to submit its views and comments on the CCMA. At the outset, we wish to emphasise that we agree with much of the content the CCMA and we believe that clear guidelines on good practices in respect of how mortgage arrears should be handled are of benefit both to borrowers in payment difficulties and to the mortgage industry. Indeed, many of the practices and processes set out in the CCMA are either already being carried out by Capstone (for and on behalf of Stepstone) or in the process of being adapted accordingly. However, some of the provisions of the CCMA, in our view, require greater clarification and we set out below our specific responses, using the headings in the Consultation Paper CP 46 to identify the section we are referring to, as requested.

Level of Communication

Capstone is committed to the fundamental principles of the CCMA of early and proactive engagement with borrowers in arrears and strongly supports the principle at section 17 CCMA that a lender must pro-actively encourage borrowers to engage with their lender about an arrears situation. Capstone believes that early and pro-active engagement is the key to constructively managing a borrower in arrears and in its experience, most arrears situations which are successfully resolved result from such proactive engagement. Capstone further agrees that, as a

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general principle, the level of contact and communications from a lender to a borrower should be proportionate and not excessive (section 18 CCMA), but is concerned that the imposition of the limit in section 19 (that prevents lenders from initiating no more than three unsolicited communications in a calendar month) may have the unintended consequence of causing the principle at section 17 to be impeded and, potentially, have a detrimental effect on borrower outcomes that could be achieved through pro-active engagement.

It seems to us that the intention of the CCMA is that only communications *not required* under the CCMA will be subject to the limit set out in section 19 CCMA. We would observe, however, that there are various further communications with borrowers which, we believe, are necessary in order to carry on pro-active management of the account and there is often a need to communicate with borrowers at frequent intervals in order to ensure that the lender (or the third party acting on the lender's behalf) is kept up to date in respect of the borrower's (frequently rapidly) changing circumstances. For instance, it is important that borrowers are communicated with promptly when an agreed payment has not been received, a payment is returned unpaid or a promised Standard Financial Statement or other supporting documentation is not received by an agreed date, Further clarification on information provided on the Standard Financial Statement or supporting documentation be required or other important facts need to be established.

Limiting the quantity of contact might, in addition, prevent better outcomes from being achieved for borrowers, for example, where lenders seek to establish better income and expenditure information, understand the reason why an agreed payment has not been received or provide the customer with information regarding unpaid items so that they can engage with their banks at the earliest opportunity. Under the CCMA the lender should obtain the Standard Financial Statement and supporting documentation before carrying out its assessment of the best option available for the customer. Capstone is already very active in this regard and it is our experience that a lender will often need to follow up with the borrower to ensure that it receives requested financial information, that all requested information is included and that the supporting documentation is complete. Any communications in this regard will be limited as they are not required by the CCMA but they are very much in keeping with the spirit of raising an assessment based on a complete picture of the borrowers' financial position.

We think that by focussing on restricting the number of communications in the CCMA, there is a risk that lenders will concentrate too much on managing the volume of communications with borrowers rather than reviewing the quality, purpose or outcome of the communication or even if such communication is appropriate in the first place (which in our view, should be the key focus). The current proposals to limit the number of communications may not, for example, prevent a lender from repeatedly contacting a borrower three times each month to ask for the same information (which is just one example of poor practice) nor will they prevent a lender from asking for payments without taking the borrower's situation into account or offering suitable options.
Rather than set a threshold limit on communications or imposing a prescriptive "one size fits all" numeric approach which may have the unintended consequence of restricting pro-active engagement with a borrower in arrears, we believe that a more principles based approach to this area should be applied and the focus of the CCMA should be on **requiring lenders to ensure that every communication with the borrower is appropriate to the borrower's known circumstances, is not repetitive in content, is not unnecessarily duplicative and is proportionate and reasonable.** In addition, each lender should record MI in respect of the level and nature of communication with individual borrowers so that poor practices (such as frequent communications which are also found to be duplicative, inappropriate, unreasonable or disproportionate) can be identified and investigated as appropriate. (Whether or not required strictly by the CCMA, Capstone's view is that capturing and tracking this level of MI available is best practice.)

Alternatively, if the Financial Regulator takes the view that limiting the number of unsolicited communications addresses the concern around poor practice in this area, we would request that further clarity is provided around what types of communications that (1) would fall within the exemption at section 19 of communications that are "required by the CCMA" since, as mentioned above, we think that on a strict view, many communications which may be desirable and essential in maintaining pro-active engagement with borrowers might not be captured by this exemption and, therefore will fall within the restriction; and (2) fall within an "unsolicited communication", as

potentially every communication from a lender which is not in response to a direct borrower contact is unsolicited. For example, would any of the following be considered an "unsolicited communication" and thus count towards the limit: messages left on a borrower's phone; unanswered call attempts that are nevertheless recorded on a borrower's mobile phone as a "missed call"; home visits where the borrower himself/herself was not contacted but a third party at the property was (and the borrower would thus be made aware that a home visit had been made); letters reminding borrowers that an agreed payment under an arrangement is due or that such payment has not been received.

Without clarity, confusion between borrower and lender is very likely to ensue. For example, a lender may call a borrower 3 times during the course of a month in order to check or follow up on outstanding information relating to a borrower's income and expenditure which the lender was expecting. The reason for contacting the borrower may be legitimate and may also be in the context of the lender obtaining full financial information, making its assessment and ensuring all alternative repayment measures are examined. However, unless clarity of what communication would constitute an "unsolicited communication" is provided we would anticipate (from past experience) disputes with borrowers about whether a call or letter constituted an "unsolicited communication".

Arrears

As a mortgage servicer, we have no strong view on how "arrears" should be defined since we will work to the definition required by lenders. From experience, however, we think that it would make sense to link the definition in some way to a time period of, say a full month, to avoid the arrears definition capturing late payments (which may occur at any time in the month in which the payment is due). To ensure that matters are dealt with as quickly as possible, we think that the borrower should be contacted as soon as is reasonably possible after the amount becomes overdue. We would also suggest that the calculation of the arrears balance should only include arrears of contractual payments and should not include other amounts due such as arrears fees or interest on arrears: this, in Capstone's view, is in the borrower's best interests.

We also believe that whatever the definition of "arrears", one practice which we have adopted (and we encourage lenders on whose behalf we service, to adopt) is to set a threshold amount above which, active management on the account commences. By way of example, we set a threshold amount at 33% of a borrower's contractual payment so that only if the amount of arrears owed by the borrower is 33% and above of the contractual monthly payment, would we start actively managing the account. We would continue to perform activity on the account if the arrears on the account were below 33% of the borrower's contractual payment (we would, for example, provide the requisite information to the borrower under section 20 CCMA) although we would manage these accounts less actively. This is because we believe that less activity is necessary for accounts where the arrears amounts are relatively small and it is in borrowers' interests (as well as the interests of lenders) to concentrate on those borrowers who more clearly need help in controlling their arrears situation.

Primary Residence

We have no substantive comments.

Appeals

Capstone supports the proposals requiring lenders to establish an internal appeals process to independently review the decision of the lender in relation to an alternative arrangement. Capstone also supports the provisions that allow a borrower to refer a complaint to the Financial Services Ombudsman where a complaint has not been resolved to the borrower's satisfaction.

Our view is that a separate mechanism to allow borrowers to appeal a lender's decision on an alternative arrangement to an independent external body is unnecessary and if established, would be potentially difficult to operate and administer.

A lender (or a third party on behalf of the lender), when deciding whether or not to enter into an alternative arrangement with a borrower, will take into account the lender's policies on alternative arrangements as well as other relevant factors (some which may be objective in nature and others, subjective). Objective factors would relate, for example, to the current financial position of the borrower. More subjective factors would be based, for example, on the intent and co-operation demonstrated by the borrower over an extended period of time. These factors together with considerations such as the viability of the borrower's future plans to deal with their financial problems are often established through a series of conversations between the borrower and the lender over an extended period of time. In effect, when considering whether to agree to an alternative arrangement, a lender must essentially go through a very intensive process to examine the borrower's circumstances and prospects which may have many subjective aspects and will also take into account the lenders historical experience. In other words, the credit decision with respect to agreement of an arrangement must ultimately be made by the lender since the risk is retained by the lender.

Given the process the lender needs to go through when deciding on an alternative arrangement, our view is that it would be extremely difficult and inappropriate for an external body to assess a risk decision at which a lender has arrived. In order to do so effectively, the external body would have to become fully familiar with the various lenders' criteria to allow it to apply the same review and assessment process that such relevant lender would have followed in coming to its decisions: we believe that this would be a cumbersome and impracticable process for an external body to operate.

We would suggest that the focus of an appeal (in connection with an alternative arrangement) should be instead in respect of *the way in which the process is handled*, namely that the Mortgage Arrears Resolution Process set out by the lender has been followed, rather than on the substance of the decision: a lender may legitimately come to a decision based on the factors discussed above and if so, we would submit that this decision should not be second-guessed (even if the borrower does not agree with the decision). However, if the process the lender follows in coming to that decision is arbitrary or the process applied by the lender does not follow its Mortgage Arrears Resolution Process or its process does not comply with the CCMA, the borrower should be entitled to complain through the normal complaints process (with the ability to appeal to an independent body if required).

We also have some other observations on the CCMA that were not referred to directly in the Consultation Paper CP 46 and we set these out below.

Communication with Borrowers

Capstone supports the issuing of an initial arrears letter containing the various information as prescribed in section 20 of the CCMA. We would suggest that this initial arrears letter should be issued as soon as an account is more than one contractual monthly payment in arrears. This will avoid customers being sent unnecessary letters in respect of late payment or for a relatively small arrears balance.

We would also question the requirement to provide an updated version of all of this information in all subsequent correspondence (as provided for in section 21). We feel that borrowers will find this content repetitive and may feel that the lender is not adequately taking their circumstances into consideration. This could result in borrower apathy with the consequence that borrowers may not read the content of letters from lenders properly and may fail to fully engage with their lender in a positive manner.

We do, however, strongly feel that it is important that all borrowers in arrears are provided with regular updates as to the status of their account as outlined in section 20. One approach is for borrowers in arrears to be sent an arrears statement together with all of the information specified in section 20 every three months [from the date that they are sent the initial arrears letter] regardless of whether they are in a performing arrangement or not. This will ensure that *all* customers receive a regular and full update of their arrears position, regardless of any other arrears correspondence being issued.

Re-starting the Twelve-Month Period

Capstone supports the principle (set out in section 46 of the CCMA) that borrowers who are co-operating reasonably and honestly with their lender should be given a reasonable amount of time to remedy their financial problems before the lender can apply to court to commence repossession and we believe that a twelve month moratorium is a reasonable time period subject to our further comments below.

However, we believe that the proposals outlined in the CCMA which provide that the twelve-month period should commence when the arrears first arose, if a revised repayment arrangement has not been agreed, or when the borrower ceases to adhere to the terms of a revised repayment arrangement and no further arrangements are being entered into may go too far in terms of "re-setting the clock" in respect of the moratorium period.

Currently, it is in the interest of lenders to agree an arrangement with a borrower and lenders will go to great lengths to establish contact and work with the borrower to agree a repayment proposal; in many cases even if this means that the lender will be receiving reduced payments for a period. Often it is not clear that the customer has a sufficient level of income (the self-employed, for instance) or the longer term financial capability to maintain the proposed level of payment, but the borrower, nevertheless, demonstrates their desire and commitment to making an arrangement. Our experience has been that in many of these instances the lender would be prepared to agree the arrangement to give the customer a chance to re-establish regular payments rather than pursue the alternative (which may well be open to the lender given the uncertainty around the borrower's level of income and financial stability) of commencing legal action. This is because, the lender is aware if the arrangement does breakdown after a short period then there are still options open to the lender. In other words, the lender is motivated to provide the borrower an opportunity to try to re-establish regular payments, and does not thereby suffer a reduction in the options available to the lender, including re-negotiating the arrangement and making another attempt to establish long term regular payments.

However, the proposals in the CCMA in respect of when the twelve-month period commences and runs from, may result in lenders becoming much more reluctant to enter into arrangements that have a possibility of failing, especially for temporarily reduced payments. For example, if a revised repayment arrangement is agreed in month ten of the initial twelve month period and this arrangement breaks down two months later, the twelve month period restarts again. If a revised arrangement is agreed subsequent to this and breaks down some time later, the twelve month period starts again. Almost certainly lenders would require a stricter approach to evidencing income and expenditure and borrowers in payment difficulties might start finding it more difficult to make an arrangement. Additionally, lenders are likely to be less inclined to agree to new arrangements where previous arrangements have failed.

Capstone's view is that a more balanced approach, that would continue to protect the borrower for a period of time, would be to commence the twelve-month period when the arrears first arose but at the point a revised repayment arrangement has been agreed, the clock should stop and the period should be suspended for so long as the arrangement is being adhered to. However, if the arrangement fails, then at that point, the clock should re-start and the twelve-month period should continue from the point it was suspended. Where the twelve-month period has already expired then it could be reset to zero if the borrower maintains a performing arrangement for an extended period, say eighteen months. Capstone believes that this approach would ensure that the borrower's and the lender's interests remain aligned in respect of negotiating and agreeing arrangements.

As mentioned previously, we have experience in dealing with borrowers in arrears and, in addition, we are active as a servicer in the international securitization markets. Our view is that this proposed provision of the CCMA in effect allows for a continual resetting of the clock in respect of when the twelve month period commences. This lack of certainty would put Irish lenders at a disadvantage in comparison to other European lenders when it comes to securitization. Rating agencies and investors typically take into account foreclosure timelines when reviewing securitized transactions. While rating agencies may be familiar with the current twelve month timeframe, the new proposals carry considerable risk that the timeframe will be

unclear going forward for the reasons which are outlined above. This could have a significant impact for any lender in the Irish mortgage market who sought to securitise any part of their residential book. We are not aware of any other similar provision in any of the other major European jurisdictions which have actively accessed the securitization markets and this lack of visibility and uncertainty would, very likely, be seen as negative by the securitization markets.

Mortgage Arrears Resolution Process – Step 2, Financial Information

Capstone fully agrees with the need to obtain up-to-date financial information from a borrower in arrears before an assessment can be made of the best solution for that borrower. Capstone will currently work with a borrower who is suffering from long term financial difficulties to get full details of income and expenditure before entering into any discussion regarding payment arrangements. In exploring alternative repayment measures with borrowers, it is critical that a lender is basing its final decision on a full picture of the borrower's financial position to ensure that any resolution reached is sustainable. In our experience, however, borrowers often resist the provision of this information or frequently provide incomplete information including incomplete supporting information to corroborate the information provided. Paragraphs 25 – 28 of the CCMA do not seem to address this scenario and indeed Step 3 and 4 suggest that a lender cannot move on to make its assessment or try to reach a resolution if it has not received the SFS or if the information provided is incomplete. Whilst Capstone has no difficulty with an obligation to use all reasonable endeavours to obtain this information, there is a real risk that many current arrears resolution processes will stall at Step 2 because of the absolute nature of this requirement and because of the assumption that all borrowers are cooperative where in the case of some borrowers, their stance may be less than cooperative and they may seek to delay conversations. We would therefore seek clarity for a lender to move to Steps 3 and 4 where a borrower is not cooperative in providing such information required in Step 2, as long as the lender has undertaken all reasonable effort to request such information from the borrower.

Borrower Co-operation and Honesty

The CCMA puts the onus on lenders to establish the correct checks and controls and to conduct themselves in a compliant and responsible manner. Capstone fully understands and supports the need for this to be the case.

The CCMA also places a certain responsibility on borrowers to co-operate reasonably and honestly with the lender and, where they fail to do this, for example, by failing to make a full and honest disclosure of information in the Standard Financial Statement, the lender may seek repossession and is not required to wait twelve months from the time arrears first arise or from the time a revised repayment arrangement breaks down (section 46(c) CCMA). In addition, where it is clear that the borrower is deliberately not engaging with the lender, or where other circumstances reasonably justify, the lender may seek repossession in the absence of any engagement with the borrower (section 46(d)). Capstone believes that it would be of significant benefit if additional detail and guidance is provided in the CCMA as to what a lender might have regard to when trying to decide if a borrower's behaviour constituted reasonable co-operation and honesty (please see section 46(a)). We have set out the following possible suggestions:

1. The borrower must provide complete and accurate financial information to the lender when requested and notify the lender of material changes when they occur.
2. Where the borrower has been referred to MABs, then they must engage with them in a timely and pro-active manner.
3. If acceptable to the lender the borrower should agree to make payments in line with the details provided in the Standard Financial Statement.
4. Where a borrower is unable to make an agreed payment then they must immediately contact the lender to discuss their circumstances.
5. The borrower must engage with the lender when a reasonable request is made by the lender for them to do so, were no payment arrangement is in place or a payment arrangement has not been maintained for instance
6. The borrower must keep the lender informed of any change of residential address.

Please do not hesitate to contact us should you have any queries or wish to further discuss any of the issues raised in this letter, which we hope you have found constructive and helpful. As an organization that is committed to arrears management and to the Irish mortgage market, Capstone would welcome an opportunity to participate in any discussions with the Financial Regulator in relation to these topics or arrears management in general.

Yours faithfully

Jason Williamson
Capstone Mortgage Services Limited