



CIVIL JUSTICE COUNCIL

CONSULTATION PAPER

MORTGAGE ARREARS PROTOCOL

This consultation will end on 23 May 2008.

A consultation paper produced by the Civil Justice Council.

This information is also available on the Civil Justice Council website at

www.civiljusticecouncil.gov.uk.

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INTRODUCTION

The Civil Justice Council is proposing to recommend to the Head of Civil Justice, Sir Anthony Clarke, that he should bring into force a pre-action protocol relating to proceedings in which a residential possession claim is made by a mortgage lender against a borrower for mortgage arrears.

There are currently 9 pre-action protocols in force, being: -

Personal Injury

Clinical Negligence

Construction and Engineering Disputes

Defamation

Professional Negligence

Judicial Review

Disease and Illness

Housing Disrepair

Rent Arrears

The overall intention of pre-action protocols is to ensure that before proceedings are commenced all reasonable steps are taken to avoid the necessity for litigation and particularly

- to encourage the exchange of early and full information about the prospective legal claim;
- to enable parties to avoid litigation by agreeing a settlement of the claim before the commencement of proceedings; and

- to support the efficient management of proceedings where litigation cannot be avoided.

The CJC, as a non-departmental public body, is not covered by the code of practice on written consultation issued by the Cabinet Office. However such bodies are encouraged to follow the code, and the consultation is being conducted in line with it as far as appropriate.

The consultation period is 12 weeks terminating on 23 May 2008.

CONSULTEES

Copies of the consultation paper are being sent to:-

Abbey National

Accreditation Network UK

Advice Services Alliance

Advice UK

Association of District Judges

Association of Residential Letting Agents

Association of Residential Managing Agents

Barclays

Bar Council

Bradford & Bingley

British Bankers' Association

British Property Federation

Building Societies Association

Chartered Institute of Housing

Citizens Advice

Civil Court Users Association

Communities and Local Government

Community Legal Service

Consumer Credit Counselling Service

Consumer Direct

The Co-operative Bank

Council of Circuit Judges

Council of Mortgage Lenders

Credit Action

Department for Business, Enterprise and Regulatory Reform

Department for Work and Pensions

Eversheds

Financial Ombudsman Service

Financial Services Authority

Financial Services Consumer Panel

HM Treasury

Housing Law Practitioners Association

Housing Ombudsman Service

HSBC Bank

Institute of Money Advisers

Joseph Rowntree Foundation

Law Centres Federation

Law Commission

Law Society

Legal Services Commission

Lloyds TSB

Local Government Association

London Councils

Ministry of Justice

National Assembly for Wales

National Association of Estate Agents

National Debtline

National HMO Network

National Housing Federation

National Federation of Residential Landlords

National Landlords Association

Nationwide Building Society

Natwest

Northern Rock

Office of Fair Trading

Payplan

Residential Landlords Association

Royal Institution of Chartered Surveyors

Sechiari Clark & Mitchell

Shelter

UK Association of Letting Agents

Wragge & Co

THE CIVIL JUSTICE COUNCIL

The Civil Justice Council is a non-departmental public body, sponsored by the Ministry of Justice (MoJ). It was established under Section 6 of the Civil Procedure Act 1997 and is charged with: -

- Keeping the civil justice system under review;
- Considering how to make the civil justice system more accessible, fair and efficient;
- Advising the Lord Chancellor and the Judiciary on the development of the civil justice system; and
- Referring proposals for changes in the civil justice system to the Lord Chancellor and to the Civil Procedure Rule Committee, and making proposals for research.

The Civil Justice Council comprises of a full Council of 24 members (including those ex officio). The Civil Procedure Act requires that membership of the Council must include: -

- Members of the Judiciary;
- Members of the legal profession;
- Civil servants concerned with the administration of the courts;
- Persons with experience in and knowledge of consumer affairs;
- Persons with experience and knowledge of the lay advice sector; and
- Persons able to represent the interests of particular kinds of litigants (for example, businesses or employees).

Housing & Land Committee

The Housing & Land Committee played an instrumental role in the development of the Rent Arrears Pre-Action Protocol that was implemented in October 2006. The introduction of that protocol has led to consideration of the need for a protocol along similar lines for mortgage arrears cases. This Committee has taken the lead in developing a Pre-Action Protocol for possession claims based on mortgage arrears.

Terms of reference of the Housing & Land Committee are: -

- To consider and respond to proposals relating to civil procedure specific to housing and land cases;
- To consider existing court rules and practice relating to housing and land cases and make proposals to the Council for improvement; and
- To monitor proposed and existing housing legislation, its impact on procedure, and to make such response as appropriate.

ACTION FOLLOWING CONSULTATION

The Housing & Land Committee will initially consider the responses to the consultation. After the responses have been considered, it will make recommendations and consult with the Executive of the Council, the full Council and the Ministry of Justice. Recommendations will then be made to the Head of Civil Justice. The making of pre-action protocols falls entirely within his discretion. He will ask the Civil Procedure Rule Committee to review the drafting of the proposed protocol in due course.

THE PROPOSALS

Background

Since the Civil Procedure Rules 1997 came into force there have been a number of initiatives to draft and put into effect pre-action protocols. One of the most recent protocols has been the Rent Arrears Protocol, which was introduced in October 2006. There is no protocol for possession claims based on mortgage arrears. As identified above, the purpose of a pre-action protocol is to ensure that all reasonable steps are taken to avoid the necessity to commence litigation.

Historically, “social landlords” such as local authorities and Housing Associations have issued the bulk of possession claims. For example, at the end of 2004, they accounted for 60% of all possession cases. However, more recently, there has been a shift in the balance from social landlords to mortgage lenders/private landlords issuing the majority of possession claims. Statistics for the third quarter 2007 show that whilst possession claims issued by local authority and social landlords has decreased (the number of claims for the third quarter 2007 is 9% lower than the equivalent period in 2006), mortgage arrears cases have increased (1% higher in third quarter 2007 compared to the equivalent period 2006). Figures for the third quarter 2007 show that slightly more mortgage arrears possession claims were issued (34,717) than standard landlord possession claims (31,227).

The draft Pre-Action Protocol for mortgage arrears (as set out below) mirrors in many respects the Rent Arrears Protocol in seeking to regulate pre-litigation conduct. The draft Pre-Action Protocol adopts many of the provisions of and reflects guidance on good practice by lenders in dealing with borrowers in arrears as set out in the Mortgage Conduct of Business Rules within the Financial Services Authority Handbook – for details see link <http://fsahandbook.info/FSA/html/handbook/MCOB/13> .

The draft Pre-Action Protocol is addressed to residential mortgage lenders. All persons that commence proceedings are required by the Practice Direction to have complied in substance with the terms of an approved protocol or, in the event that no protocol applies, the Court will expect the parties to act reasonably in trying to avoid the

necessity for the start of proceedings. It is intended that the Protocol will apply to residential possession claims on the basis of mortgage arrears

The Practice Direction for Protocols provides that the Court may impose sanctions for a failure to comply with the terms of a pre-action protocol. For ease of reference for consultees, a link to the Practice Direction is attached:

http://www.justice.gov.uk/civil/procrules_fin/contents/practice_directions/pd_protocol.htm .

Draft Protocol for Possession Claims Based on Mortgage Arrears

Aims and Scope of the Protocol

The Protocol is intended to provide a clear structure to be followed in residential possession claims on the basis of mortgage arrears, encouraging more pre-action contact between the parties and enabling court time to be used effectively. It recognises that it is in the interests of both lenders and their borrowers to ensure that mortgage payments are made promptly and to ensure that difficulties are resolved wherever possible without court proceedings.

The protocol is intended to ensure that lenders deal fairly with borrowers in arrears and to that end lenders must put in place and operate within a written policy (agreed by its respective governing body) and procedures for complying with the requirement to deal fairly with borrowers. Courts should take into account whether this protocol has been followed when considering what orders to make using case management powers in any possession proceedings brought against residential mortgage borrowers.

Initial contact

- 1) If a borrower falls into arrears, lenders shall contact the borrower as soon as reasonably possible and in any event within 15 business days of the date that the lender became aware of the fact arrears have accrued. Lenders shall provide borrowers with a mortgage arrears information sheet issued by the Financial Services Authority, a list of due payments either missed in whole or in part, the total of the arrears, details of any charges incurred as a result of the arrears and the total outstanding debt excluding charges that may be added on redemption. Lenders should also provide an indication of the nature (and where possible the level) of charges the borrower is likely to incur unless the arrears are cleared. In the event of a joint mortgage, lenders shall write to each borrower.
- 2) Lenders shall take all reasonable steps to discuss with a borrower or her/his representative the cause of the arrears, the borrower's financial circumstances, and the borrower's entitlement to any relevant benefits and repayment of the arrears. Lenders should give borrowers a reasonable period of time to consider any

proposals for payment that a lender has put to a borrower. Additionally lenders should consider, in appropriate cases, extending the term of the mortgage, changing the type of a mortgage, deferring payment of interest due under the mortgage, capitalising the arrears and also agreeing to the arrears being paid off over the remaining term of the mortgage. Lenders shall give to borrowers in writing reasons for any decision to reject one or more of these options within 10 business days of the day when these options were discussed with the borrower.

Borrowers shall notify lenders where they are unable to meet the monthly instalments when they fall due and to discuss what steps are being proposed to deal with this default. Where borrowers have decided to sell the security, borrowers will give lenders details of the estate agent instructed and authorise that estate agent to disclose to lenders from time to time information concerning the progress of the sale.

Lenders must not put unreasonable pressure upon borrowers through excessive telephone calls or correspondence, or by contact at an unreasonable hour.

- 3) Lenders and borrowers should try to agree affordable sums for borrowers to pay towards arrears, based upon the borrower's income and expenditure (where such information has been supplied in response to the lender's enquiries).

Lenders should accept a reasonable request from borrowers to change the date of payment (within the same payment period) or the method by which payment is made and give borrowers a written explanation of their reasons if they refuse the request.

- 4) When an account is in arrears lenders should provide, on no less than a quarterly basis, statements of payments due, the level of arrears, charges arising from such arrears and the total amount remaining to be paid under the mortgage in a comprehensible format.
- 5) If lenders are aware that borrowers have difficulty in reading or understanding information given, lenders should take reasonable steps to ensure that borrowers understand any information given. Lenders should be able to demonstrate that

reasonable steps have been taken to ensure that the information has been appropriately communicated in ways that borrowers can understand.

- 6) Possession proceedings for mortgage arrears should not be started against borrowers who can demonstrate that they have –
 - (a) provided the Department of Work and Pensions with all the evidence required to process a claim for payment of mortgage interest or provided any Mortgage Protection Policy Insurer with any claim for payment under such a policy;
 - (b) a reasonable expectation of eligibility for payment of mortgage interest or entitlement under any such policy; and
 - (c) an ability to secure payments of any mortgage instalment not covered by the claim made to the Department of Work and Pensions or the insurer.
- 7) Bearing in mind that mortgage arrears may be part of a general debt problem, lenders should advise borrowers to seek assistance from Citizens Advice, Community Legal Advice (formerly CLS Direct), debt advice agencies or other appropriate agencies as soon as possible. Lenders should offer to assist borrowers in any claim they may have for appropriate welfare benefits.
- 8) Possession proceedings for mortgage arrears should not be started where borrowers can demonstrate that they have taken all reasonable steps to market the property subject of the mortgage, at an appropriate price in accordance with reasonable professional advice, providing that borrowers have agreed to keep lenders informed with progress of the sale.

After service of statutory notices

- 9) After service of any “letter before action” or equivalent statutory notice but before the issue of proceedings, lenders should make further reasonable attempts to contact borrowers, to discuss the amount of the arrears, the cause of the arrears, repayment of the arrears and any relevant welfare benefit position.

- 10) If borrowers comply with an agreement to pay the current mortgage and a reasonable amount towards arrears, lenders should agree to postpone court proceedings so long as a borrower keeps to such an agreement. If borrowers cease to comply with such agreements, lenders should warn borrowers of their intention to bring proceedings and give borrowers clear time limits within which to comply. In making any decision to issue proceedings lenders shall have regard to the extent to which they are at risk if proceedings are delayed for example whether there is adequate security for the mortgage debt because of the amount of equity available.

Alternative Dispute Resolution

- 11) The parties should consider whether it is possible to resolve the issues between them by discussion and negotiation without recourse to litigation. Proceedings should not normally be issued where a bona fide complaint has been lodged with the Financial Ombudsman Service in relation to any decision of a lender until such time as that complaint has been finally determined. Where lenders intend to issue such proceedings they shall, at least 5 working days before issuing proceedings, send the borrower in written form their reasons for not awaiting the outcome of the complaint's investigation by the Financial Ombudsman Service. The parties may be required by the court to provide evidence that alternative means of resolving the dispute were considered. Courts should take the view that litigation should be a last resort, and that claims should not be issued prematurely when settlement is still actively being explored.

Community Legal Advice has published a booklet on 'Alternatives to Court', which lists a number of organisations that provide alternative dispute resolution services - see link http://www.clsdirect.org.uk/en/legalhelp/leaflet23_2.jsp

Court Proceedings

- 12) Not later than 10 business days before the date set for the hearing, lenders should:
 - a) provide borrowers with an up to date mortgage statement containing the information required under the Practice Direction to Civil Procedure Rule 55 and in particular PD 55 paragraph 2.5(2) and PD 55B paragraph 6.3/6.3A;

b) disclose to borrowers what knowledge they possess of the borrower's welfare benefit position.

13 (a) Lenders should inform borrowers of the date and time of any court hearing and the order to be applied for including whether any money or other judgment will be sought in addition to possession. Lenders should advise borrowers to attend the hearing as the borrower's home is at risk. Records of such advice should be kept.

(b) If borrowers comply with agreements made after the issue of proceedings to pay the current mortgage payments and a reasonable amount towards arrears, lenders should agree to postpone court proceedings so long as borrowers keep to such agreements.

(c) If borrowers cease to comply with such agreements, lenders should inform borrowers of their intention to restore the proceedings and give borrowers a clear and reasonable time limit within which to comply.

14) Where after the issue of proceedings an agreement is reached between the parties both parties shall advise the court in writing of the terms of the agreement reached and shall summarise the reasons why they have reached the agreement concluded.

15) If lenders unreasonably fail to comply with the terms of this protocol, the court may impose one or more of the following sanctions –

a) an order for costs or direct that the lender shall not be entitled to its costs;

b) an order staying or adjourning the claim.

QUESTIONNAIRE

We would welcome responses to the following questions set out in this consultation paper:

1. Do you consider a protocol for mortgage arrears cases would be helpful? If so, what do you consider would be the advantages? If not, why not?
2. Will the protocol have any impact on your area of business or sector – particularly in terms of benefits or costs?
3. What sector of the mortgage lender market is likely to be affected by the introduction of the protocol? Can you give details of the size/significance of this sector?
4. Do you agree with the scheme of the protocol – i.e. early intervention when mortgage arrears begin; agreement of instalment payments; assistance to the borrower to gain benefits and manage debt; postponement of proceedings?
5. What should the sanctions for non-compliance be?
6. Any other comments?

PARTIAL IMPACT ASSESSMENT

Pre-Action Protocol for Possession Claims based on Mortgage Arrears

General Background

Where a borrower falls into arrears with mortgage repayments, and no repayment arrangement can be agreed between the lender and borrower, the lender can start possession action in the county court. In 2007 a total of 137,605 mortgage possession claims were issued and 95,374 possession orders made. Since many of the orders will not be enforced however, these figures do not reflect how many properties have actually been taken into possession. Figures published by the Council of Mortgage Lenders show that 27,100 properties were taken into possession in 2007.

Annual figures for mortgage possession actions from 1987 are given in the table below:

Year	Claims Issued	All Orders made (incl suspended)	Properties taken into possession¹
1987	79,160	48,814	26,390
1988	72,655	47,769	18,510
1989	91,309	53,066	15,810
1990	145,350	103,508	43,890
1991	186,649	142,905	75,540
1992	142,162	126,881	68,540
1993	116,181	105,283	58,540
1994	87,958	77,681	49,210
1995	84,170	75,258	49,410

1996	79,858	71,203	42,560
1997	67,073	57,156	32,770
1998	84,836	66,055	33,900
1999	77,885	55,964	30,000
2000	70,430	50,918	22,900
2001	65,862	47,997	18,300
2002	63,203	41,759	12,000
2003	65,886	41,038	8,500
2004	77,250	46,683	8,000
2005	114,764	70,964	15,100
2006	131,232	90,589	22,700
2007	137,605	95,374	27,100

¹ Figures from the Council of Mortgage Lenders (CML)

These figures show that after a decade of relative stability, the numbers of claims issued and orders made have increased steadily since 2004. The latest available figures for the fourth quarter 2007 show that, compared to the equivalent quarter of 2006 there was an increase of 14% in the number of mortgage possession claims issued, from 31,415 to 35,662. There was an increase of 6% in the number of orders made (including suspended orders) from 23,547 to 25,008.

In comparison however, it should be noted that these numbers are still lower than during the recession of the early 1990's. For example, during 1991, an average of over 46,000 possession claims were issued per quarter.

In the 1990s the growth in mortgage arrears and repossessions were caused by substantial increases in the interest rates and downturn in the economy. The recent interest rate rises have been relatively slight in comparison and economic conditions

more favourable. It is therefore possible that changes in the mortgage market itself are a significant factor in the recent increase in court possession actions.

The mortgage market has diversified and expanded to meet the demand for larger and riskier loans. The sub-prime sector of mortgage lending, which specialises in lending to lower income and “credit impaired” borrowers has grown rapidly in recent years.

A recent CML study¹ has found that the rate of arrears in the sub-prime sector was almost four times greater than the prime sector; the percentage increase in applications for first time court hearings was eleven times greater in the sub-prime sector compared to prime sector; and properties that provided security for sub-prime loans were ten times more likely to be taken into possession than properties providing security for prime loans.

The FSA’s Mortgage Conduct of Business (MCOB) Rules has regulated mortgage lending since 2004. The MCOB rules make particular provisions regarding arrears management and seeking possession action in court – for example lenders must write to customers who fall into arrears within prescribed time limits, and must be willing to enter into an agreement to pay back the arrears within a timescale that is reasonable according to the customer’s circumstances. These rules apply to all first charge mortgage lending but do not cover second charge loans or mortgages taken out before October 2004. Second charge lending and buy-to-let renting remains unregulated by the FSA.

An element of regulation of second charge mortgages, and arrears management practice, can be found in the OFT requirement for lenders to be fit to hold a consumer credit licence under the provisions of the Consumer Credit Act 1974. OFT guidance to licence holders sets out best practice on arrears management that states that lenders should only seek repossession of a borrowers property as a last resort. Second charge loans over £25,000 are however currently not covered under these provisions – although this limit will be removed from April 2008.

¹ Stephens and Quilgars, *Managing arrears and possessions*, CML 2007

The effectiveness of this regulation scheme and arrears management practice – particularly with regard to the sub-prime sector – has been questioned, not least by the CML study findings mentioned above, which imply that borrowers who fall into arrears in the sub-prime sector may be twice as likely as those borrowing from mainstream lenders to be repossessed. Such concerns are supported by a recent study published by Citizens Advice² that found that sub-prime lenders were responsible for a level of possession action substantially above and disproportionate to their share of the market.

The CAB study suggests that lenders – particularly in the sub prime sector – have little incentive to consider alternatives to court action, and so can take possession action quickly, contributing to the increase in mortgage possession claims and adding substantial additional costs to the borrowers debt.

One of the main recommendations in the CAB report is the introduction of a pre-action protocol for mortgage arrears claims. This would help to ensure that lenders only take possession action as a last resort and not as a routine response to arrears. This recommendation was echoed in a recent Policy Briefing Paper published by Shelter³ that suggested a mortgage arrears pre-action protocol would provide similar protection to that given to tenants in the social housing sector by the current rent arrears pre-action protocol.

Options

i) Do nothing – given the significant and continuing rise in the number of mortgage possession claims, and the increasing influence of the sub prime sector in this area, a “do nothing” option would not promote the action needed to ensure that existing regulation and arrears management practice is operating as effectively as intended i.e. to ensure that repossession action can be avoided if at all possible.

ii) Introduce the pre-action protocol – although regulatory regimes do exist to cover all sectors of mortgage lending, regulators are not best placed to monitor compliance, and

² *Set Up to Fail* CAB December 2007

³ *Mortgages and repossessions* Shelter January 2008

introduction of the protocol will provide the courts with the means of assessing whether the lender is in compliance with the expected regulatory standards at the point where an application for a possession order is made.

Costs

The mortgage pre-action protocol adopts many of the provisions of the FSA MCOB Rules and mirrors in many respects the OFT guidance on arrears management to lenders. The introduction of a mortgage pre-action protocol should therefore incur no significant additional costs to lenders, other than possibly a “one-off” cost of ensuring that their arrears management systems are compliant. Consultees have been asked to identify/estimate costs as part of the consultation exercise.

Benefits

The introduction of a mortgage pre-action protocol should lead to improved communications and engagement between lenders and borrowers who face difficulties in meeting loan repayments.

Where lenders are able to reach agreements with borrowers regarding payment of arrears, they would benefit from a reduction in costs associated with taking court action, but it is not possible to predict what the engagement and agreement rates (and thereby possible savings) would be. Consultees have been asked to identify benefits as part of the consultation exercise.

Conclusion

The introduction of a mortgage pre-action protocol will provide lenders with a clearly structured approach to ensure that they follow established regulations and guidance on managing mortgage arrears before beginning court action. It will provide clear guidance on what the court will be expecting lenders to have done prior to arriving at court and aims to encourage more pre-action contact between lenders and borrowers and thereby enable court time to be used effectively.

HOW TO RESPOND

Please send your response by 23 May 2008 to: -

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Room E218
Royal Courts of Justice
Strand
London WC2A 2LL

Telephone: 020 7947 7870

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Extra Copies

Further paper copies of this consultation can be obtained from this address and it is available online at www.civiljusticecouncil.gov.uk.

Publication of Response

A paper summarising the responses of this consultation will be published in five months time. The response paper will be available online at www.civiljusticecouncil.gov.uk.

Representative Groups

Representative groups are asked to give a summary of the people and organisations they represent when they respond.

Confidentiality

The Civil Justice Council may wish to publish responses to this consultation document in due course. Please ensure your response is marked clearly if you wish your response or name to be kept confidential.

If you are replying by email, your consent overrides any confidentiality disclaimer that is generated by your organisation's IT system, unless you specifically include a request to the contrary in the main text of your submission to us.

Confidential responses will be included in any statistical summary of numbers of comments received and views expressed.

Civil Justice Council,

Room E218, Royal Courts of Justice, Strand, London WC2A 2LL