Legislation changes for regulating credit servicing firms under the bank of irela...

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Introduction

The sale of non-performing loan portfolios by lenders over the past decade was driven by a need for banks to reduce the negative impact of these portfolios on their balance sheets. However, the sale of such loan portfolios has been rife with borrower dissatisfaction, political pressure, media attention and ultimately led to the Consumer Protection (Regulation of Credit Servicing) Act 2015, which introduced a new regulatory regime for Credit Servicing Firms.

This paper will look at the legislative change that brought Credit Servicing Firms under regulatory remit of the Central Bank of Ireland (the Central Bank), the background as to why this was deemed necessary and what this meant from a regulatory perspective. In his explanatory memorandum, the Minister for Finance

stated that the purpose of this legislative change " *is to regulate the activity of ' credit servicing' and the ' credit servicing firms' engaged in such activity so that the borrowers retain the protections that they have before a loan book is sold* ".[i]

Consumer Protection (Regulation of Credit Servicing) Act 2015

In July 2015, the Consumer Protection (Regulation of Credit Servicing) Act 2015 (the CSF Act 2015) was enacted, amending Part V of the Central Bank Act 1997. The CSF Act 2015 introduced a new regulatory regime for persons (& firms) carrying out credit servicing activities, as defined in the

CSF Act 2015 – these firms became a new entity type called ‘ Credit Servicing Firms’.[ii]

Credit Servicing Firms service credit agreements on behalf of unregulated loan owners – such credit agreements include mortgages, personal loans, loans to small and medium enterprises (SMEs) and credit cards. In practice, this means that the a Credit Servicing Firm manages all interactions with the borrower, including collection of repayments, issuing statements, notifying the borrower of changes in interest rates, managing complaints and assessing a borrower’s financial circumstances when considering the most appropriate repayment arrangements for that borrower.[iii]

In general, when a lender sells a portfolio of loans to an unregulated loan owner, that loan owner must use a Credit Serving Firm to service these loans. The only exemption is if the new loan owner is regulated separately by the Central Bank.

If a Credit Servicing Firm services loans for loan owners that are regulated by the Central Bank, the Credit Servicing Firm does not need to obtain a separate Credit Servicing license, as this arrangement is considered to be an outsourcing arrangement.[iv]

The CSF Act 2015, allowed for transitional arrangements, meaning that a person or firm who was carrying out this activity prior to the introductions of the CSF Act 2015, could continue to do so, once they submitted a Credit Servicing license application to the Central Bank by 8 October 2015 and could evidence that they were undertaking credit servicing activities before

July 2015 when the CSF Act 2015 was enacted. These persons/firms were taken to be authorised under the transitional arrangements, until such time as the Central Bank made a decision on the firms application.

As of 26 October 2018, there are 8 authorised Credit Servicing Firms and 2 transitional Credit Servicing Firms listed in the Central Bank's registers of authorised firms.[v]

Why introduce a Credit Servicing Regime?

Over the past decade, the Irish economy experienced a systemic crises, with non-performing loan levels rising to the highest levels in Europe.[vi]As Deputy Governor Sharon Donnery said in her speech " 10 year on – What have we learned?" (September 2018) – " *T he crisis affected every aspect of Irish society, of the Irish economy, of the Irish banking system. A decade later, significant numbers of people across the country are still dealing with its legacies* ."[vii]This is particularly true for those borrowers who experienced financial difficulty, falling into arrears on their mortgage or other loans and who ultimately had their loans sold to unregulated loan owners. As noted above, lenders were required to reduce their non-performing loan portfolios because of the negative impact on their balance sheets. The Central Bank set milestones and key performance indicators against which each lender's progress was measured.

One of the key changes brought about by the CSF Act 2015, was that borrowers whose loans were sold to unregulated loan owners, retained the regulatory protections that they had prior to the sale of their loan. This includes the protections provided by the Central Bank’s statutory Codes of Conduct including:

- the Consumer Protection Code 2012;

- the Code of Conduct on Mortgage Arrears 2013;

- Lending to Small and Medium-sized Enterprises) Regulations 2015; and

- the Minimum Competency Standards.

Some of these core protections include:

- Customers know at all times, who is servicing their loan – under Provision 3. 11 of the Consumer Protection Code 2012, a lender must give the customer 60 days’ notice before transferring their loan to another loan owner and that loan owner (and Credit Servicing Firm, where applicable) must be named. This was not the case before the CSF Act 2015, as credit servicing was not an activity regulated by the Central Bank and thereby subject to the Central Bank’s Statutory Codes of Conduct.[viii]

–The Code of Conduct on Mortgage Arrears 2013 ensures that customers in financial difficulty are treated fairly and transparently. Customers who are co-operating with lenders / loan owners via a Credit Servicing Firm, will also have the protections of the Mortgage Arrears Resolution Process (MARP) – a four step process which ensures that a customer’s specific circumstances are considered, the most suitable alternative repayment arrangement available from that loan owner is offered to the customer and that repossession is used only as a last resort. In the event that an alternative repayment arrangement cannot be agreed, a customer must be given alternative options in writing, for example voluntary surrender of the property and legal action cannot be commenced by the loan owner for a further three months.[ix]

What does this mean from a regulatory perspective?

The Central Bank as the competent authority in Ireland under the CSF Act 2015, implemented a regulatory framework for Credit Servicing Firms. This included:

- A robust Authorisation process for Credit Servicing Firms under the Central Bank’s statutory “ gatekeeper” role, whereby the Central Bank can permit or refuse an applicant firm in order to mitigate against a firm potentially causing consumer detriment or harm to the wider market following authorisation.[x]

- Drafting and publishing the Authorisation Requirements and Standards for Credit Servicing Firms – a set of requirements that Credit Servicing Firms have to meet in order to obtain and retain their authorisation.[xi]Some key requirements include:

☂ the need to have appropriate governance structures in place, including the need to have the ‘ heart and mind’ of the firm based in Ireland;

☂ appropriate loan serving agreements in place with loan owners;

- appropriate professional indemnity insurance of €1. 25m per claim and €1. 85, in aggregate; and

- the need to have appropriate business continuity and disaster recovery plans in place.[xii]

There has been extensive engagement with Credit Servicing Firms since the introduction of the credit servicing regime, however, there has been no Administrative Sanctions taken against any Credit Servicing Firms since the enactment of the CSF Act 2015.

In the public eye

The sale of non-performing loan books by lenders to unregulated loan owners has received substantial media attention over the last 3 years, driven in the main by borrowers who were concerned about losing their homes. The power of the media has been quite influential in creating fear and mis-understanding, particularly around the legality and appropriateness of lenders selling off mortgage books, despite the fact that loan agreements generally include a clause that allows the lender to sell the loan on to another firm. For example, an Irish Times article by Kitty Holland (August 2018) reads " *Remember, it is not just mortgages that are being sold, it's the lives of Irish people, many of whom are where they are because of the reckless lending of the very banks now selling them into destitution* ."[xiii]

However, the media can also be useful for providing clarity and understanding on a complex topic, for example this Irish Times article by

Ross Maguire (February 2018), which reads “ *My experience is that honest borrowers are not disadvantaged when their loans transfer to funds – though this does not suit every narrative. For those borrowers who want to sell and reach a compromise on residual debt, dealing with a fund means you are dealing with a motivated party who expects a deal to involve debt write off. It is quite a different case for the investor hoovering rents and not paying their mortgage, or for the won’t pay brigade. The arrival of a fund puts an end to this behaviour. There are, of course, difficult cases – but those cases are difficult whether with bank or fund. The argument that an Irish bank will act more benignly toward Irish defaulting debtors is laughable* .”[xiv]

There is little evidence that borrowers aremorelikely to lose their homes because their loan has been sold by their lender and is being serviced by a Credit Servicing Firm. Some loss of ownership is inevitable, particularly where a customer is not co-operating with the loan owner to resolve the issue. The Central Bank 2016 Report on Mortgage Arrears notes that those cases were legal proceedings were commenced by loan owners, 87% of these cases were severely in arrears (over 720 days) and most of these customers were not co-operating. Of those cases were the customer’s property was repossessed, approximately 66 per cent were voluntarily surrendered or abandoned.[xv]

Since the start of 2016, there has been on average 6 Parliamentary Questions (PQs) per year relating to CSFs, with Deputy Michael McGrath submitting over half of these. The types of questions asked relate to:

- the number of credit servicing firms that have been authorised and the average time for such a firm to obtain approval from the Central Bank;

- if any firms have provided unauthorised credit servicing;

- whether it is the unregulated loan owner or the Credit Servicing Firm who makes the final decision as to whether a restructuring agreement is entered into;

- what enforcement action, if any, that the central Bank has taken against Credit Servicing Firms.

- whether the CSF Act will be expanded to bring unregulated loan owners into the regulatory sphere.

Amendment to CSF legislation

The CSF Act 2015 is in operation for over three years now and following increasing political pressure, as evidenced by the volume of PQs on this topic, the Consumer Protection (Regulation of Credit Servicing Firms) (Amendment) Bill 2018 (the CSF Bill 2018) was introduced in the Dáil by Deputy Michael McGrath in February 2018, which proposes changes to the existing Credit Servicing regime. There has been multiple Dáil debates on the CSF Bill 2018 to date, with the latest draft and debate on 12 July 2018.

The main proposed change is to regulate loan owners (‘ credit agreement owners’ as per the CSF Bill 2018), which will bring unregulated loan owners under the regulatory remit of the Central Bank. Such firms would be required to seek an authorisation from the Central Bank and would be subject to financial services legislation, including all Statutory Codes of Conduct, as outlined above.[xvi]Other key proposed changes include:

- restrictions on loan owners acquiring loans, where the borrower is a competitor firm; and

- specific information must be provided to a customer within 30 days of the loan owner acquiring the customers loan.[xvii]

Conclusion

Did the introduction of a Credit Servicing regime work well? In my view, yes it has. Borrowers have generally kept the terms of their original credit agreements, retained the protections that they had before their loans were sold and it would also appear that there has been minimal home repossessions. Furthermore, the Irish Times article by Ross Maguire (February 2018) notes that “ *it is the funds who have completed almost all the mortgage to rent cases – selling properties at a discount to approved housing bodies to ensure defaulting borrowers remain in their homes* .”[xviii]

With regard to the proposed amendments to the CSF Act, it is my view that unregulated loan owners should they have been regulated in the CSF Act 2015, instead of/as well as Credit Servicing Firms. This is echoed by the significant media attention and number of PQs received, indicating widespread misunderstanding of the Credit Servicing regime and increasing political pressure to amend it. However, I believe that the Central Bank has provided clear responses to all PQs and media queries with a view to ensuring that there is as much clarity as possible around the existing Credit Servicing regime. The challenge from a regulatory perspective will be the volume of firms requiring authorisation, the resources to meet this demand and amending the existing Credit Servicing regime to include loan owners. Will it work any better than the existing Credit Servicing regime? Only time will tell.

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