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BY EMAIL ONLY

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Dear Sirs

HM Treasury Consultation Paper on mortgage regulation (published in December 2009)

The City of London Law Society ("**CLLS**") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

General comments

Before responding to the specified questions on Chapter 4 (Questions 21 and 22), we have the following general comments:

(i) We note that the proposed definition of "managing a regulated mortgage" is not intended by HMT to bring within the scope of regulation firms that own or hold a regulated mortgage contract, but do not carry out any activity that is material to the borrower, in that they do not have power to exercise or control the exercise of any rights of a lender under such a contract. This is based, in particular, on the view that special purpose vehicles (SPVs) and similar vehicles may own or hold relevant contracts, but have no role in decisions which affect borrowers. Our members' experience, based on the structuring of such transactions, is that this view is not strictly correct. A SPV which acquires a portfolio of mortgages will generally purchase a beneficial interest in the portfolio from the seller (normally a credit institution). The legal title to the assets will normally either be retained by the seller or, more commonly, will be transferred to a professional agent/manager which administers the portfolio on behalf of the purchaser (a "servicer"). The servicer will be regulated by the FSA if the portfolio includes regulated mortgage contracts. Under such structures, though most decisions affecting borrowers will in practice be taken by the servicer, it is equally true that, under the services contract between the purchaser and the servicer, the purchaser will retain discretion to exercise or control the exercise of rights under contracts comprised in the portfolio. This may be important for commercial reasons, but is more generally important for tax purposes in order to establish the substance of the purchasing entity. Consequently, it is not correct to analyse a SPV purchaser as being a wholly "passive" owner; it is important in such structures that the purchaser should have the right to take decisions or to direct the servicer, and that, in appropriate cases, it should actually do so.

(ii) Furthermore, in practice, hedge funds, private equity firms and similar purchasers will normally acquire an interest in a portfolio using a SPV. Therefore, to this extent, HMT's policy objective of bringing such firms within the scope of mortgage regulation, but at the same time to exclude SPVs, are at odds with each other. For the reason given above, it is also likely to be very difficult, if not impossible, to distinguish in the legislation between SPVs formed by such financial firms (on the one hand) and other SPVs (on the other), since, in both cases, the SPVs will enjoy the rights and powers described in (i) (that is to say, they may not be categorised as wholly "passive").

(iii) It is also common practice for lenders to appoint third parties, such as estate agents or bailiffs, to carry out certain activities in the event of, for example, a repossession of a property. In such cases, the lender delegates his power to exercise his rights under a regulated mortgage contract to that third party, although he retains primary control over the exercise of such rights. Under the proposed definition of 'managing' a regulated mortgage contract then, such third parties would be inadvertently caught under this definition as 'having the power to exercise...any of the rights of a lender under a regulated mortgage contract'.

(iv) For the reasons given in (i), (ii) and (iii) above, we believe that the chosen method of achieving HMT's policy objective is flawed. While it may catch the types of purchaser referred to, it will also catch other vehicles which are apparently intended to be excluded. In this regard, we do not believe that, as drafted, the proposed exclusion in Article 62A will assist, because the servicer's (B's) rights to manage the contract and to make decisions will be subject to the rights of the purchaser (A) described above. As such, the proposed exclusion is likely to be inadequate, unless it is made clear in Article 62A (a) that B's powers may be subject to powers retained by A (which, we appreciate, would probably undermine the intended scope of the exclusion).

(v) We believe, however, that the stated policy objectives may be achieved in a simpler way. As noted above, servicers will be regulated by FSA, to the extent that a portfolio includes regulated mortgage contracts. Further, any rights and obligations of the servicer under its management/services agreement with the purchaser will be subject to the servicer's duties under FSA's principles and rules. Put a different way, the purchaser will accept under such an agreement that, in managing a

portfolio, the servicer will be bound by FSA principles and rules. It would therefore be possible to achieve the stated policy objective by adding appropriate FSA's rules and guidance in order to clarify that servicers should not take any step which would, or would be likely to, result in the adverse consequences for borrowers which are identified in Chapter 4. In our view, this would not require substantial extensions to MCOB, since MCOB 12 and 13 already contain relevant obligations which apply to mortgage administrators. We do not consider that this approach would entail any risk of "regulatory arbitrage", since a purchaser could not dispense with the requirement to appoint a servicer without either obtaining authorisation itself to act as mortgage administrator or arranging for the selling bank to retain administrative duties (in which case, the bank would similarly be obliged to treat its customers fairly under FSA principles and rules).

(vi) The alternative solution outlined above would also be entirely consistent with the government's stated intention in relation to mortgage regulation, which appears in PERG 4.16.2G in the FSA Handbook.

> "The government's intention behind the regulatory regime for mortgages was "to ensure that, at any one time, it would be possible for each mortgage to be linked to one and only one FSA authorised firm (with mortgage permission) to have the ongoing regulatory responsibility towards consumers" (HM Treasury, Regulating Mortgages, February 2002, paragraph 47). In other words, it should be possible to arrange a securitisation transaction so that the SPV and other third parties do not carry on regulated activities, so long as an authorised person (with appropriate permission) is involved."

As HMT said, the involvement of one authorised person should be sufficient. We do not believe that the current consultation has demonstrated any failure and other factor which would lead to a different conclusion and, as noted above, HMT's objectives may be achieved without the amending legislation which is proposed.

(vii) Furthermore, we believe that a distinction should be made by HMT between those who have primary decision-making powers over the enforcement of a regulated mortgage contract (i.e. those who effectively 'manage' the regulated mortgage contract) and those who are delegated the power to exercise rights under a regulated mortgage contract, who should fall outside the proposed definition.

We would urge HMT, together with FSA, to reconsider its suggested approach in the light of these factors. If the proposed approach is followed, we believe that the consequences for the market may be severe.

Boundary between FSMA and the Consumer Credit Act ("CCA")

We wish also to take this opportunity to draw HMT's attention to a problem with the existing boundary between the FSMA and CCA regimes (to which reference is made in paragraphs 2.25 and 2.30 of the consultation paper). If the proposals in Chapters 2 and 3 of the consultation paper are carried into effect, this problem would be perpetuated and come to affect second charge and buy-to-let lending.

The problem concerns the CCA ancillary activity of "debt administration", described in s. 145(7A) CCA. So far as relevant, debt administration is the taking of steps: (a) to perform duties under a consumer credit agreement on behalf of the creditor; or (b) to exercise or to enforce rights under such an agreement on behalf of the creditor.

To the extent that a person performs those activities in relation to a regulated mortgage contract, they will require a licence from the OFT for Category G. They are likely also to require FSA authorisation for the regulated activity of "administering a regulated mortgage contract" under Article 61(2) RAO. In this respect, the boundary between the two regimes is not clearly defined. The problem arises because there is no

exclusion in s.146 CCA where the relevant ancillary activity is carried on in relation to a regulated mortgage contract. By contrast, other relevant CCA ancillary activities defined in s. 145 CCA (for example credit brokerage) are subject to an exclusion in s.146 CCA where the relevant activity is carried on in relation to a regulated mortgage contract.

We propose that a new s.146 (5E) should be inserted as follows:

> "It is not debt administration for a person to carry on an activity mentioned in paragraphs (a) or (b) of section 145(7A) if - (a) the debt in question is due under a relevant agreement; and (b) that activity is a regulated activity for the purposes of the 2000 Act."

We believe it unlikely that HMT would be able to make this amendment by means of statutory instrument under section 22 FSMA but suggest that it might be possible to make the amendment by order under the Legislative and Regulatory Reform Act 2006.

A similar boundary problem arises in relation to the CCA ancillary activity of debt collecting under s. 145(7) CCA, but we assume that this overlap between the two regimes is intentional.

Specific responses

In light of the above, we also have the following specific comments on questions 21 and 22:

Question 21

We agree, but would also note that the proposed definition would catch other activities that have no potential to cause harm to borrowers when mortgages are sold on. This is because the proposed definition would include any of the rights of a lender under a regulated mortgage contract, irrespective of how material or immaterial those rights may be. It would be preferable if the definition were to refer to the primary decision-maker in relation to those decisions which are of concern (i.e. increasing rates and/or taking steps to enforce a loan (including repossessing the mortgage property) to the exclusion of other activities) rather than the generic right to exercise rights under a mortgage.

Question 22

We do not agree for the reasons summarised above.

We would be delighted to discuss the above comments with you. You may contact me on +44 (0)20 7295 3233 or by e-mail at margaret.chamberlain@traverssmith.com.

Yours faithfully,

M. Chamberlain

Margaret Chamberlain

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