

CONSUMER PROTECTION ON THE SALE OF LOAN BOOKS

Public Consultation
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An Roinn Airgeadais
Department of Finance

Public Consultation Paper:

Consumer Protection on the Sale of Loan Books

Department of Finance

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1. Introduction

Government Objective

The mission of the Government is straightforward:

To ensure that borrowers whose loans are sold by a regulated entity to a currently unregulated entity maintain the same regulatory protections as they had prior to the sale, including under various Central Bank Codes (including the Code of Conduct on Mortgage Arrears (CCMA)).

The Government is considering options on how best to achieve this. The proposed approach is through legislation as set out at Annex 1 and views are now being sought on the proposed draft legislation and relevant issues.

Proposed Legislation

In a nutshell, the proposed draft legislation makes the ownership of credit a ***newly regulated financial activity*** which requires Central Bank authorisation. It does this by changing the definition of “retail credit firm” to include firms which own the credit. As a result the owner of the loan would now be subject to regulation by the Central Bank of Ireland and affected mortgage holders would be covered by the regulatory protections under the Central Bank Codes. They will also have access to the Financial Services Ombudsman.

Why is it necessary to change the existing Legislative and Regulatory Regime?

The existing regulatory regime operates by requiring financial institutions which are providing specified financial services, including mortgages, to be regulated by the Central Bank and empowers the Central Bank to impose sanctions on these regulated financial institutions for certain breaches of the central bank codes. **Unregulated financial institutions are not bound by any of the Central Bank Codes.**

When a loan book is sold by a regulated financial institution to an unregulated entity, the borrowers are not entitled to the protections of the Codes.

It is generally accepted that consumers need protection when they are taking out credit, during the course of holding the credit and when they are repaying the credit. It is not equitable that some of these protections can be avoided due to the regulatory position of the entity which owns the credit. **The proposed legislation will return consumers to the position in which they were before the loan book was sold.**

What Central Bank Codes protect consumers and how?

Code of Conduct on Mortgage Arrears

Customers of regulated financial institutions must be dealt with in accordance with the Mortgage Arrears Resolution Process which sets out the steps to be followed on communication, gathering financial information, assessing the circumstances of the borrowers and proposing a resolution. There are also complaints and appeals procedures.

Consumer Protection Code

Customers of regulated financial institutions also have the protection of the Central Bank's Consumer Protection Code regarding limits on communications, personal visits and other contacts, complaint resolution processes, error handling, compliance of outsourced activity with the code, post-sale information provisions including warnings on switching from a tracker mortgage to a variable interest rate mortgage.

Code of conduct for business lending to Small and Medium Enterprises

SME customers of regulated financial institutions have the protection of the business lending code regarding arrears handling and complaint resolution etc.

Financial Services Ombudsman

Customers of regulated financial institutions have access to the Financial Services Ombudsman, whose role is to investigate, mediate and adjudicate complaints about the conduct of regulated financial service providers.

Why is voluntary compliance not sufficient?

It is understood that a number of the purchasers of mortgage loan books are abiding, on a voluntary basis, by the Central Bank Code of Conduct on Mortgage Arrears. Voluntary adherence to the Code seems to be in the interests of both the consumer and the purchasers at this time.

However, this is not the same as the consumer having the right to the protection of the Codes. There can be no guarantee that the owners of the loan books will correctly and properly apply the Codes without the supervision of the Central Bank. The Central Bank places the interests of the consumer at the heart of its work and the independence of the Central Bank ensures that financial institutions can be forced to comply with the appropriate Codes.

One way it does this is through the range of sanctions it has available to it, ranging from cautions or reprimands to the imposition of significant financial penalties. However, the Central Bank does not have the power to impose such penalties on institutions which are not regulated by it, even where these institutions indicate that they are voluntarily complying with the Codes and will continue to do so.

In addition, the free service provided by the Financial Services Ombudsman in the event of a dispute cannot apply in the case of voluntary compliance.

What are the next steps in the process?

The Government committed in March 2014 to bring forward legislation to protect mortgage holders whose mortgage had sold to an unregulated entity. The Government now proposes to protect all consumers whose loans are sold to an unregulated entity by ensuring that owners of credit are regulated and therefore comply with the applicable Central Bank Codes. Consumers will also have access to the Financial Services Ombudsman. The Government remains committed to working with the members of the Finance and Public Expenditure and Reform Committee to achieve the best solution for consumers.

2. The Consultation Process

Consultation Period

The consultation period will run from today to 22 August 2014, a period of 5 weeks. Any submissions received after this date cannot be considered.

How to Respond

The preferred means of response is by email to: consumer.protection@finance.gov.ie

Alternatively, a response may be posted to:

Public Consultation on Consumer Protection on the Sale of Loan Books Bill
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

Please include contact details if responding by post.

Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Acts. Parties should also note that it is the intention that responses to the consultation will be published on the website of the Department of Finance.

What happens after this Consultation?

The issues raised during this public consultation will inform the ongoing development of legislation to protect consumers on the sale of loan books to unregulated entities.

3. What is being proposed and why

Origins of the current issue

The Central Bank Act 1997 was amended by the Markets in Financial Instruments and Miscellaneous Provisions Act 2007. The main purpose of this amendment was to bring non deposit taking lenders under the remit of the Central Bank.

‘Retail credit firm’ was defined as meaning “a person prescribed for the purpose of paragraph (g) of the definition of ‘credit institution’ in section 3 of the Consumer Credit Act 1995, or any other person who holds itself out as carrying on a business of, and whose business consists wholly or partly of, providing credit directly to relevant persons”.

There were a number of exclusions contained in the section and the significant one in this context was “in relation to credit that was originally provided by another person, a person to whom all or any part of that other person’s interest in the credit is directly or indirectly assigned or otherwise disposed of”.

This provision had the effect of excluding Special Purpose Vehicles to which interest in credit was sold or otherwise assigned. It subsequently emerged that it also covers unregulated entities which purchase mortgage loan books from regulated entities.

Proposed Solution

The proposed solution involves a revised definition of “retail credit firm” which would include currently unregulated entities which purchase loan books but, specifically excludes Special Purpose Vehicles which do not take an active part in the management of books in which they hold a beneficial ownership.

A number of additions and amendments to the Central Bank Act 1997 are needed to achieve this.

Firstly the definition of “retail credit firm” needs to be changed to include owning credit as well as providing credit. The exemption in relation to credit provided by another person is being narrowed to restrict it to SPVs which do not carry out loan book servicing activities. An additional definition of “loan book servicing activities” is therefore required.

Hitherto unregulated firms will need to seek authorisation from the Central Bank. The proposed legislation contains transitional provisions which ensures that they can continue to undertake their activity pending a decision by the Central Bank on their application for authorisation.

The definition of Securitisation Special Purpose Vehicle (SSPV) is based on the definition of a Securitisation Special Purpose Entity (SSPE) in Article 4(66) of the Capital Requirements Regulation [EU – 575/2013]. This will refine the exclusion so as to capture owners of retail credit while still excluding securitisation SPVs. A different term is being used so as to avoid possible confusion if the definition in the Regulation were to be changed at a later stage.

What credit is covered?

The definition of credit in the Central Bank Act is not being changed. ‘Credit’ means a cash loan (whether or not provided on the security of a mortgage or charge over an estate or interest in land), but does not include credit of a class specified in section 3(2) of the Consumer Credit Act 1995. This

excludes credit union and Friendly Society credit, judgements, pawnbroker credit, credit from utilities, credit without interest, overdraft facilities, and credit from an employer at reduced interest rates. However, it means that ownership of mortgage credit and unsecured credit are included in the newly regulated activity.

Regulating the ownership of credit rather than the activity of mortgage loan book servicing means that all purchasers of cash loan books will be covered. For example, this means that the protections will extend to purchasers of personal credit books and SME cash loan books. Although no commitment has been given to applying the protections to such books, it is consistent with the intent of ensuring that consumers retain the same protections as they have at the taking out of a loan regardless of transfers of ownership. This also covers the anomaly that would otherwise arise if only secured loans were covered whereby the protection of regulation would fall away in respect of the unsecured outstanding loan left after enforcement of the lender's security (e.g. post repossession of the family home).

Is the proposed legislation retrospective?

The legislation is not retrospective. However, it will apply to all owners of loans, regardless of when they were acquired, thus capturing entities which have already purchased loan books. A similar approach was used last year in relation to debt management firms. Also, when the requirement for a retail credit firm authorisation was itself introduced in 2007, existing non-deposit taking lenders (which up to then did not require authorisation from the Central Bank) had to seek and receive an authorisation from the Central Bank in order to continue their business, and so were in the same position as loan transferees would be under this proposal.

This approach is more suitable for the Central Bank to implement since the Bank will be continuing to apply an existing authorisation regime and supervisory framework, and existing rules, to new entities rather than having to develop a new authorisation and supervisory framework and new rules for an entirely new type of regulated activity (i.e. mortgage loan book servicing). In addition, the concept of a 'retail credit firm' and the process and requirements for authorisation are familiar to the financial services industry and their legal, tax and accounting advisers.

The restrictive tight definition of SSPV which will be confined to activities appropriate to securitisation should ensure that owners of loan books cannot use SSPVs to circumvent the regulation. Adopting a definition similar to existing EU regulation should provide a degree of familiarity and clarity (domestically and internationally) about the type of entity we mean to exempt from authorisation and the policy rationale for doing so.

What other options were considered?

- **Regulating the activity of servicing loan books**

The Department spent some time examining the possibility of regulating the activity of servicing mortgage loan books. This involved defining the provision of mortgage loan book services, establishing how authorisation would work for existing and new mortgage book servicers, insurance requirements and legal requirements in the event of repossessions. Once mortgage book servicers are regulated, they would be required to comply with all relevant Central Bank Codes including the Code of Conduct on Mortgage Arrears.

The effect of this approach would have been minimal on loan book buyers because they have indicated that they intend applying the Code in any case. There were no regulatory capital issues because the activity of servicing, rather than the owners of the loans, would be regulated.

However, regulating a new activity would have meant the introduction of a completely new set of authorisation requirements and ongoing standards for loan book servicers and deciding on the appropriate additional consumer protection requirements which should apply to the new activity. It could also require amendments to Codes such as the Minimum Competency Code. These could have unavoidably delayed the implementation of the changes.

- Making it a precondition to the sale or transfer of residential mortgage to entities that are not subject to the supervision of the Central Bank that such entities agree to be bound by the relevant Codes of Conduct and agree access to the Financial Services Ombudsman.

This approach was proposed in a Private Member's Bill discussed in the Dáil in March 2014. However, a contract is not generally enforceable by a person not party to it. Therefore such a precondition would create an unenforceable obligation on the purchaser. This could potentially lead to further stress for the borrower.

The question also arises as to what would happen if an entity not regulated by the Central Bank were to breach the Central Bank's Codes of Conduct. With regard to a regulated entity, the Central Bank has a range of sanctions available to it, ranging from cautions or reprimands to the imposition of significant financial penalties. However, the Central Bank does not have the power to impose such penalties on entities which are not regulated by it.

A similar issue arises in the case of the Financial Services Ombudsman. The Financial Services Ombudsman is a statutory officer who deals independently with unresolved complaints from consumers about their individual dealings with regulated financial service providers. The limitation of the role of the Ombudsman to regulated financial service providers is contained in primary legislation establishing his Office. Any extension to the work of the Ombudsman would require primary legislation.

Will the proposed legislation make it more difficult to sell a loan book?

Compliance with the new regulatory regime will increase the costs borne by the mortgage owner. Both the Central Bank of Ireland and the Financial Services Ombudsman impose levies on regulated financial services providers to fund their activities. New owners will have to ensure that their business complies with the provisions of the various applicable codes e.g. structures, procedures, systems, adequately trained staff, communications policies and record management systems. Many of these make good commercial sense and new owners have said that they intend complying with the CCMA in particular.

Any process which provides additional protection to the consumer may potentially restrict the freedom of action of the financial service provider and increase the costs that they face. However, there are good public policy reasons why these consumer protections should be applied, not least of which is that the amendment proposed is restoring protections lost. All the protections applied when the consumer took the credit from the **regulated** credit provider, but were lost on subsequent sale to an unregulated entity. These protections are being restored.

Potential buyers have long been aware of the possibility of Government action in this area.

Will the protections apply if the loans are resold again?

Ownership of the credit will be a regulated activity so it does not matter whether the loans are sold more than once. Any owners will require authorisation regardless of whether they bought the loans from a regulated entity or an unregulated entity.

What is the relationship between this proposed legislation and the Land and Conveyancing Law Reform Act 2013?

The proposed legislation will not change the provisions of the Land and Conveyancing Law Reform Act 2013. The provisions of that Act which allow a court to adjourn proceedings to give a borrower time to consult with a Personal Insolvency Practitioner are not affected by the proposed legislation.

One of the things to which the court has to have regard is “whether the mortgagor has participated in any process relating to mortgage arrears operated by the mortgagee concerned which has been approved or required by the Central Bank of Ireland and which process relates to the land the subject of the mortgage”. The proposed legislation will end any ambiguity which may have existed in relation to **unregulated** entities operating processes which were approved by the Central Bank.

Will the Central Bank allow foreign based entities to buy loan books?

The relevant legislation (the Central Bank Act 1997 as amended by the Markets in Financial Instruments and Miscellaneous Provisions Act 2007) provides at section 31A(f) that

“...in order to obtain and retain an authorisation, a retail credit firm or home reversion firm shall satisfy the Bank that the organisation of the firm’s business structure is such that it, and any of its associated or related undertakings (so far as appropriate and practicable) are capable of being supervised by the Bank.”

In this regard, the Central Bank would require that Retail Credit Firms would have to maintain a presence in the State. It is a criminal offence for an unauthorised person or firm to provide financial services in Ireland that would require an authorisation under the relevant legislation.

4. The Consultation Questions

In responding to this consultation you are invited to:

- Give your views on the specific questions set out below. You do not have to answer every question – you may choose to answer any or all of the questions.
- Provide details of any issues or concerns you feel should be considered in dealing with the issues being addressed.
- Provide details of relevant issues not covered in this paper.
- Where appropriate, provide some analysis of the regulatory and/or financial impact of the proposed approach.

Your views are important as they will help to confirm what works with the proposed legislation and will also help to identify further considerations.

Question 1

Do you think that the proposed approach will provide appropriate protections for mortgage holders whose loans are sold on?

Question 2

Can you identify potential positive and negative impacts of the proposed approach?

Question 3

Do you think that the proposed approach is the best way to ensure that the protections enjoyed by mortgage holders with regulated entities are maintained when their loans are sold on? If not, what approach would you adopt?

Question 4

Will the proposed approach have any impact on the choice between outsourcing collection and selling on a loan book?

Question 5

Please provide details of any further work or future challenges you can identify with this issue.

Annex 1 Proposed Legislation

Consumer Protection on the Sale of Loan Books Bill 2014

Legislation to ensure that the protections which apply to borrowers with regulated entities also apply if the loan is sold to an unregulated entity.

The purpose of these amendments is to ensure that the purchasers of loan books will not be exempt from authorisation by the Central Bank of Ireland and compliance with the applicable statutory codes except where that entity is a Securitisation Special Purpose Vehicle (SSPV) similar to the definition of Securitisation Special Purpose Entity (SSPE) in Article 4(66) of the Capital Requirements Regulation [EU – 575/2013].

Bill entitled

“Consumer Protection on the Sale of Loan Books Bill 2014”

1.—The Central Bank Act 1997 is amended—

(a) in section 28, by substituting the following definition for the definition of “retail credit firm”:

‘retail credit firm’ means a person prescribed for the purpose of paragraph (g) of the definition of ‘credit institution’ in section 3 of the Consumer Credit Act 1995, or any other person who holds itself out as carrying on a business of, and whose business consists wholly or partly of, providing credit directly to relevant persons or owning such credit or both, but does not include—

(a) a person who is a regulated financial service provider authorised by the Bank or another EEA regulator to provide or own credit otherwise than under this Part, or

(b) a person who is an authorised credit intermediary under Part XI of the Consumer Credit Act 1995 when carrying on the activity of a credit intermediary, or

(c) in relation to credit that was originally provided by another person, a Securitisation Special Purpose Vehicle (SSPV) that has obtained all or part of another person’s interest (by direct or indirect assignment, sale or otherwise) in the credit, or

(d) a person who provides credit on a once only or occasional basis, but only if the provision of the credit does not involve a representation, or create an impression (whether in advertising, marketing or otherwise), that the credit would be offered to other persons on the same or substantially similar terms, or

(e) a person who is exempted, or who belongs to a class of persons that is exempted, under section 29A from being required to hold an authorisation as a retail credit firm;”;

(b) in section 28, by inserting the following definition after the definition of “retail credit firm” (as substituted by paragraph (a)):

'securitisation special purpose vehicle' or 'SSPV' means a corporation trust or other entity, other than a credit institution, organised for carrying out a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPV from those of the originator of the loan or loans, and in which the holders of the beneficial interests have the right to pledge or exchange those interests without restriction but shall not include an entity which carries out loan book servicing activities:

(c) in section 28, by inserting the following definition after the definition of “home reversion firm”:

“loan book servicing activities” means

- a) communicating with borrowers including responding to requests from borrowers, notifying the borrower of changes in interest rates or payments due under the loan contract, or of other matters of which the contract requires him to be notified;
- b) making decisions in relation to contracts including enforcement and changes to interest rates, terms, conditions, repayment schedules and duration of loan contracts,
- c) taking any necessary steps for the purposes of collecting or recovering payments due under the contract from the borrower; or
- d) taking any necessary steps for the purposes of enforcing the security on a loan.

Transitional provision for retail credit firms

2.—The Central Bank Act 1997 is amended by inserting the following section after section 28C—

“Transitional provision for retail credit firms”

28D.—(1) Notwithstanding section 29, a person carrying on the business of a retail credit firm who did not require authorisation immediately before the commencement of the *Sale of Loan Books to Unregulated Third Parties Act 2014* is taken to be authorised to carry on the business of a retail credit firm until the Bank has granted or refused authorisation to the person, provided that the person applies to the Bank under section 30 for authorisation no later than 3 months after that commencement.

(2) If a person is taken to be authorised to carry on the business of a retail credit firm under subsection (1), the Bank may do either or both of the following:

- (a) impose on that person such conditions or requirements or both as the Bank considers appropriate relating to the proper and orderly regulation and supervision of retail credit firms;
- (b) direct that person not to carry on the business of a retail credit firm for such period (not exceeding 3 months) as is specified in the direction.

(3) A condition or requirement imposed, or a direction given, under this section is an appealable decision for the purposes of Part VIIA of the Act of 1942.