

# Implementation of the Mortgage Credit Directive and the new regime for second charge mortgages

September 2014





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We are asking for comments on this Consultation Paper by 29 December 2014.

You can send them to us using the form on our website at:  
[www.fca.org.uk/your-fca/documents/consultation-papers/cp14-20-response-form](http://www.fca.org.uk/your-fca/documents/consultation-papers/cp14-20-response-form).

**Or in writing to:**

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We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Consultation Paper from our website: [www.fca.org.uk](http://www.fca.org.uk). Or contact our order line for paper copies: 0845 608 2372.

## Abbreviations used in this paper

<b>“MCD” or “the Directive”</b>	Mortgage Credit Directive
<b>ADR</b>	Alternative Dispute Resolution
<b>AML</b>	Anti-Money Laundering
<b>APRC</b>	Annual Percentage Rate of Charge
<b>BBR</b>	Bank of England Base Rate
<b>CBA</b>	Cost-benefit analysis
<b>CCA</b>	Consumer Credit Act 1974
<b>CF</b>	Controlled Function
<b>CML</b>	Council of Mortgage Lenders
<b>CONC</b>	Consumer Credit Sourcebook
<b>CP</b>	Consultation Paper
<b>DSR</b>	Debt Service Ratio
<b>DISP</b>	Dispute Resolution: Complaints
<b>EIA</b>	Equality Impact Assessment
<b>EBA</b>	European Banking Authority
<b>ERC</b>	Early Repayment Charge
<b>ESIS</b>	European Standardised Information Sheet
<b>FCA</b>	Financial Conduct Authority
<b>FLA</b>	Finance and Leasing Association
<b>FOS</b>	Financial Ombudsman Service
<b>FPC</b>	Financial Policy Committee

<b>FSB</b>	Financial Stability Board
<b>FSCS</b>	Financial Service Compensation Scheme
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>HNW</b>	High-Net Worth
<b>KFI</b>	Key Facts Illustration
<b>LTI</b>	Loan-to-income ratio
<b>LTV</b>	Loan-to-value ratio
<b>MAS</b>	Money Advice Service
<b>MCOB</b>	Mortgages and Home Finance: Conduct of Business Sourcebook
<b>MIPRU</b>	Prudential sourcebook for Mortgage and Home Finance Firms and Insurance Intermediaries
<b>MLAR</b>	Mortgage Lenders and Administrators Return
<b>MMR</b>	Mortgage Market Review
<b>OFT</b>	Office of Fair Trading
<b>PERG</b>	Perimeter Guidance Manual
<b>PII</b>	Professional Indemnity Insurance
<b>PRA</b>	Prudential Regulation Authority
<b>PSD</b>	Product Sales Data
<b>RAO</b>	Regulated Activities Order
<b>RMAR</b>	Retail Mediation Activities Return
<b>RTS</b>	Regulatory Technical Standard
<b>SRB</b>	Sale and Rent Back
<b>SUP</b>	Supervision Handbook
<b>SVR</b>	Standard Variable Rate
<b>SYSC</b>	Senior Management Arrangements, Systems and Controls
<b>TC</b>	Training and Competence Sourcebook
<b>URS</b>	Underwriting Risk Score

# 1. Overview

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## Introduction

- 1.1 This consultation paper sets out our proposed approach to implementing the Mortgage Credit Directive (MCD).<sup>1</sup>
- 1.2 The MCD applies equally to first and second charge mortgages and the UK government has decided that second charge mortgage regulation should move from our consumer credit regime into our mortgage regime as part of the Directive implementation.
- 1.3 In this paper we set out our proposals for the new second charge lending regime alongside our plans for MCD implementation.

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## Who does this consultation affect?

- 1.4 This consultation will interest lenders, administrators, intermediaries, and consumers in both the first and second charge mortgage markets and bodies representing these groups, including firms dealing with niche mortgage products such as bridging finance or lifetime mortgages.

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## Is this of interest to consumers?

- 1.5 These proposals will interest first charge mortgage consumers, as the Directive introduces additional protections beyond our existing requirements.
- 1.6 Our proposals are likely to be of greater interest to second charge mortgage consumers. We propose to introduce conduct requirements for second charge firms that are broadly consistent with our existing first charge mortgage rules, which will provide a more appropriate degree of consumer protection.

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## Context and summary of proposals

### Implementing the MCD

- 1.7 The MCD introduces a European framework of conduct rules for firms selling both first and second charge mortgages. In many ways the MCD is designed to achieve similar consumer protection objectives as our existing mortgage rules. This alignment reflects our active

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<sup>1</sup> Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property

involvement in the MCD negotiations and the fact that our recent approach to domestic mortgage policy was developed to maximise compatibility with the expected MCD text.

- 1.8** In view of the overlap between the MCD and our existing mortgage regime, we propose that wherever possible we should implement the MCD using provisions in our existing rules. Where this is not possible, we propose to copy out the Directive. This approach is designed to cause the least possible disruption to the market.
- 1.9** Before consulting formally, we discussed our implementation approach with the industry, consumer representatives and the independent FCA statutory panels representing the interests of firms and consumers. We have benefited greatly from the views of two industry workings groups.<sup>2</sup> These discussions revealed a strong preference for the approach outlined in this paper.
- 1.10** Our implementation proposals are outlined in detail in Chapter 2, which provides an overview of the areas in which our existing rules will change. This will interest firms dealing with first charge mortgages, who are already subject to our mortgage regime. It will also be relevant to firms dealing with second charge mortgages, who will be subject to our mortgage regime for the first time.
- 1.11** For completeness, Annex 3 lists the areas where we have not made changes to our rules because we believe they already meet the MCD requirements.

### **Second charge mortgages**

- 1.12** Second charge mortgages are currently regulated as consumer credit. Following the government decision to move the regulation of second charge mortgages into our first charge mortgage regime when the UK implements the MCD, we are consulting on the rules that we propose to apply. As well as implementing the MCD for second charge firms, we propose to apply some additional protections from our first charge mortgage regime, which we believe are appropriate to protect consumers in the second charge market.
- 1.13** We recognise that second charge mortgages are beneficial to some consumers. However, we are aware of various poor practices that have put consumers at risk, such as poor sales practices, affordability assessments and the treatment of customers in payment difficulties. Our analysis indicates that consumers are subject to similar, and in some areas heightened, risks compared to those in the first charge market, particularly given the predominance of second charge mortgages taken to consolidate debt. The degree of risk is illustrated by arrears rates for second charge mortgages, which are significantly higher than for first charge mortgages. Given the risk of consumer harm, we want to embed good practice and ensure that past poor practice cannot re-emerge.
- 1.14** Our proposals for second charge lending can be found in Chapter 3, and our proposed approach to the authorisation of second charge lenders and intermediaries can be found in Chapter 6.

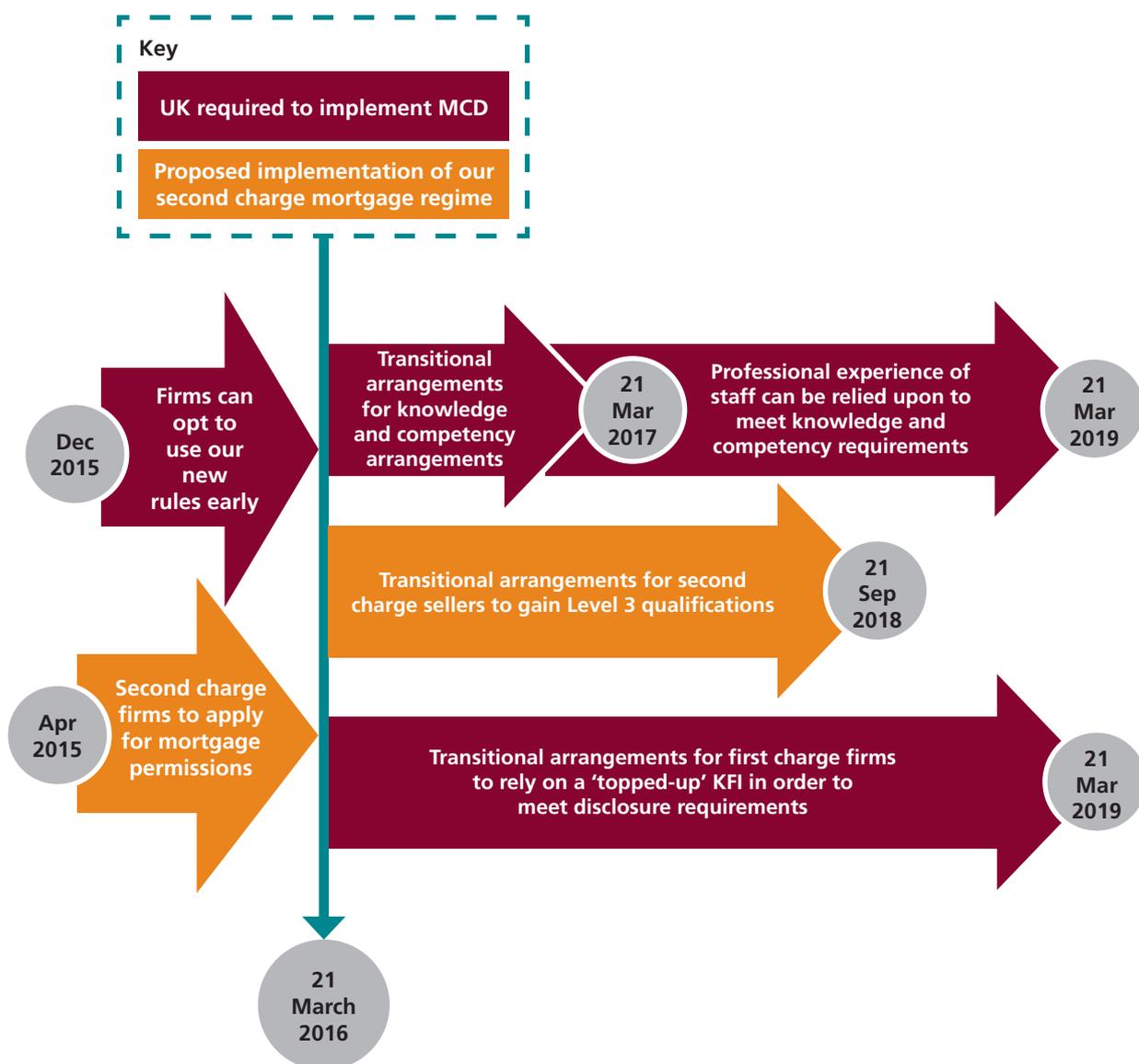
### **Additional MCOB changes**

- 1.15** This consultation also covers a number of areas where we propose to strengthen consumer protection and ensure consistent practice across both first and second charge lending. This includes proposals on disclosure of alternative finance options, provisions on the fair treatment of customers with payment shortfalls and rules on information sharing between charge holders. These changes to MCOB are outlined in Chapter 5.

<sup>2</sup> The following firms were members of one or both of these working groups: Lloyds Banking Group, HSBC, GE Money Home Lending, Coventry Building Society, Newbury Building Society, Principality Building Society, Freedom Finance, V Loans, London & Country Mortgages, Nemo Loans, Central Trust, Shawbrook, Paragon Group, Exact, Prestige Finance, L&G, Norton Finance and Virgin Money

**Timetable of changes**

**1.16** A summary of the key milestones for firms is set out below. Further details of the transitional arrangements under the MCD are explained later in this CP (see paragraph 2.54).



**Further detail on transposition**

**1.17** The Treasury has recently published a consultation<sup>3</sup> that sets out details of the legislative changes necessary to implement the Directive and move second charge mortgages from the interim consumer credit regime into our mortgage regime, including existing second charge mortgages.

**1.18** Where the MCD introduces a new prudential duty, the Prudential Regulation Authority (PRA) will impose the requirements on the firms that they prudentially regulate. The PRA will be consulting on changes to their rules separately.

<sup>3</sup> Treasury consultation 'Implementation of the EU mortgage credit directive' (September 2014).

### Consultation scope and compatibility with FCA objectives

- 1.19** This consultation does not address any matters relating to activity that is defined in the Treasury's consultation paper as 'consumer buy-to-let'. We will consult as appropriate on any changes to our regulatory framework which might be required for us to supervise this type of activity.
- 1.20** This consultation also does not consider the regulatory fees that second charge firms will pay to us. We will be consulting on our proposed approach to fees for second charge firms as part of our annual consultation on fees in October.
- 1.21** We are not using this consultation to set out how we might apply relevant minimum knowledge and competency requirements to firms passporting into the UK. Any proposals on this topic will be subject to later consultation.
- 1.22** The transfer of second charge mortgage activity from our consumer credit regime to the mortgage regime will mean that we need to make some changes to the Consumer Credit Sourcebook (CONC) to reflect this. These changes are not considered in this consultation paper. We will consult on these changes in a separate consumer credit consultation paper planned for December.
- 1.23** The MCD contains complaints handling requirements for firms and requires cooperation between Alternative Dispute Resolution (ADR) entities where there is a cross-border complaint. We plan to consult on changes to our dispute resolution rules to implement MCD and the ADR Directive in the autumn.<sup>4</sup>
- 1.24** For a full breakdown of how all our proposals support our objectives please see the compatibility statement in Annex 2.

### Equality and diversity considerations

- 1.25** We have conducted an assessment of the likely equality and diversity impacts of the proposals and we do not think they give rise to any concerns. We would welcome comments from any interested parties.

### Next steps

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#### What do you need to do next?

- 1.26** We want to know what you think about the proposals in this paper. Please respond to our questions by 29 December. You can find a consolidated list of questions in Annex 4.

#### How?

- 1.27** Please respond to this consultation by using the online response form on our website or write to us at the address on page 2.

#### What will we do?

- 1.28** These proposals are driven by our need to implement the MCD by 21 March 2016. To give firms sufficient time to prepare for implementation, we will consider your feedback and aim to publish our rules in a policy statement by the end of Q1 2015.

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<sup>4</sup> European Directive on Alternative Dispute Resolution (ADR) (2013/11/EU)

## 2. Mortgage Credit Directive

### Introduction

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- 2.1** This chapter sets out our approach to implementing the Mortgage Credit Directive (MCD). The MCD covers both first and second charge loans, so this chapter describes our policy approach to both markets. Chapter 3 describes our detailed proposals for regulating second charge mortgages.

### Background

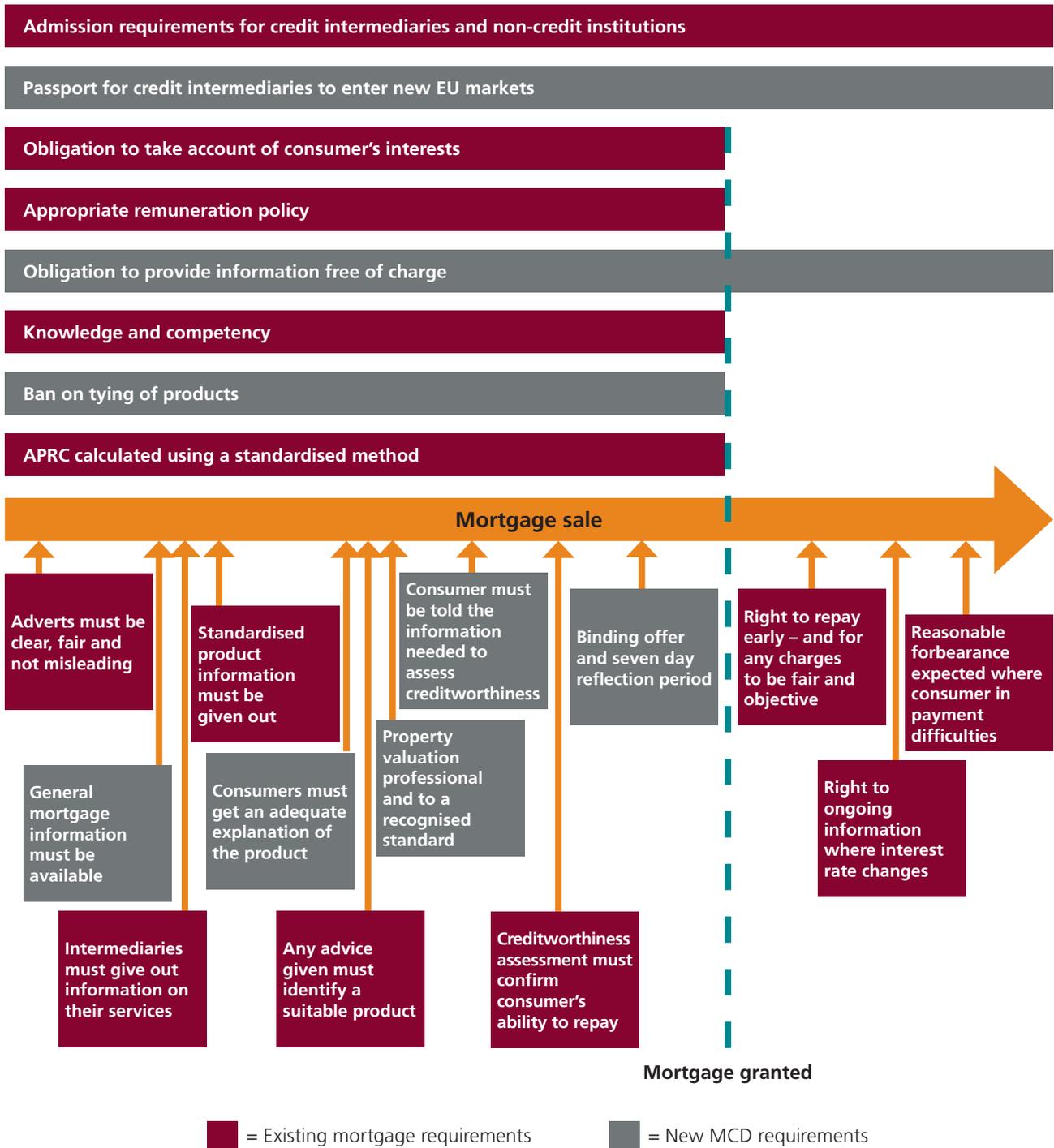
- 2.2** The MCD introduces a framework of conduct rules for mortgage firms. We already have mortgage rules and guidance in place in many of the areas covered by the MCD. Figure 1 summarises the key regulatory standards introduced by the MCD. The shading shows how many of the MCD requirements are on issues already covered by our national regulation. This means that there are several aspects of the MCD where we propose making no changes to existing regulation. Annex 3 summarises these. For several other parts of the MCD we are able to satisfy the directive by only making some minor tweaks to our rules rather than wholesale changes.

### Scope

- 2.3** Exemptions in the MCD mean we can avoid imposing new rules on certain types of lending, such as:
- **Lifetime mortgages** – the distinctly different nature of lifetime mortgages, for example, with interest typically rolling up, is recognised by such loans being exempted from the MCD. We think it appropriate to apply this exemption, but to do so we need to amend the current Handbook definition of a lifetime mortgage as it differs slightly from the approach in the MCD (see the draft Glossary definition in Appendix 1). In particular this new definition removes any link with the age of the target market for the product. The MCD definition also puts beyond doubt that equity release loans requiring regular repayments of capital are not lifetime mortgages. This has implications for new so-called ‘hybrid mortgages’. We have been discussing these products with the Equity Release Council and will provide an update on our thinking in the feedback statement.
  - **Bridging loans** – the specific issues raised by short term lending are reflected in there being an MCD exemption for bridging loans. We can make use of this exemption to carry on applying more tailored requirements for such lending. However, the MCD exemption is narrower than our existing Handbook definition of bridging loans and so there will be some bridging loans where we will need to apply the MCD obligations.
  - **Credit union mortgages** – an MCD exemption for credit unions allows us to avoid imposing new requirements, but credit unions will still have to meet our existing rules.
  - **Overdrafts lasting less than one month** – while there are likely to be very few loans of this kind it might be a useful exemption for some specialist lending, such as for secured overdrafts for high net worth consumers.

- **Business lending** – while we are not proposing regulatory change it is worth emphasising that the MCD largely excludes business borrowing (as do our existing rules).

*Figure 1 – Key MCD interventions and a comparison with our existing mortgage rules*



- 2.4** Where the MCD does not apply, we still want to allow firms to adopt the MCD standards voluntarily. There is just one area where we have decided not to allow this. A firm selling lifetime mortgages will not be able to choose to use the MCD disclosure document (the European Standardised Information Sheet – or ESIS) rather than a lifetime mortgage Key Facts Illustration (KFI). We consider a disclosure document designed with lifetime mortgages in mind better serves consumers.

### **Product disclosure and the Annual Percentage Rate of Charge (APRC)**

- 2.5** The MCD largely establishes minimum standards for mortgage sales. However, in two areas (product disclosure and the APRC) maximum harmonising standards are set. On these two topics we need to replicate the MCD requirements.

#### **Product disclosure content and ‘topping up’ the KFI**

- 2.6** The ESIS is a prescribed and standardised product disclosure document designed to help consumers shop around. The MCD allows Member States until 21 March 2019 to make the transfer to the ESIS where there is an equivalent national disclosure regime already in place.
- 2.7** To take advantage of the transitional provision, our existing national disclosure document – the Key Facts Illustration (KFI) – needs to provide equivalent information. There is a high degree of equivalence between the KFI and the ESIS; however, to ensure the same content is addressed, we believe it will be necessary for firms who intend to keep using the KFI for the transitional period, to make three extra disclosures. These ‘top-up’ disclosures cover:
- information on the new seven day right of reflection period the MCD introduces (see paragraph 2.19)
  - where applicable, extra information for foreign currency loans, including an illustration of the impact of a 20% change in the exchange rate and new rights introduced for foreign currency borrowers because of the MCD (see paragraph 2.47)
  - information for consumers on the potential impact of interest rate changes, describing both the APRC and monthly payments should interest rates rise to the highest level seen in the past 20 years
- 2.8** This ‘top-up’ information (see MCOB TP 42) should be provided with the KFI, but to reduce the cost for firms and consumers we propose that it need not to be part of that document. Our approach to this ‘top-up’ information is to express it in similar terms to the ESIS requirements because eventually that is the form of disclosure all firms will need to provide. However, it might be that respondents can see alternative means of achieving the same objective of the disclosure being equivalent to the specific ESIS requirement.
- 2.9** The ESIS transitional is not open to second charge firms as there is currently no equivalent national disclosure regime in place. For this lending, there is no alternative to meeting the ESIS requirement from 21 March 2016.

**Q1: Do you agree with our proposed approach to implementing the transitional arrangements by requiring ‘top-up’ disclosure?**

**Q2: What, if any, might be the alternative approaches that would allow us to meet our legal obligations when implementing the transitional?**

**2.10** We have drawn up several example ESIS documents. These show how a firm could illustrate common loan types and features. However, each firm will need to satisfy itself that their ESIS meets the new requirements. The example documents are in Appendix 2.

**2.11** There is no freedom to amend the form or content of the ESIS; however, there is some scope for us to provide further guidance on the instructions that go with the template. From discussions with firms and sourcing systems providers we have identified a few areas where we believe this would be helpful. These additions should help firms understand the new disclosure obligations. For example, we have provided guidance to clarify how to use the ESIS to illustrate multi-part mortgages. The ESIS instructions on which we are consulting are a direct 'copy out' from the Directive. We would welcome views on whether it would be useful to present these instructions in standard Handbook format, cross-referencing to defined terms.

**Q3: What difficulties, if any, can you see with using the ESIS instructions and template (see MCOB 5A Annex 1R and 2R) to prepare pre-sale mortgage illustrations?**

**Q4: Do you have views on whether the ESIS instructions should be drafted in standard Handbook format?**

**2.12** The MCD requirements on the accuracy of cost information are less prescriptive than our current standards. This provides an opportunity for some simplification, replacing the current detailed tolerances allowed for different types of firms. Our proposed approach is instead aligned with PRIN 7 and the MCD obligation for all advertising and marketing to be fair, clear and not misleading.

**Timing of the disclosure**

**2.13** The MCD requires firms to give out the ESIS in good time before the consumer can accept any offer. The default position is that the ESIS is given alongside the binding offer made by the lender. However, there is flexibility in the directive allowing us to require the ESIS to be given earlier. We propose to take advantage of this and to keep the same timing triggers as for the delivery of the KFI, for example, when advice is given or the consumer has provided details of a product they would like to proceed with on an execution-only basis.

**2.14** We believe this increases the usefulness of the disclosure as a shopping around tool. However, because of the way the MCD is drafted adopting this approach means we will only be able to require the product disclosure to be re-stated at offer stage where there has been a change in the deal. We understand from discussion with industry stakeholders that firms are likely to continue to provide a product disclosure document as part of every offer, even if this won't always be a regulatory requirement.

**Conditional and binding offers**

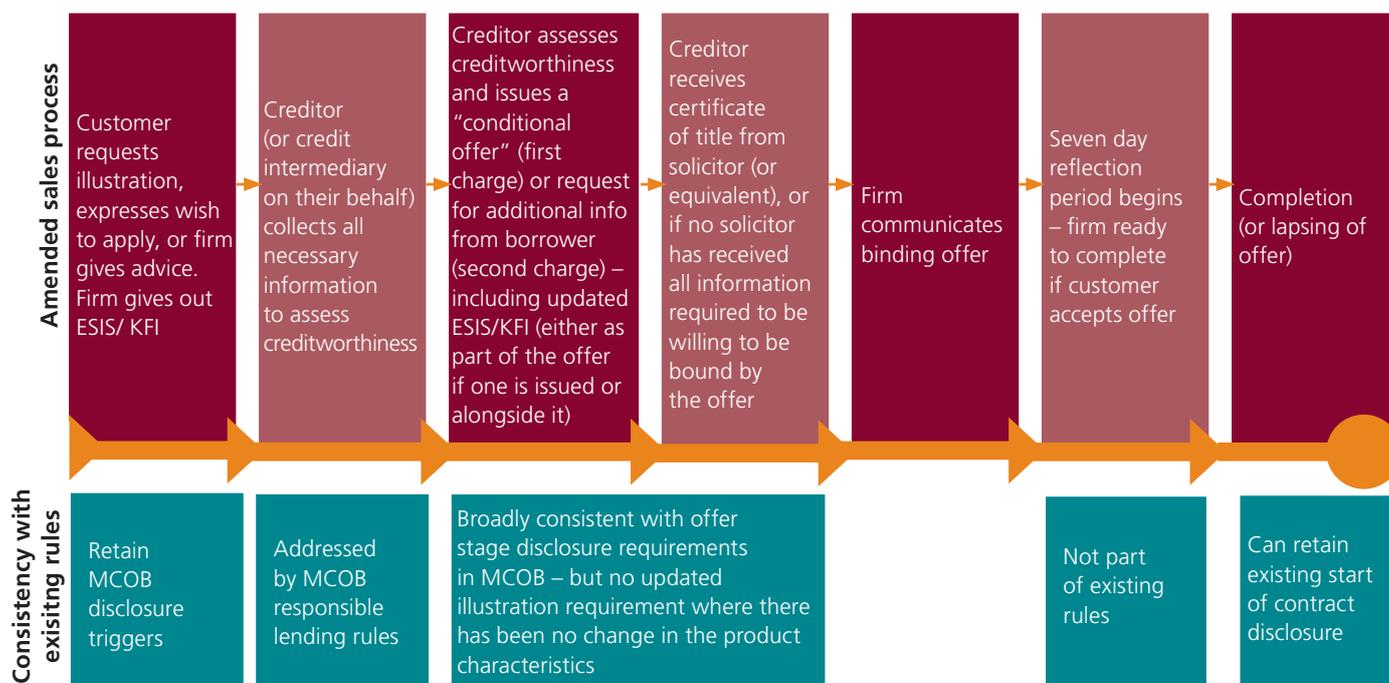
**2.15** The MCD requires lenders to make a binding offer, whereas in the UK market it is common practice for lenders to first make conditional offers that are then subject to varying degrees of due diligence. These conditional offers can be useful for consumers. They show a willingness in principle to lend (which can be helpful, for example when making an offer to buy a property).

**2.16** Under our existing rules mortgage firms can provide conditional offers, which the lender clearly presents as being subject to further checks. The MCD does not prevent such offers. However,

the directive is clear that the consumer must ultimately receive an offer that does not contain such conditions. This may well be a new step for firms.

**2.17** Our discussions with stakeholders have identified a means of transposing the MCD requirements while minimising complications to the existing sales approach or introducing significant new cost and delay. Figure 2 shows how we intend to approach the requirement. As now, firms will be able to make a conditional offer and then carry out the further actions they need to satisfy themselves that they are willing to lend on the terms indicated. At a point when they have completed their due diligence, there will have to be a new step. The firm will need to make its offer binding. Our draft rules allow the firm to make this binding offer in a new document, or simply confirm the details already given in a conditional offer. We propose leaving it to firms to establish the precise trigger for their making this binding offer, it could, for example be when obtaining references and a satisfactory survey, equally it could be when receiving the certificate of title from the solicitor.

**Figure 2 – the proposed post-MCD sales process**



**2.18** The MCD focus on there being a binding offer supported by an ESIS will mean firms need to review their approach to loans made available in stages (typical examples being self-build mortgages or mortgages with retentions). One possibility might be to make a binding offer for the full anticipated amount. The alternative would be to treat each tranche as replacing the previous loan, requiring a new ESIS each time. We have added guidance (see MCOB 6A 3.7G) to explain how a firm might approach the new requirement.

**Q5: Do you agree with the proposed approach to implementing the MCD requirement for a binding offer?**

**Consideration period**

**2.19** The binding offer is also the starting point for a new requirement for consumers to have time to reflect on the offer. This period has to be of at least seven days from the making of the binding offer and can either be a reflection period before entering the contract or a right of withdrawal after the contract. Member states have to choose one of these two options. We propose to

require a compulsory pre-sale seven day period of reflection as this will be much less disruptive for property sales. In line with the directive, our draft rules also set out that the consumer can accept the offer at any point during this reflection period.

- 2.20** When giving out the binding offer, the MCD requires that consumers should also receive a draft of the credit agreement. Many firms combine the offer and the credit agreement, so complying with this obligation should be straightforward.
- 2.21** The MCD does not go into detail on the form of notice the lender has to provide for the reflection period, or how the consumer must exercise their option to end the period early. Rather than being prescriptive, we propose not to add to the MCD in this area. Instead firms need to ensure that they can evidence how they told consumers about the reflection period and record those instances where the consumer chooses to waive the reflection period.

**Q6: Do you agree that the MCD consideration period is better enacted as a pre-sale reflection period, rather than a post-sale cooling-off period?**

#### **Annual percentage rate of charge (APRC)**

- 2.22** Our existing mortgage rules standardise the way in which firms calculate the annual percentage rate of charge. For loans covered by the MCD, these rules will need to reflect the method now set down in the directive. Although expressed differently from the formula in MCOB 10, the approach to calculating the APRC is very closely aligned with our existing rules. It also closely follows the approach of the Consumer Credit Directive as transposed in our Consumer Credit sourcebook (CONC). There are some minor differences in the assumptions used, to address the different features of borrowing such as secured overdrafts and shared equity agreements.
- 2.23** We propose to copy out the MCD approach to the APRC in full as new MCOB 10A. This means MCOB will contain two different sections on the calculation of the APRC, with firms needing to identify which approach to follow.

**Q7: Would it simplify matters, for example in terms of the compliance obligations for firms, to apply the MCD approach to the APRC calculation to all lending rather than just that covered by the directive?**

- 2.24** A more significant difference is that the MCD introduces a need for a second APRC where borrowing is on a variable rate. This second APRC forms part of the ESIS, and is part of the proposed 'top-up' where a firm is still using a KFI (see para 2.7). Where the variable interest rate tracks an external reference rate (such as the Bank of England base rate – often abbreviated to BBR) the second APRC has to use a 20-year high of that reference rate.
- 2.25** In other circumstances, the MCD requires us to set a benchmark rate for any firm to use for their second APRC. We propose that this benchmark should be the difference between the current BBR and the highest level of BBR over the past 20 years, with this being added to the reversionary interest rate for the mortgage in order to calculate the second APRC. So, for example, for its second APRC a firm with a current reversionary rate of 5% would currently need to add a further 7% to the applicable interest rate (7% being the difference between current BBR of 0.5% and the 7.5% level of BBR that applied for some time in 1998).

**Q8: Do you agree with our proposed approach to specifying a benchmark that firms may need to use when calculating a second APRC?**

- 2.26** The European Commission is developing a calculator tool to help firms meet the new obligations. This will give further information on the detailed approach, and allow firms to sense check the approach they are adopting. However, the forthcoming availability of a calculator will not mean changes to the MCD content so firms can begin preparing for the APRC requirements now.

### Other presale disclosure obligations

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#### Financial promotions

- 2.27** The MCD provisions are similar to our existing advertising rules. The key aim is that any advertising must be fair, clear and not misleading. The MCD also introduces a requirement for firms to provide a full representative example of the mortgage costs if advertising mentions an interest rate or anything to do with the cost of the loan (such as the monthly amount).
- 2.28** The implementation of the MCD also gives us the opportunity to review and simplify our advertising rules, not just for mortgages, but also for home reversions and home purchase plans. We propose a number of changes that should allow firms to be more flexible and innovative while continuing to ensure a high standard of consumer protection. This includes removing the requirement for a generic risk statement, or for the APRC to be shown in adverts targeting those with restricted access to credit. We believe this is appropriate for mortgages because of the relatively limited role advertising plays in the purchasing decision. This is very different from the role of advertising for some other financial services, including unsecured credit.
- 2.29** We propose to bring together the requirements on communications and financial promotions, in line with changes made to our rules on other products. These will now form part of the proposed MCOB 3A. These draft rules also significantly simplify the surrounding obligations on systems and controls. We believe we can do this because the current requirements in MCOB 3 largely repeat material found elsewhere in the Handbook and because of similar changes already made to the advertising rules for other products.
- 2.30** The replacement of MCOB 3 with MCOB 3A, and the deletion of MCOB 2.2, will mean minor consequential changes such as updating cross referencing to those provisions in the rest of MCOB and the Handbook. This will be carried out separately and we do not propose to consult further on this.
- 2.31** Advertisers will, of course, still need to ensure their promotions are fair, clear and not misleading; and also that their promotions balance the presentation of risks.
- 2.32** We do not propose to make the same changes for the sale and rent back market. We have only recently developed our financial promotion controls in this area and we believe that they remain relevant to the particular risks and features of this market.

**Q9: Do you agree with our proposed approach to transposing the MCD requirements on financial promotions and the wider simplification of our rules in this area?**

#### Adequate explanations

- 2.33** The directive requires lenders and intermediaries to provide an adequate explanation of the disclosures made by the firm, the essential features of the product, any ancillary products and the impact on the consumer.

- 2.34** For firms conducting advised sales, the MCD requirements should not require major changes to existing processes. However, the impact is likely to be greater for execution-only sales. The MCD recognises that the manner and the extent of the explanation can vary depending on the circumstances of the sale. It might mean, for example, firms designing their online sales channel so it includes a 'walk through' guide to any ESIS they give out.

**Q10: What challenges do you see in providing consumers with an adequate explanation, for example in an execution-only sale?**

**General information**

- 2.35** We propose to copy out MCD requirements for firms to make available general information about mortgages, e.g. how they work and the costs and the choices involved in borrowing.
- 2.36** The information can be on paper, another durable medium, or in electronic form, so firms might choose to provide this information on a website.

**Intermediary service disclosure**

- 2.37** The MCD requires intermediaries to provide information on their services in good time before providing the service. Implementation of these requirements will result in some minor changes to the content of the key disclosures. In particular, where an intermediary has ties to either one or a group of lenders they will now need to name these lenders. Firms paid by commission must tell consumers that they have the right to ask for information on the commissions paid by different lenders, and ensure that they have access to relevant market data to allow them to respond to such a request. The MCD will also mean firms having to consider the wider market to which the MCD applies when describing the limitations on their product range.
- 2.38** Many of these new intermediary disclosures must be in writing or made using a durable medium. This will pose particular challenges for telephone sales and online channels. However, many firms who use these channels have already developed means for providing information in writing as the sale progresses. For example, they might ask the consumer for an email address and send them relevant details as the telephone sale continues. It would be possible to use a similar approach to satisfy the new MCD requirements. We do not intend to change the current approach of requiring oral disclosure of the key messages where there is spoken interaction.

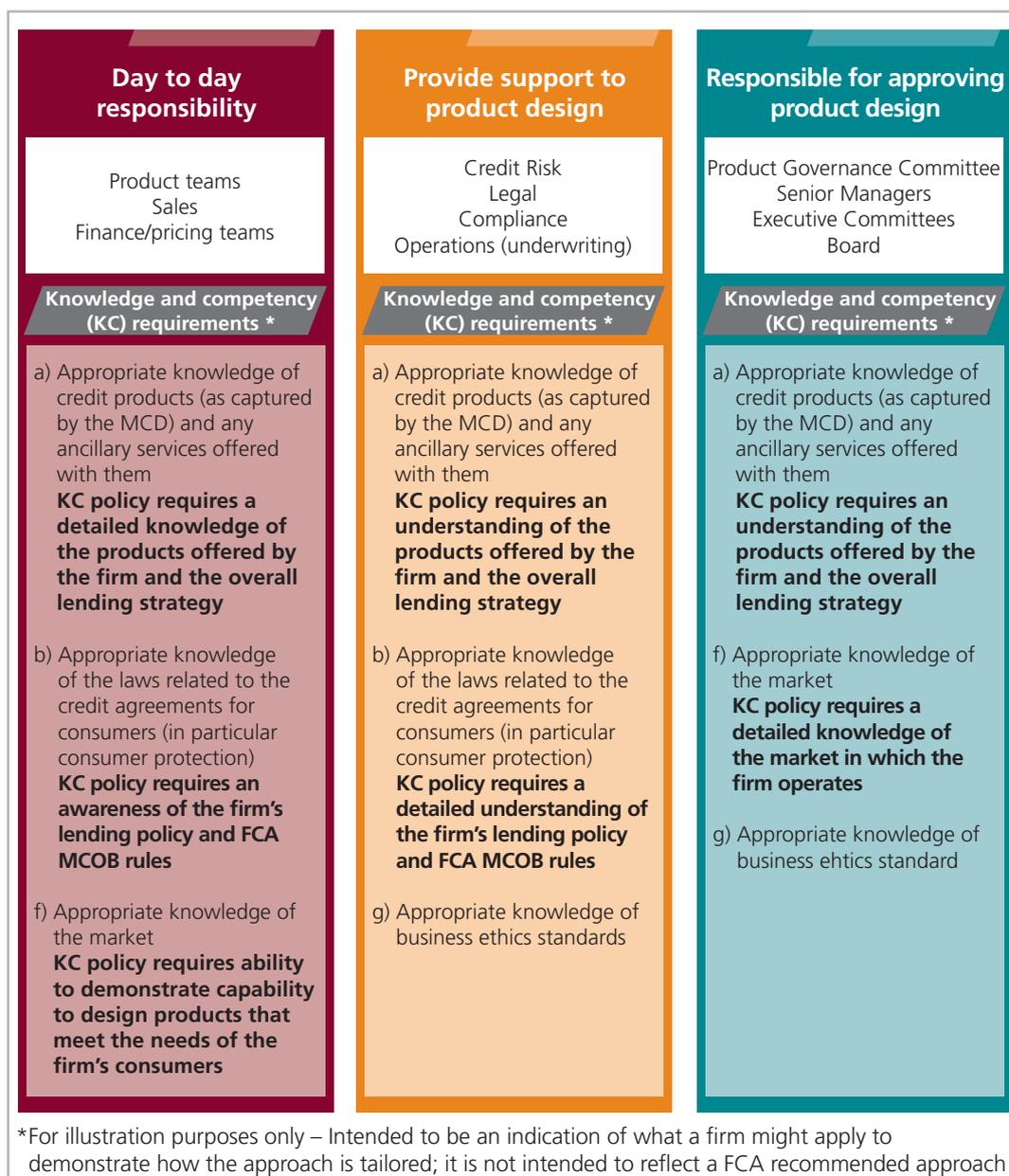
**Conduct requirements expanded by the MCD**

**Knowledge and competency**

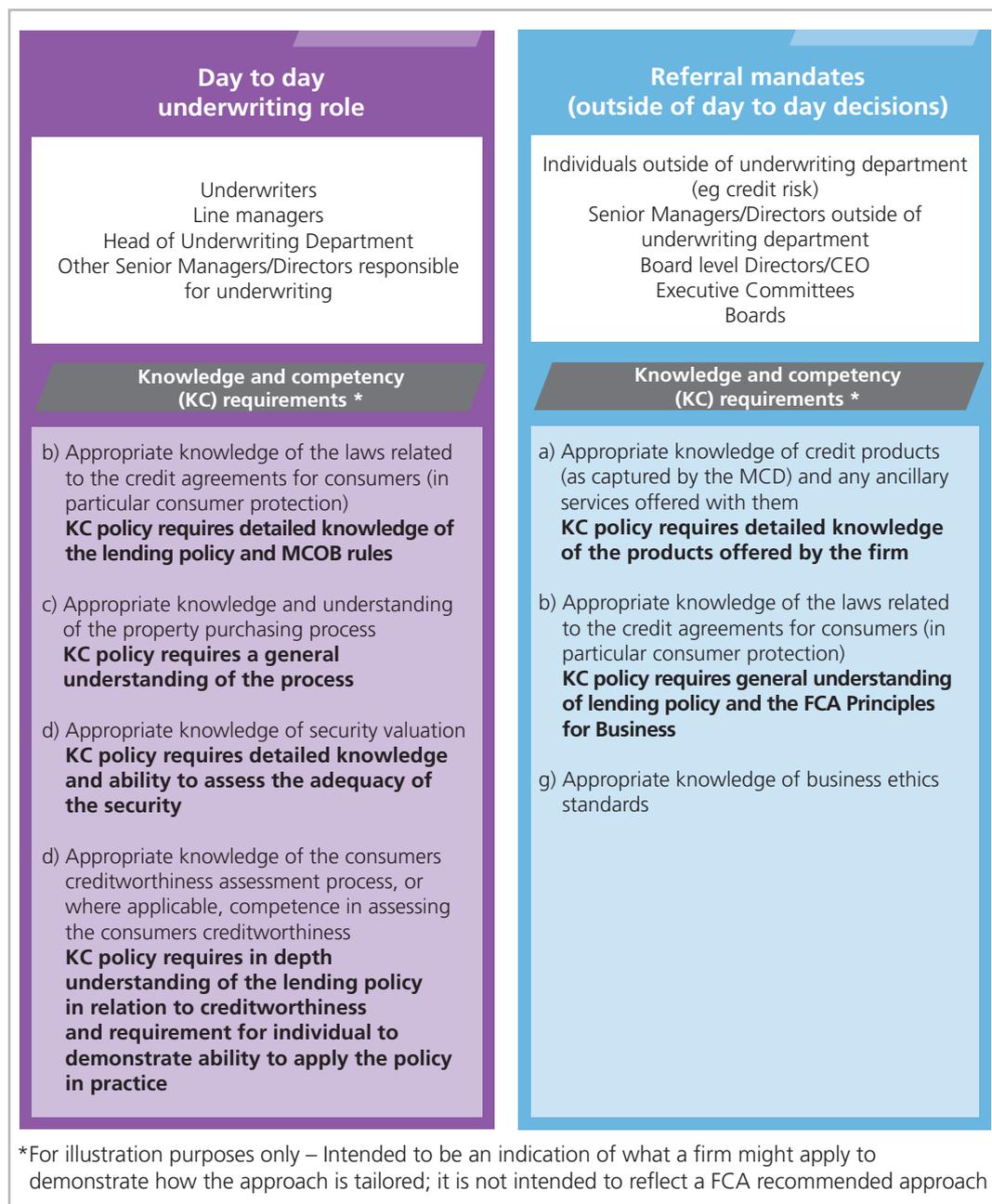
- 2.39** The MCD sets minimum standards of professionalism for mortgage lenders and intermediaries, those involved in the manufacture of mortgages and those involved in granting loans. The Directive lists nine areas of appropriate knowledge (including the loan products offered, the property sales process, valuations, ethics and assessing affordability).
- 2.40** Our existing mortgage rules require all sellers to have a level 3 qualification. We consider that those with the existing qualification will meet the MCD standard.
- 2.41** However, for those involved in the manufacture of mortgages or granting credit, our existing high-level competency requirements in the Training and Competence (TC) Sourcebook will not meet the MCD standard. We propose to add the MCD requirements into TC (see TC 2.1). Those involved in the manufacture of mortgages or granting credit will not be required to get a specific qualification, although they might choose to obtain a similar qualification to mortgage sellers.

**2.42** The MCD recognises that roles in mortgage firms vary and not all require the same types of knowledge. Our proposed rules allow each lender to consider the role each individual performs and determine which areas of knowledge are required. Figures 3 and 4 provide an illustrative outline of how a firm might go about this. The MCD allows an extra year (until 21 March 2017) for individuals to reach the required standards and our rules reflect this.

**Figure 3 – an approach to knowledge and competency for individuals with a role in the manufacture of mortgages**



**Figure 4 – an approach to knowledge and competency for individuals with a role in granting mortgages**



### Tying and bundling

#### 2.43

'Tying' describes an arrangement where a mortgage is only available if you also take out other financial products or services. The MCD bans this practice. Our proposed rules copy out the ban as well as the available exemptions, which allow a firm to:

- require a tied payment or savings account (either to allow the credit to be repaid or to provide added security for the lender)

- require an investment or pension product, again either to help in repayment or to provide security. This could be a tied product from the same firm
- require a mortgage alongside a shared equity loan
- require an insurance policy e.g. buildings insurance (providing the consumer is free to get equivalent insurance from another firm), or
- sell a mortgage with another tied product or service where they can show, if challenged, a clear consumer benefit.

The final exemption does not mean that we will be pre-approving products; rather that the onus is on a firm to satisfy itself that it can prove the clear benefit of the tied product if we ask them.

### **Affordability**

**2.44** The MCD requires firms to conduct a creditworthiness assessment for every new loan, to ensure that it is affordable for the consumer. Our existing responsible lending rules for first charge firms already give effect to the MCD requirements; however, firms should be aware that there will be some changes to our rules:

- A lender will not be able to cancel or alter a credit agreement to the consumer's harm where they have failed to assess affordability adequately.
- Lenders will be reminded of their existing obligation under the Data Protection Act<sup>5</sup> to tell consumers about any use made of databases. This also covers the details of any database used where the information provided has caused the lender to decline the application.
- Lenders must set out in advance the information they need to consider any mortgage application. This information must be proportionate to the lender's assessment. Firms must also inform consumers of their obligation to provide correct information and that not providing this information will stop the lender from considering any application.

### **Early repayment**

**2.45** Although the ability to repay early is effectively universal in the UK, it has not been a specific right provided by mortgage regulation. The MCD changes this, introducing a right for full or partial early repayment. In other respects the MCD approach is similar to our existing rules, e.g. limiting any charges made by the firm to the costs that are linked to early repayment.

**2.46** The MCD also introduces a new disclosure obligation on firms where a consumer signals their interest in repaying early. The lender has to give the consumer relevant information on the implications of settling early, and where the lender needs to make assumptions to provide this information these assumptions need to be clear and justifiable.

### **Foreign currency mortgages**

**2.47** The MCD introduces significant new obligations for firms dealing in foreign currency mortgages. We intend to copy out these requirements in our rules and adopt the Directive definition of a foreign currency loan. The definition encompasses loans that are in a currency other than that of the consumer's income and also loans in a currency that differs from that in the country where the consumer is resident. So, for example, a UK consumer living in Spain but with a sterling mortgage on their UK property, would have a loan defined as a foreign currency mortgage.

<sup>5</sup> Section 12 of the Data Protection Act 1998 – Rights in relation to automated decision-making

- 2.48** The new rules include disclosure obligations for firms, both on the potential impact of exchange rate fluctuation, and subsequently if there is adverse exchange rate movement. In addition, lenders must put in place extra steps to protect consumers from exchange rate risks. These might include a right to convert the loan into an alternative currency or to otherwise limit the consumer's exposure to such risks.

**Q11: What do you consider will be the impact of the new MCD rules on the availability of foreign currency mortgages?**

### Other MCD changes

- 2.49** Several of the MCD obligations impose relatively minor change. These include:
- **Remuneration** – the MCD specifically highlights the need for remuneration arrangements not to cause a conflict with a broad duty on firms to take account of the consumer's interest when carrying out activities covered by the directive. The MCD also specifies the approach to this kind of conflict management for individuals who are either assessing loans or giving advice. To supplement this we propose to copy out the Directive's more detailed remuneration rules.
  - **Property valuations** – alongside the new conduct obligations introduced by the MCD, there are also some prudential requirements. Firms are required to use reliable property valuation standards and those carrying out property valuations must be professionally competent and sufficiently independent from the mortgage underwriting so they are impartial and objective. For the firms that we prudentially regulate, we will implement these requirements through changes to the MIPRU rules (see MIPRU 1.3). The PRA will consult separately on introducing these requirements for the firms that they prudentially regulate.
  - **Database access** – the MCD requires member states to ensure there is non-discriminatory access for creditors to databases used for responsible lending checks. We already regulate these databases. Rather than introducing new rules on this point we will expand our existing approach of using our threshold conditions to ensure databases do not discriminate in the access that they provide.
  - **Variable rate mortgages** – where lenders use indexes or reference rates as the basis for the interest rate they charge, the MCD requires that these are clear, accessible, objective and verifiable. There is also a need for historical records of any indexes used. The proposed rules place this obligation on lenders.
  - **Underwriting policies** – the MCD introduces a new requirement for lenders to keep records of the property types they will lend on as well as any related underwriting policies. We propose a new rule (see MCOB 11.6.21AR) to implement this.
  - **Interest rate changes** – our existing mortgage rules (see MCOB 7.6.1R) require firms to tell consumers about any changes in interest rate that lead to a change in payments. We need to make a small change to our disclosure rules on interest rate changes. Lenders will need to describe any impact of the change on the number of payments the consumer has to make. We expect there will be very few cases where this extra disclosure will arise.
  - **Professional indemnity insurance** – the MCD specifies new limits for the level of professional indemnity insurance held by firms (in a Regulatory Technical Standard developed

by the EBA<sup>6</sup>). The new levels proposed by the EBA are €460,000 for each individual claim, and €750,000 per year for all claims (see MIPRU 3 for our new rule). We don't plan to change the required level of any comparable guarantee used.

- **Passporting** – the MCD allows FCA authorised credit intermediaries to 'passport' into other member states without being subject to a new set of admission requirements from 21 March 2016. This gives mortgage intermediaries similar legal freedoms to those already afforded to investment and insurance intermediaries under EU law. The MCD imposes information provision requirements on intermediaries that are looking to passport, and obliges national competent authorities to cooperate in the exchange of this information and in supervising firms using their ability to passport (see the changes proposed to SUP 13, 13A and 14). The EBA is developing guidelines for national authorities to help them with the passporting notices.
- **Information free of charge** – the MCD prevents a firm charging for disclosure materials. We do not have an equivalent existing rule so we have drafted a new measure (see MCOB 2A.6.1R).
- **Information on the FCA register** – the MCD requires the FCA to include certain information about firms on its register, including the names of the persons within the management who are responsible for the intermediation business and whether a credit intermediary is tied or not. We have therefore drafted rules in MIPRU 2.2 to ensure that firms allocate responsibility for mortgage intermediation and in SUP 15.8 requiring firms to notify us where they become a tied credit intermediary.

### MCD lending not secured on the home

- 2.50** In addition to covering loans secured on residential property, the MCD also applies to a small subset of lending that is not secured in this way but which is used to acquire or retain property rights. Such loans may either be unsecured, or secured on commercial property or other assets. We do not believe that such lending exists on any significant scale in the UK.
- 2.51** HMT is proposing that such loans should remain as credit agreements, but should be excluded from the scope of 'regulated credit agreements'. As such, the Consumer Credit Act 1974 (CCA) will not generally apply to such loans, and they will be covered instead under MCD plus relevant parts of MCOB and CONC.
- 2.52** Our proposed approach to this lending is to create a new chapter within MCOB detailing the requirements that will apply to this kind of lending. The requirements will be largely derived from the MCD, together with important conduct protections from the existing mortgage and consumer credit regimes. In some cases, firms will be required to comply with specific provisions in MCOB or CONC. In other cases, where they provide comparable protections for consumers, firms will be able to elect which set of provisions to comply with. This is intended to allow greater flexibility for firms and minimise regulatory burdens.
- 2.53** Our proposed MCOB 14, illustrative of our high-level approach, can be found at Appendix 1, and we will consult on the detail of the interface between MCOB and CONC and consequential changes to CONC in a separate consumer credit consultation paper planned for December. We welcome input from stakeholders to aid in developing this approach further.

<sup>6</sup> [www.eba.europa.eu/regulation-and-policy/consumer-protection-and-financial-innovation/draft-regulatory-technical-standards-rtss-on-professional-indemnity-insurance-pii-for-mortgage-credit-intermediaries](http://www.eba.europa.eu/regulation-and-policy/consumer-protection-and-financial-innovation/draft-regulatory-technical-standards-rtss-on-professional-indemnity-insurance-pii-for-mortgage-credit-intermediaries)

**Q12: What do you think will be the impact of this approach on firms and consumers?**

**Q13: What, if any, might be alternative approaches that would allow us to meet our legal obligations when implementing the Directive for this type of lending?**

### Transitional arrangements

**2.54** Member states have to transpose the MCD by 21 March 2016. There are only a few exceptions to this date, which we have largely described already in this paper. They are as follows:

- One further year, until 21 March 2017, to comply with the MCD requirements on knowledge and competency.
- One further year, until 21 March 2017, for credit intermediaries that have not previously been subject to national mortgage or consumer credit regulation to meet the MCD standards. Because the UK has long regulated credit and mortgage markets, we consider it unlikely that there will be intermediaries for whom this extra year is available.
- Three further years, until 21 March 2019, for first charge mortgage firms to make the changeover from the KFI to the ESIS.
- Three further years, until 21 March 2019, for firms to move away from purely using professional experience as the means of assessing knowledge and competency.

**2.55** To allow firms time to smooth the introduction of changes driven by the Directive we propose to turn on the MCD rules from 21 December 2015. From this date firms would be able to choose to start applying the MCD rules to new business in preparation for the 21 March 2016 implementation date.

**Q14: Do you consider that the proposed transitional approach is effective in allowing firms to prepare early for the implementation of the MCD?**

### Further detail on transposition and the wider international context

**2.56** Besides the MCD there are other relevant international initiatives on the conduct of the mortgage market. In response to the recent financial crisis the Financial Stability Board (FSB) reviewed mortgage underwriting standards<sup>7</sup> and subsequently adopted a set of principles for sound mortgage underwriting.<sup>8</sup> We have actively contributed to this work.

**2.57** The MCD specifically recognises how the FSB work on underwriting informs the Directive's requirements on lending standards. The European Banking Authority (EBA) has also adopted an Opinion on responsible mortgage lending, which reinforces the FSB's approach.<sup>9</sup> This Opinion complements the MCD and develops the FSB principles by describing examples of good lending practices.

<sup>7</sup> Thematic Review on Mortgage Underwriting and Origination Practices - Peer Review Report. FSB. 17 March 2011

<sup>8</sup> FSB Principles for Sound Residential Mortgage Underwriting Practices. FSB. 18 April 2012

<sup>9</sup> Opinion on good practices for responsible mortgage lending. EBA. 13 June 2013

- 2.58** The EBA is now embarking on an exercise of reassessing the content of this Opinion. Potentially it will convert relevant content into EBA guidelines setting out how financial institutions should meet obligations on creditworthiness in MCD Article 18. There will be a 'comply or explain' obligation on national supervisors as well as a requirement on financial institutions to comply with the guidelines.
- 2.59** Given these developments it makes sense for us to consider both the FSB and EBA approaches when transposing relevant MCD obligations. In a similar vein, we have closely considered the EBA's 2013 Opinion on the fair treatment of borrowers in payment difficulties<sup>10</sup>, whose publication we welcomed. The EBA highlighted this Opinion as relevant to national transposition of the obligations on arrears and foreclosure set out in MCD Article 28. We understand the EBA also intends to review the Opinion with the possibility of converting relevant parts into guidelines. Our proposals for implementing the MCD therefore also aim to deliver the requirements set out in the EBA Opinion.
- 2.60** We will contribute to the further EBA work, and there will be a chance for firms and consumers to comment during public consultation on any EBA guidelines. We will keep under review the need for any changes to our proposals (although we think such changes are unlikely).

#### **Draft Rules**

- 2.61** The draft instrument that sets out the rule changes required to implement the MCD can be found in Appendix 1. This should be read in conjunction with our existing MCOB rules, which can be found in our Handbook.

**Q15: Do you have any comments on the draft rules in relation to implementation of the MCD set out in the draft Mortgage Credit Directive Instrument 2014 at Appendix 1? Do you agree that the rules reflect the stated policy intention?**

<sup>10</sup> Opinion on good practices for the treatment of borrowers in mortgage payment difficulties. EBA. 13 June 2013

## 3.

# Our proposed approach to second charge mortgages

### Background

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**3.1** The government has confirmed its intention to move the regulation of second charge mortgages into the regulatory regime for mortgages rather than the regime for consumer credit.<sup>11</sup> This move will take place when the UK implements the MCD on 21 March 2016. At this point, second charge mortgages will move from our interim consumer credit regime into our mortgage regime. This will be achieved through the Treasury amending Article 61 of the Regulated Activities Order (RAO) to extend the definition of a *regulated mortgage contract* to include second charge mortgages.

**3.2** This chapter sets out how we propose to apply our mortgage regime to second charge mortgages.

### Our approach to regulating second charge mortgages

**3.3** We want to ensure that our regulatory regime for second charge mortgages results in a market that is flexible and sustainable, encouraging competition and innovation, and meeting consumer needs, while ensuring that consumers (many of whom may be in potentially vulnerable financial circumstances) are adequately protected from unfair and irresponsible practices.

**3.4** As described in Chapter 1, the MCD applies equally to first and second charge mortgages, so we must apply MCD requirements in full to second charge mortgages. In addition, we propose to apply most elements of our existing mortgage regime to second charge mortgages, because we believe that they pose very similar risks to consumers as first charge mortgages – most significantly that the consumer might lose their home. In some respects the risks might be greater, given the predominance of debt consolidation mortgages. Our approach is strongly supported by consumer representatives.

**3.5** The move into our mortgage regime will result in second charge mortgages being removed from the consumer credit regime and generally speaking from the Consumer Credit Act (CCA). While this will mean some consumer protection measures no longer apply<sup>12</sup>, we believe that these will be replaced with more appropriate measures specifically designed to protect consumers with mortgages. We believe that moving away from the CCA measures will also facilitate a more flexible and open second charge mortgage market, with more competition, that is better placed to meet the needs of consumers. We are seeking views on this approach through this consultation.

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<sup>11</sup> Treasury consultation '*Implementation of the EU mortgage credit directive*' (September 2014).

<sup>12</sup> Such as the unfair relationships test; restrictions on the charging of upfront fees; restrictions on early settlement fees; and the requirement for modifying agreements. Some of these protections will be retained for existing second charge loans. The Treasury consultation provides more detail on this (see section 2.3).

- 3.6** The conduct requirements for second charge mortgages will be set out in MCOB<sup>13</sup>, the section of our Handbook that sets out our conduct rules for mortgages. Second charge mortgages will fall under the definition of a *regulated mortgage contract*, so most MCOB provisions will apply to second charge mortgages, unless we decide to specifically not to apply the rule. Where this is the case, this will be made clear in the individual rules.
- 3.7** Given that most of the application of MCOB to second charge mortgages will be done simply by extending the definition of a *regulated mortgage contract*, which does not require a change to each MCOB rule, firms should look at all of MCOB, as well as the changes in set out in Appendix 1 to understand the proposed regime.

### **Second charge mortgage market**

- 3.8** The second charge mortgage market is currently relatively small. There has been a steep decline in lending since the start of the financial crisis, with current annual levels of lending (around £0.5 billion) perhaps a tenth or less than pre-crisis levels.
- 3.9** Although around 1,400 lenders and 4,500 intermediaries applied for an interim permission to carry out activities linked to second charge mortgages when consumer credit regulation was transferred to the FCA, we believe the number of firms actively engaged in the market is somewhat smaller. We estimate that there may be as few as 20-25 active lenders.
- 3.10** The average second charge loan made in the period 2005-2013 was £25,000-£30,000, smaller than the average first charge loan of around £137,000, although in some cases second charge mortgages can be made for much higher amounts. Interest rates tend to be significantly higher than for first charge loans, typically ranging from 9 and 13%<sup>14</sup>, but with some lenders' rates closer to 18%.

### **Consumer risks**

- 3.11** Second charge mortgages can be beneficial to consumers, allowing them to borrow money at rates that can be lower than unsecured lending, and without them needing to make any changes to their first charge mortgage. This provides flexibility, and the opportunity to fund home improvements, repairs, and other consumer spending, or raise capital for purposes such as funding businesses.
- 3.12** The most common purpose of a second charge mortgage is to consolidate debts. This can also be beneficial, as second charge interest rates can be lower than unsecured loans, and payment of the debt can be spread over a longer period, therefore reducing a consumer's outgoings and potentially leaving them in a better financial position. However, there are downsides – primarily the risk that they will lose their home if they cannot repay, but also the cost of spreading repayment over a longer term and the costs associated with payment difficulties. Our analysis indicates that around two thirds of second charge mortgages are used for debt consolidation.
- 3.13** We are aware of a number of poor practices that have been found in the second charge market, which can exacerbate risks to consumers. These include:
- the 'upselling' of loans (i.e. selling a bigger loan than originally requested by the consumer, therefore increasing the costs of the loan and increasing the risk of default)
  - selling loans without making the consumer aware that other options might be available

<sup>13</sup> Mortgages and Home Finance: Conduct of Business sourcebook: [fshandbook.info/FS/html/FCA/MCOB](http://fshandbook.info/FS/html/FCA/MCOB)

<sup>14</sup> Median interest rate during 2005-2013

- not making consumers aware of the consequences of taking out a secured loan (i.e. that they might lose their home)
- poor affordability assessments (e.g. some firms have assessed loans as affordable solely on the basis that a consumer's monthly outgoings will decrease if they consolidate debts – rather than assessing whether they can afford to repay)
- charging very high fees, particularly when a consumer is in payment difficulty

**3.14** These risks are particularly acute where loans are for debt consolidation. Consumers struggling to cope with debt may feel pressured to find a solution, without giving due consideration to the risks and alternatives. While consolidating debts through secured loans can be the right solution for some consumers where it is affordable, it can also prolong and exacerbate financial difficulties. As well as potentially stretching out the period over which the consumer pays interest, and so costing more in the long term, it can lead some into a spiral of debt where they repeatedly consolidate unaffordable debt through secured loans, rather than addressing debt problems, e.g. by seeking independent free debt advice. Ultimately, consumers can lose their homes when they run out of equity and can no longer borrow more to sustain repayments.

**3.15** The potential risks posed to consumers are illustrated by the high arrears rates for second charge mortgages.<sup>15</sup> For mortgages originated before 2008, around a third fell into arrears during the first year, and half suffered arrears at some point in the life of the loan. Arrears rate dropped materially for mortgages that originated from 2009-2012 (with 10-15% experiencing arrears in the first year, and a fifth to a third in total after origination), but are still significantly higher than the average for first charge mortgages, and comparable to the mortgages that formed the 'poor tail of lending' that our MCOB rules seek to address for first charge mortgages.

**3.16** Given the risks of consumer harm, we want to embed good practices and ensure that past poor practice cannot re-emerge. We intend to apply the key protections of our mortgage regime to second charge mortgages, given the potential risks, with the aim of ensuring that consumers enter into second charge mortgages only where:

- it is appropriate for them to do so
- they can afford it
- they are treated fairly if they fall into payment difficulties

**3.17** We expect our proposals to work for second charge firms, as we understand that most have already adopted similar practices to those that we are proposing (such as an income and expenditure-based affordability assessment based on evidence of income); or have expressed an appetite to do so (e.g. to provide advice). This is particularly true for firms that conduct both first and second charge business, where consistency of approach is likely to reduce costs.

#### **Timing of implementation**

**3.18** The proposed rules in Appendix 1 are drafted on the basis that they will come into force on 21 March 2016. However, we understand that firms will need time to make the proposed changes. We have little flexibility in our timetable for transposing the MCD by 21 March 2016. But we can decide when to implement the non-MCD elements of second charge mortgage regulation. It is difficult to unpick some MCD elements from the non-MCD elements, given that we are implementing some MCD requirements through existing MCOB rules, as in the case

<sup>15</sup> Based on FCA analysis of data supplied by a sample of firms. Details are in the CBA Annex 1.

of MCD creditworthiness assessment requirements. Nevertheless, there are discrete elements we could separate out, which may be helpful to firms to implement over a longer timetable. From our discussions with industry, we understand that specific areas where a staggered implementation might be helpful are:

- advising and selling standards (see paragraph 3.45)
- training and competence qualification requirements (see paragraph 3.120)
- data reporting (see Chapter 4)

**3.19** For us to make a decision on the implementation timetable we need to carefully consider whether a delay would be helpful for firms. It may be the case that implementing the proposals in more than one stage could actually lead to increased costs to firms (e.g. if they have to make two sets of systems changes). We must also consider the impact on consumers. We would like to gather views on both of these aspects.

**Q16: Are there any particular elements that you think should be implemented on a different timetable to MCD requirements? If so, which elements, and why, and to what timetable?**

#### **Pipeline**

**3.20** The government is still considering how the legislation can best support firms in managing their pipeline of loans in the transition to the new regime with the aim of minimising disruption to consumers and firms. We are working with the government on this.

#### **Existing second charge loans (the 'back book')**

**3.21** Second charge loans that are in existence when we implement the new regime will transfer into our new regime. This will mean that the proposed MCOB protections discussed below that apply during the life of the loan, such as post sale disclosure (e.g. annual statements), contract variations, charges, and payment shortfalls and repossessions will apply to existing loans, as well as to new loans made.

**3.22** However, certain existing protections will be retained for existing loans, including the restrictions on early settlement fees. This is because it would be unfair to remove such protections where there is an existing expectation that they will apply. Further details of this are set out in the Treasury consultation.<sup>16</sup>

### **Specific proposals for second charge mortgages**

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#### **Disclosure**

**3.23** The MCD will introduce significant changes to disclosure requirements, particularly in relation to pre-sales disclosure. The changes are explained in Chapter 2.

**3.24** As for first charge mortgages, we propose to implement these changes to second charge mortgages through new MCOB rules.

<sup>16</sup> Treasury consultation '*Implementation of the EU mortgage credit directive*' (September 2014). See section 2.3.

### ***Service disclosure***

- 3.25** We propose to apply the existing MCOB requirements around service disclosure to second charge mortgages, requiring firms to make an initial disclosure covering two key messages about their scope of service and remuneration. We think this is important so that consumers can form a view about the service on offer. Our MCOB rules (see MCOB 4.4A) provide further detail on this. In addition, as explained in Chapter 2, we also propose to introduce a third key message to highlight the range of alternative borrowing choices that may be available (e.g. a further advance or an unsecured loan).
- 3.26** These key messages have to be clear and prominent, and made orally where there is spoken contact with the consumer. There is no other prescription about the format of the information.
- 3.27** The MCD also imposes requirements to provide some additional service disclosure for intermediaries and some general information, as explained in Chapter 2.

### ***Product disclosure***

- 3.28** In the second charge market, current product disclosure typically consists of marketing materials and advance copies of contractual information. This will need to change to comply with the MCD. The new obligation for an ESIS is maximum harmonising, meaning we have to copy the requirement for the ESIS in our rules. We also have to remove any contradictory requirements from national rules.
- 3.29** Chapter 2 describes the ESIS, and we have created several example documents (see Appendix 2) to help firms understand the requirements. We understand that this new disclosure may be an expensive change for firms.<sup>17</sup> However, because there is no comparable disclosure currently required (such as the key facts illustration for first charge mortgages), firms will not be able to use the ESIS 'top-up' transitional provision that is available for first charge firms.
- 3.30** Firms will be able to carry on providing additional product information when giving out the ESIS. However, this will need to be in a document separate to the ESIS.

### ***Adequate explanation***

- 3.31** As described in Chapter 2, a firm needs to provide consumers with an adequate explanation of the product disclosures they have made, the essential features of the product, any ancillary products and the impact on the consumer (including the consequences of default).
- 3.32** This is likely to result in a change in the existing processes of many second charge firms, requiring a new contact point with the consumer. The MCD permits different approaches to providing the adequate explanation according to the circumstances of the sale, e.g. whether it is provided verbally or in writing, and whether by the intermediary or the lender.

### ***Offer disclosure***

- 3.33** The purpose of the ESIS is to help consumers to shop around, so it must be given out early in the sale. The MCD does not require a further ESIS to be provided to the customer at offer stage unless there has been a material change since the first ESIS was given. However, a firm can choose to give out an ESIS with all offers.
- 3.34** Second charge firms could use their existing arrangements for giving out advance copy documents to satisfy the MCD obligation to provide a draft of the credit agreement (see MCOB 6A).

<sup>17</sup> See the cost benefit analysis in Annex 1 for more details.

- 3.35** Alongside the MCD requirements we propose to apply the same offer stage disclosure requirements as for first charge mortgages (see MCOB 6A). This will help ensure that the consumer has full knowledge about the offer they receive, such as whether fees are non-returnable if they choose not to take out the mortgage. We believe this is particularly important given the greater freedom proposed for second charge firms to use up-front fees (following the removal of second charge mortgages from section 155 of the CCA, which restricts the amount firms can charge for applications that don't proceed).
- 3.36** Lenders will also have to provide a copy of their tariff of charges so consumers know in advance the standard fees that might apply to their mortgage.

**Q17: Do you agree with our proposals for sales disclosure for second charge mortgages?**

***Post-sale disclosure***

- 3.37** We propose to apply the same approach for post-sale disclosure for second charge mortgages as for first charge mortgages. These requirements apply to disclosure at the start of the contract, annual statements, and to certain event-driven information, such as when a customer experiences payment difficulties or a variation is made to their contract.
- 3.38** At the start of a mortgage contract (i.e. when a mortgage completes, or just as it is about to), it is already common in the second charge market for the lender to contact the consumer to confirm key details, either in writing or by phone. In some cases this might be the first direct contact between the lender and the consumer. We apply a similar approach in the first charge market, requiring firms to confirm key details when the loan starts. Disclosure at this point has a real benefit in providing a check that the mortgage is set up correctly, preventing initial administrative errors that might otherwise lead to consumer harm and subsequent complaints. We propose aligning the approach across the first and second charge markets (see MCOB 7.4).
- 3.39** We also propose to apply the MCOB requirement to send an annual statement (see MCOB 7.5) to second charge mortgage customers. This is very similar to existing obligations on second charge firms for periodic statements, although unlike current consumer credit requirements MCOB does not explicitly require an opening and closing balance or a reference to the ombudsman service. However, we do not consider that there will be a loss of consumer protection if we apply MCOB, because firms as a matter of course provide details of the opening and closing balance, and DISP (the disputes resolution section of our Handbook) requires firms to give information on internal complaints handling.
- 3.40** We also propose to apply the existing MCOB rules in relation to the notification of arrears (MCOB 13.4), which will apply instead of existing consumer credit requirements.
- 3.41** We don't propose to include an obligation for the lender to provide a copy of the credit agreement on request and payment of a fee. But if a consumer asks for a copy it is our view the firm should aim to help as part of its general obligations under the Principles for Businesses.
- 3.42** Similarly, we think it is reasonable that the same Principles should be seen as ensuring that firms meet the information needs of joint borrowers. The CCA requires information to go to each party individually. Firms generally address communications required under MCOB to all parties jointly (unless, for example, where the firm knows that they live at different addresses), and we plan to apply this approach to second charge loans. Of course, this does not prevent firms (in either the first or second charge market) from individually addressing all communications.

- 3.43** We expect that second charge firms will make much greater use of contract variations in future, given the proposal that the complex rules in respect of modifying agreements under the CCA will not apply to new second charge mortgages. To simplify matters further we propose to apply the same requirements as for first charge mortgages. This will mean giving out an ESIS for further advances, rate switches or the addition or removal of a party to the contract. Changes to payment amounts, or material changes to terms and conditions, are subject to tailored disclosure requirements.
- 3.44** We propose to apply our post sale disclosure rules to the second charge “back book.” So where event driven information or contract variations occur after our rules come into force then such firms will be required to comply with our MCOB requirements.

**Q18: Do you agree with our proposals for post-sales disclosure for second charge mortgages?**

**Advising and selling standards**

- 3.45** A mortgage is a serious financial commitment that can have significant financial implications for consumers. Taking out a mortgage is an infrequent event for most consumers, so they may have little experience or knowledge on which to base their decisions. Our past research found that many consumers assume that they are receiving advice when taking out a mortgage, even where they have been told that they are receiving a non-advised service.
- 3.46** Since April 2014 we have required advice to be given in first charge mortgage sales where there is spoken or other interactive dialogue with the consumer. We allow execution-only sales in very limited circumstances, for non-interactive sales (e.g. internet or postal applications), for some contract variations, and for some niche mortgages (e.g. to high net worth customers, mortgage professionals and for business loans).
- 3.47** We propose to apply the same approach to second charge mortgages, to help ensure that consumers buy products that they understand and that are appropriate for their circumstances. There is currently no concept of regulated advice in the second charge market, with all loans sold on a non-advised basis, so we recognise that this will be a significant change to both intermediaries and lenders. However, as discussed in paragraph 3.18 above, we could allow this to be implemented on a longer timetable.
- 3.48** Under our existing rules, where a borrower wants to raise additional funds secured on their property, we require mortgage sellers to inform them that a further advance with their existing lender may be more appropriate than a remortgage. However, there is no obligation for the seller to assess whether the further advance would actually be more appropriate.
- 3.49** In light of the transfer of second charge mortgages to the mortgage regime we believe that this should be extended so that in all such sales the customer is made aware that in addition to a further advance or remortgage, a second charge or unsecured loan may be more appropriate. (Once again, we do not propose to require the seller to consider appropriateness of these other options). Because this is an awareness raising exercise so that the customer is aware of other options, this fits better into initial disclosure at the start of the sale, rather than in the advice process. This would also ensure that this information is provided in all sales, even execution-only sales.
- 3.50** For shared equity mortgages we propose to apply some alternative considerations when assessing if a mortgage is suitable. These are set out in paragraph 3.101 below.

**Q19: Do you agree with our proposal to extend our mortgage advice and selling standards to second charge mortgages?**

**Q20: Do you agree that all borrowers looking to increase their borrowing should be made aware that a second charge or unsecured loan may be more appropriate, during initial disclosure at the start of the sale?**

### **Responsible lending**

#### ***Affordability***

**3.51** As discussed in Chapter 2, the MCD requires lenders to make a thorough assessment of a consumer's creditworthiness, based on information on their income and expenses and other financial and economic circumstances, before entering into a mortgage. This is similar to our existing regime for first charge mortgages, which requires lenders to undertake a robust assessment of affordability, based on the following elements:

- the consumer's verified income
- their credit commitments and basic living costs ('basic essential expenditure', including utility bills, basic food and essential travel; and 'basic quality of living costs' which can only be reduced with difficulty such as clothing, household goods and basic recreation)
- expected changes to interest rates, including any prevailing recommendation from the Financial Policy Committee on appropriate interest rate stress tests
- known changes to income and expenditure

**3.52** We propose to implement the MCD creditworthiness assessment through our existing MCOB affordability rules for first charge mortgages, and to adopt the same approach for second charge mortgages i.e. by extending the MCOB affordability rules to them. This will protect consumers from irresponsible or unfair lending practices, and ensure that lenders undertake a robust assessment of affordability before making a loan. This approach provides a clearer framework for firms than simply copying out the MCD requirements, which are explained in less detail than our MCOB affordability rules. As well as providing more clarity to firms, this will also help our supervision of firms, as we will have a clearer framework to supervise against. However we propose to make some amendments to reflect the nature of second charge lending, as detailed below.

**Q21: Do you agree that we should apply MCD creditworthiness assessment requirements to second charge mortgages through our MCOB affordability rules?**

#### ***Considering the effect of future interest rate rises***

**3.53** Our MCOB affordability rules require lenders to take account of future interest rate rises when assessing affordability (unless the loan is fixed for five years or more, or fixed for the term if less than five years), as set out in MCOB 11.6.18. To do this the lender:

- must consider the expected interest rate environment for a future period of at least five years
- should not use their own forecasts of future interest rates, but instead must have regard to market expectations, for example through externally published sources such as the Bank of England forward sterling rate; and also to have regard to any prevailing FPC recommendation on appropriate interest-rate stress tests

- should assume a minimum interest rate increase of 1% over the five-year period, even where the market expects interest rates to fall, or rise by less than 1% over that period

**3.54** We propose to apply this approach to second charge mortgages. In practice, the typically higher interest rate margins involved may mean that product pricing is less affected by interest rate fluctuations than for first charge mortgages (i.e. lenders may have more flexibility when deciding how much of an interest rate rise to pass on to borrowers). We recognise that this may be reflected in the stress rates used by second charge lenders. However, we will expect them to be able to justify the basis they use for interest rate stress tests, and to be able to clearly articulate this and keep appropriate records.

**3.55** Interest rate rises are also likely to affect other secured lending, most significantly the first charge mortgage, which is usually significantly larger than a secured loan. We propose to address this by applying an additional requirement for second charge mortgages, requiring the lender to also stress test affordability for higher ranking secured loans. We recognise that we need to take a proportionate and practical approach to this to avoid excessive costs and delays, as the information available to a lender on other secured loans may be limited.

**3.56** Therefore we propose that second charge lenders will need to obtain the following information for higher ranking mortgage(s):

- the outstanding balance, e.g. from a credit reference or mortgage statement
- the current interest rate, e.g. from a mortgage statement or reference, or information provided by the customer

**3.57** The lender will then apply an appropriate stress test to the higher ranking loans based on the outstanding loan and interest rate, having regard to market expectations and any prevailing FPC recommendation. So, taking a simplified example, if market expectations and the prevailing FPC interest recommendation suggest that interest rates are going to increase by 3% over the next five years, then the lender might apply a stress test which assumes that the interest rates on higher ranking loans increases by 3% over the five-year period.

**3.58** This approach to higher ranking loans (in combination with the full stress test applied by the second charge lender for their own loan) will ensure that there is flexibility in the consumer's finances to cope with expected interest rate rises. However, it does not take account of whether the higher ranking loans will revert to a higher rate, e.g. where an initial fixed or discounted rate reverts to a higher variable rate within the first five years. Information on this would be more difficult and costly to obtain. We believe that the proposed approach is proportionate, but we would welcome views on this.

**Q22: Do you agree that we should apply the MCOB interest rate stress test to second charge mortgages?**

**Q23: Do you agree with the proposed approach to stress testing higher priority loans against expected interest rate increases?**

#### ***Debt consolidation***

**3.59** For first charge debt consolidation mortgages made to credit impaired consumers we require the first charge lender to either take reasonable steps to ensure the debts to be consolidated are repaid, or include them in the affordability assessment as if they were not repaid (see

MCOB 11.6.16). This is because we are concerned about the increased risk of credit impaired consumers (who have a much higher than average incidence of mortgage payment problems) increasing their mortgage without paying off their other debts, and as a result moving into an unsustainable financial position.

- 3.60** We propose to extend this general approach to second charge mortgages. However, given the high proportion of second charge mortgages taken for debt consolidation, and the higher level of payment problems found in second charge debt consolidation mortgages (which are comparable to those historically found in credit impaired first charge mortgages), we propose to extend the requirement to all second charge debt consolidation mortgages, and not just those made to credit impaired consumers.
- 3.61** Our understanding is that the predominant current market practice is for second charge lenders to make out cheques to creditors, to be forwarded by the customer to the creditor. This would be one way in which second charge lenders could meet this proposed requirement, and therefore we do not consider that it would be burdensome. However, we would welcome views on this.

**Q24: Do you agree that we should apply the MCOB debt consolidation requirement to all second charge debt consolidation mortgages?**

***Interest-only mortgages***

- 3.62** Interest-only mortgages are not commonly found in the second charge market, other than in some niche areas, such as bridging or business loans. However, the MCOB interest-only rules will apply unless we decide to specifically switch them off. We do not propose to do this, as we believe that the interest-only rules will be needed to address consumer risks that may arise if an interest-only market does develop for second charge mortgages at any time in the future.

**Q25: Do you agree that we should apply the MCOB interest-only rules to second charge mortgages?**

***Contract variations***

- 3.63** Contract variations are not currently a common feature of the second charge market, as under consumer credit requirements firms must put a modifying agreement in place to make a change to the contract, which can be cumbersome. Modifying agreements will not be a feature of the new regime, so this will provide firms with greater flexibility to make changes to the contract during the term.
- 3.64** To ensure appropriate consumer protection, we propose to apply the current MCOB rules on contract variations to second charge mortgages. These relate to disclosure (as already discussed in paragraph 3.43), advising and selling standards, and responsible lending. Their aim is to ensure that the borrower understands the implications of the variation, and for there to be advice and an affordability check where the variation involves further borrowing. Where a transaction does not involve further borrowing, then a lighter touch approach applies, that allows borrowers to choose to transact on an execution-only basis, and for the lender not to undertake a further affordability assessment. We propose to apply our rules on contract variations to variations made under the second charge back book, once such loans fall under our mortgage regime.

**Q26: Do you agree with our proposed approach to contract variations for second charge mortgages?**

**Fees*****Rolling-up of fees and charges into the loan***

- 3.65** Our rules in MCOB 4.6A prohibit fees and charges (such as lender and broker fees) being automatically 'rolled-up' into the loan. A fee or charge can only be rolled-up where a customer has made a positive choice that this is what they want.
- 3.66** We are aware that it is common practice in the second charge market for fees and charges to be automatically rolled-up. In some cases this can be in a customer's best interests, for example where they have limited up-front funds. However, if the customer does have funds available to pay these fees, then it may be in their interest to do so – to avoid paying interest on them for the duration of the loan.
- 3.67** We propose applying our MCOB 4.6A rules to the second charge market. We anticipate that customers taking out loans for debt consolidation purposes in particular may be unable to pay fees and charges up front, but we believe that this is a matter for the customer to actively consider.

**Q27: Do you agree with our proposal to prohibit the automatic rolling-up of fees and charges into a second charge loan?**

***Early repayment charges***

- 3.68** As explained in Chapter 2, we intend to use our existing rules in MCOB 12.3, supplemented by additional rules on a right to repay early and disclosure, to implement the MCD requirements on early repayment charges (ERCs).
- 3.69** Under the CCA, firms may defer the settlement date for one month (for loans over 12 months in duration) and calculate the settlement date to a point 28 days ahead of any notice given by the customer. This can allow firms to recover up to two months additional interest. These rules restrict a firm's ability to recover the costs of a loan being repaid early. We recognise that applying MCOB 12.3 to the second charge market could lead to increased ERCs, even though they will need to be cost-reflective and subject to a pre-contractually disclosed cap.
- 3.70** However, we believe that applying MCOB 12.3 to second charge mortgages could benefit consumers by increasing the diversity of loans on offer. Discussions with our industry working group have indicated that fixed rates may become more prevalent, as firms would be able to recover breakage costs. It is also possible that firms could be able to offer lower rates, as breakage costs could be recovered through ERCs as opposed to being priced into the product rate.
- 3.71** For the second charge back book (that is loans made before 21 March 2016), the government has proposed that these will remain subject to the early settlement provisions in the CCA.<sup>18</sup>

**Q28: Do you have any comments on how our proposed approach to implementing the MCD requirements on ERCs will affect the second charge market?**

***Excessive charges***

- 3.72** MCOB 12.5 prohibits firms from imposing excessive pre and post-contractual charges on a customer. This includes guidance to help firms determine whether a charge is excessive.
- 3.73** As in the first charge market, second charge lenders charge front-end fees when a new contract is being entered into, as well as fees for various service related activities that might arise during the life of the loan.

<sup>18</sup> Treasury consultation '*Implementation of the EU mortgage credit directive*' (September 2014). See section 2.3.

- 3.74** We believe it is appropriate to apply MCOB 12.5 to second charge lenders to ensure that customers are treated fairly.

**Q29: Do you agree with our proposal to apply MCOB 12.5 to second charge firms?**

***Payment difficulties***

- 3.75** Lenders levy a variety of charges when customers fall behind on payments, typically covering costs such as issuing default letters, home visit charges and repossession costs. Evidence from consumer groups suggests that the levels of these fees can be high, and our analysis suggests that in the past such fees have been a key driver of profit for some second charge firms.
- 3.76** We propose to implement article 28 of the MCD, which requires member states to ensure that arrears charges are a reflection of costs to the creditor arising from the consumer's default, through our existing provisions to protect customers who have a payment shortfall (MCOB 12.4). As stated above, we also propose to apply MCOB 12.5, which prevents firms from applying excessive charges. These provisions will replace the current consumer credit requirements set out in CONC 7, and will also apply to existing second charge mortgages. We believe that the additional protection provided by MCOB will particularly benefit customers of firms closed to new business and in 'run-off', as evidence from consumer groups suggests that these firms are more likely to seek to maximise the value obtained from their outstanding mortgages.
- 3.77** MCOB 12.4 also prevents firms from charging fees that are a percentage of the loan balance, or monthly fees where the customer is maintaining an agreed payment plan.

**Q30: Do you agree with our proposed approach to fees and charges relating to payment difficulties?**

***Simple interest calculation on arrears fees***

- 3.78** The CCA currently restricts second charge lenders in their ability to charge interest on default charges in three specific ways. It:
- prevents firms from charging interest on arrears charges until notice has been given of those charges
  - requires firms to provide the customer with a 29 day grace period to make payments before interest is charged
  - only permits firms to charge interest on default charges on a simple, rather than compound basis
- 3.79** These requirements were introduced by the CCA 2006 following concerns that consumer harm was occurring as a result of high and frequent arrears charges coupled with high rates of interest. Compounding interest calculations meant that the monthly repayments were not always sufficient to prevent the levels of debt spiralling.
- 3.80** There are no similar restrictions for first charge mortgage lenders under MCOB. Instead, MCOB requires that payment shortfall charges are no more than cost-reflective, and limits the application of certain other fees. Our view is that this will prevent consumer harm occurring as a result of high and frequent arrears charges. We do not propose to replicate the first two CCA protections listed above in our mortgage regime.<sup>19</sup>

<sup>19</sup> Firms may continue to follow these on a voluntary basis, but only if they do so in a way which does not result in non-compliance with our rules on the allocation of payments under MCOB 12.4.1BR.

- 3.81** However, we do propose to include a new rule in MCOB to replicate the third protection, for second charge mortgages only (see MCOB 12.5.5R). This will require that interest can only be charged on default fees on a simple basis. We believe it is appropriate for this protection to continue, given the significantly higher interest rates charged by some second charge lenders, which has the potential to compound over a relatively long period of time, which could lead to some customer's debts increasing considerably.
- 3.82** We also propose to apply this to the back book of existing loans.

**Q31: Do you agree with our proposal to require interest to be charged on default fees only on a simple basis for second charge mortgages?**

**Payment shortfalls and repossessions**

- 3.83** The MCD requires Member States to adopt measures to encourage lenders to exercise reasonable forbearance before repossession action commences.
- 3.84** We, and our predecessor the FSA, have conducted a substantial amount of work over recent years to enhance protections for first-charge mortgages customers experiencing payment difficulties. This included introducing new rules in 2010 to address failings found during thematic supervisory work, to ensure lenders offer appropriate forbearance. We are confident that our rules (see MCOB 13) are able to both meet the requirements of the Directive on foreclosure and to provide an appropriate level of consumer protection.
- 3.85** Second charge firms are currently subject to arrears handling guidance under the consumer credit regime. However, this is not tailored to second charge lending, as it applies to many types of consumer credit. We are aware that the range of forbearance options currently offered to consumers is more restrictive than in the first charge market (largely as a result of restrictions imposed through the current consumer credit regime e.g. the need for modifying agreements), and feedback received from consumer groups indicates that arrears handling practices by second charge firms are causing consumer harm.
- 3.86** We are proposing to apply MCOB 13 in its entirety to second charge firms to establish a stronger framework to ensure customers in payment difficulties are treated fairly and that firms offer appropriate forbearance based on the customer's circumstances, requiring more of firms in considering alternatives to repossession. MCOB 13 also protects customers when their property is repossessed, and when there is a sale shortfall. We also propose to apply MCOB 13 to the second charge back book to ensure that all customers benefit from the enhanced protections it offers.
- 3.87** Although consumer groups have expressed support for this proposal, we are also aware of a concern that CCA protections around time orders<sup>20</sup> will no longer apply for second charge mortgages, to the harm of consumers. In fact, although not well understood, time orders will continue to exist, as they do for first charge loans<sup>21</sup>, although they are rarely used in the first charge market. We anticipate that although time orders will continue to apply to both first and second charge lending we will see a marked reduction in their use, as MCOB 13 will require second charge firms to engage with customers much earlier in the process. Therefore consumers should not need to rely on time orders to agree forbearance with the lender.

<sup>20</sup> Time orders are a legal mechanism that allows a consumer to request more time from the court to repay their arrears, and provide the courts with powers to change the monthly payment, the term of the loan and the interest rate charged. They apply under s.126 of the CCA.

<sup>21</sup> Treasury consultation '*Implementation of the EU mortgage credit directive*' (September 2014). See section 2.3.

- 3.88** For information on our proposals around vulnerable consumers and data sharing requirements around customers in arrears please see Chapter 5.

**Q32: Do you agree with our approach to protecting second charge mortgage customers in payment difficulties?**

**General conduct of business standards**

- 3.89** Our existing mortgage rules in MCOB 2 contain high-level standards for firms covering a number of specific areas, such as a requirement for firms to act in a customer's best interests and a prohibition on inducements. We believe that these provisions are equally as relevant to second charge mortgages as first charge, and so propose to apply them. They will also apply to the second charge back book, although many of the provisions affect information or practices relating to the pre-contractual or contractual stage and so will have minimal impact on firms' existing loans.
- 3.90** In some instances, similar standards will already apply to second charge firms - for example, constraints on the use of electronic media resulting from the Distance Marketing Directive and the implementation of the E-Commerce Directive. Other sections of MCOB 2, such as our rules and guidance on inducements, help us to implement the MCD.
- 3.91** Generally, we do not expect the requirements to have a significant impact on second charge firms.
- 3.92** One specific area where MCOB 2 exceeds existing second charge requirements is MCOB 2.3.6. This prohibits the use of volume overrides, e.g. where the value of an inducement paid to an intermediary or third party increases based on reaching set target of business. This goes beyond the existing CONC guidance (CONC 4.5.2G), which permits such payments where they are justified based on the extra work of the firm involved in that business. However, we believe it is appropriate to apply it to second charge mortgages.

**Q33: Do you agree with our proposal to apply the general conduct of business standards set out in MCOB 2 to second charge mortgages?**

**Implications for second charge mortgages in niche markets**

***Shared equity loans***

- 3.93** Shared equity loans are covered by the MCD, except for certain schemes provided by the government and social landlords, which will continue to be exempt. To date, shared equity schemes have fallen under the consumer credit regime (with the exception of exempt government schemes).
- 3.94** For shared equity loans that are regulated, we want to provide a framework that supports their appropriate provision, so that consumers without a big deposit can continue to access home ownership.
- 3.95** Shared equity loans are second charge loans usually provided to help consumers, most commonly first time buyers, buy a home with a lower deposit than otherwise required. They are typically available for around 20% of the value of the property, with the consumer expected to pay just a 5% deposit. They are usually provided either through government schemes (such as Help to Buy), or through house builders to fund the purchase of new build properties, although they could also be offered by other providers such as mortgage lenders.

**3.96** Shared equity loans can be repaid on the sale of the property. Alternatively, repayment may be required after a set number of years, typically 20-25 years (for government schemes), or ten years (for private schemes). Interest payments may be required after a certain period, often five years, and the amount of interest charged may increase over the term.

**3.97** A key feature of shared equity loans is that the lender benefits from a share of any increase in equity over the term. So if property prices rise, the borrower may have to pay back significantly more to the lender than they originally borrowed. Where the value of the property falls, then the borrower may have to bear more of the loss than the lender (depending on how the scheme is set up).

**3.98** Shared equity loans pose some specific consumer risks. For example:

- consumers may focus on the purchase of the home without considering the risks of the shared equity loan, such as the potentially escalating debt
- the sale of a shared equity loan may not be appropriate for the consumer e.g. if they could have purchased the property without needing to take a shared equity loan
- the shared equity loan may not be affordable when interest repayments become due
- the consumer may not have considered the need to sell the property to repay the shared equity loan when full repayment becomes due
- consumers may not understand the effect of changes to house prices on the amount they owe to the lender

**3.99** We believe it is appropriate to address these risks through our regulation. We therefore propose to apply the same requirements as for other second charge loans, with the following tailoring.

#### ***Sales process***

**3.100** Shared equity loans must not be sold on an execution-only basis.

**3.101** When giving advice, the seller must consider the following factors:

- whether it is appropriate for the customer to take out an equity loan to purchase the property, or purchase from their own resources
- the term of the loan (particularly in relation to the customer's intentions for repayment of the first charge loan)
- whether it is appropriate for the customer to have flexibility in payments (i.e. the ability to pay interest on the loan, or to make capital repayments via regular payments or lump sums)

**3.102** We will expect the seller to make it clear to the customer how the debt may be affected by changing property values, through the MCD requirement to provide an adequate explanation of the essential characteristics of the product, including the specific effects the product may have on the consumer (see MCOB 4A.2.1R(2)(c)).

#### ***Responsible lending***

**3.103** If the contract requires that regular payments (whether interest or capital) become due during the term of the shared equity loan, the lender must undertake an affordability assessment

before entering into the loan. If the loan is structured as an interest-roll up mortgage (i.e. neither capital nor interest is required or anticipated until the end of the term), then an affordability assessment is not required (see MCOB 11.6.57).

- 3.104** Where the shared equity loan is an interest-only loan (i.e. where capital will still be outstanding at the end of the term), the lender must also consider the credibility of the repayment strategy in accordance with our interest-only rules. Sale of property may be an acceptable repayment strategy, subject to specific customer circumstances. As with our existing interest-only rules we do not expect firms to give advice on the repayment strategy.

**Q34: Do you agree with our proposed approach to shared equity loans?**

***Business loans***

- 3.105** In the current consumer credit regime, secured loans that are wholly or predominantly for business purposes, where the loan is over £25,000, are excluded from regulation. Loans up to £25,000 are regulated, on the basis that smaller loans are more likely to be taken by smaller traders who need more consumer protection – for example, to inject cash into struggling small businesses. This approach will be carried across by the government into our mortgage regime, so we will only have the power to regulate secured loans for a business purpose that do not exceed £25,000 (before any fees are added to the loan).
- 3.106** As explained in Chapter 2, business loans are not caught by the MCD on the basis that it applies only to consumers.<sup>22</sup> Therefore regulated mortgages made for a business purpose will not need to comply with MCD requirements. However, dual purpose loans, where the trade, business or professional purpose is so limited as not to be predominant in the overall context of the contract will be caught and the MCD will apply in full.
- 3.107** We propose to apply a similar approach to second charge loans as to first charge business loans, and therefore the existing MCOB tailoring for disclosure, advising and selling standards, and responsible lending will apply. Other MCOB requirements, e.g. charges, and arrears, payment shortfalls and repossessions, will apply in full.
- 3.108** There is no current qualification requirement for first charge business lending, and as business lending is not in the scope of the MCD we do not propose to introduce one. We intend to apply the same approach to second charge mortgages.

**Q35: Do you agree with our proposed approach to second charge business loans?**

***Bridging loans***

- 3.109** As set out in Chapter 2, the MCD has an exemption for bridging loans, and therefore it will not apply to loans that meet its definition of a bridging loan.<sup>23</sup> However, existing MCOB requirements will apply to first charge bridging loans, and given the similar risks to consumers we believe it is appropriate to apply this same framework to second charge bridging loans. This includes several tailored provisions, particularly in relation to disclosure, advising and selling standards, and responsible lending.

**Q36: Do you agree with our proposed approach to second charge bridging loans?**

<sup>22</sup> i.e. a natural person acting outside their trade, business or profession.

<sup>23</sup> "A credit agreement of either no fixed duration or which is due to be repaid within 12 months, used by the consumer as a temporary financing solution while transitioning to another financial arrangement for the immovable property"

**High net worth individuals**

- 3.110** There is no exemption in the MCD in relation to high net worth (HNW) individuals, and so the MCD applies in full. As a result, the current consumer credit regime exemption for HNW individuals is not being carried across into the mortgage regime.
- 3.111** However, we do have some flexibility in our approach to non-MCD requirements, so we propose to apply the same approach as for first charge mortgages. This will allow firms to use tailored provisions for consumers who meet our Handbook definition of a *'high net worth mortgage customer'*, i.e. consumers who have net income of no less than £300,000 or net assets of no less than £3m. These tailored provisions apply to our advising and selling standards, and responsible lending rules.

**Q37: Do you agree with our proposed approach to high net worth individuals taking a second charge mortgage?**

**Non-MCOB matters****Prudential requirements**

- 3.112** First charge non-bank lenders, administrators and intermediaries are subject to prudential requirements set out in our Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU). These requirements were strengthened as part of the MMR, which introduced for lenders and administrators:
- risk-based capital requirements
  - restrictions on the quality of eligible capital
  - a tailored liquidity requirement
- 3.113** Our requirements under MIPRU will continue to apply to firms engaged in first charge business, irrespective of whether or not they are engaged in second charge business. In addition, the MCD establishes new minimum limits for the level of professional indemnity insurance held by firms (see paragraph 2.49).
- 3.114** However, other than the minimum required by the MCD, we believe there is a strong case for deferring consideration of whether and how our prudential requirements should be applied to non-bank lenders, administrators and intermediaries in the second charge market until after the transfer of second charge into our mortgage regime. The draft MIPRU rules in Appendix 1 set out our proposed approach, excluding firms carrying out a second charge activity but not first charge, and clarifying that second charge activity would not count towards firms' annual income for the purposes of calculating capital requirements (see draft MIPRU 4.1.13AR, 4.1.13BR, 4.3.3G and 4.3.7AR).
- 3.115** Under our consumer credit regime, firms are not currently subject to any prudential requirements for their second charge activity. Applying our MIPRU rules to second charge non-bank lenders, for example, would represent a greater incremental burden than the staged approach we have taken for first charge firms since the introduction of mortgage regulation.
- 3.116** To make a considered assessment of whether prudential requirements should be applied to second charge firms and at what level, we will need to understand how these firms' business models and lending profiles have altered as a result of the transfer to the mortgage regime. In this respect, analysis of second charge firms' current activity is unlikely to help us form this assessment.

- 3.117** With insufficient evidence, we would risk imposing either a capital requirement that is too high, potentially affecting competition or consumer choice, or too low, resulting in firms incurring compliance costs with no additional consumer benefit.
- 3.118** We are proposing to revisit this issue by March 2017. The effects of the transfer should be clearer by this point, although it is possible that further consideration will be needed after this date. We intend to use data collected as part of firms' regulatory reporting to help inform this assessment.
- 3.119** This proposal will present interim risks, including the possibility of regulatory arbitrage and the implications of firms not holding sufficient capital to mitigate unforeseen risks. Regulatory arbitrage is a risk that exists at present, as second charge non-bank lenders administrators and intermediaries are not subject to capital requirements. We expect our proposals on responsible lending and sales standards to improve the quality of second charge lending.

**Q38: Do you agree with our proposal to defer consideration of whether prudential requirements should apply to second charge firms?**

**Q39: Do you agree with our proposed timetable for deferral?**

#### **Training and competency**

- 3.120** Our proposed approach to implementing the MCD requirements on knowledge and competency are set out in Chapter 2. In addition to this, we have considered whether our existing requirement for mortgage sellers to hold a Level 3 mortgage qualification should apply to second charge firms. This applies to mortgage advisers, arrangers and those designing scripts for execution-only sales.
- 3.121** Professionalism is an important component of a sales process that works in the best interests of customers. Therefore, we believe that the same requirements should apply to the second charge market, to ensure that properly qualified individuals are an integral part of the sales process and help to deliver good customer outcomes.
- 3.122** We do not envisage the need for a qualification specific to second charge. There are clear similarities across all secured lending, which will be strengthened by the application of broadly consistent conduct rules to both first and second charge. However, existing qualifications may need tailoring to accommodate features distinct to second charge.
- 3.123** We are proposing to give staff until 21 September 2018 (two and a half years from the date the rules come into force) to obtain the qualification. While individuals are in the process of obtaining the qualification, we will expect them to operate under supervision and use the MCD knowledge and competency standards to demonstrate competency on an ongoing basis. However, as discussed above in paragraph 3.18 we are interested in views on this timetable.

**Q40: Do you agree with our proposed approach to training and competency?**

#### **Financial Services Compensation Scheme**

- 3.124** The Financial Services Compensation Scheme (FSCS) provides a financial safety net for consumers in the event that an authorised firm is unable to meet its financial obligations, such as where a firm provides incorrect advice that has resulted in a consumer losing money and then ceases to trade. The rules covering compensation are in the COMP sourcebook of our Handbook.

- 3.125** First charge mortgage advice and arranging activities are covered by the FSCS, but providing and administration activities are not, on proportionality and cost-effectiveness grounds.<sup>24</sup> Second charge mortgage activities currently sit outside of the scope of the FSCS. However, we believe that similar risks exist for second charge mortgages, and so we propose to bring second charge advising and arranging activities into scope from 21 March 2016, to coincide with the move into the mortgage regime. FSCS protection would cover activities that take place from this date, so claims arising from activities (e.g. incorrect advice) that occurred prior to this would not be covered, even where a consumer loss occurred afterwards.
- 3.126** Firms within scope are required to pay a levy to the FSCS, which is collected by the FCA. There are two types of fee:
- management expenses levy, which covers the costs of running the compensation scheme
  - compensation costs levy, which provides the funds to make valid compensation claims
- 3.127** The fees charged are generally based on the firm's activities and their annual eligible income (as set out in our Handbook in FEES 6).<sup>25</sup>

**Q41: Do you agree with our proposal to include second charge advising and arranging activities into the scope of FSCS?**

**Financial Ombudsman Scheme**

- 3.128** Most second charge mortgages already fall within the compulsory jurisdiction of the Financial Ombudsman Service (FOS) and will continue to do so when second charge mortgages are moved into our mortgage regime.

**FCA fees**

- 3.129** Authorised firms pay two types of fees to us, an application fee, to pay for our evaluation of their application for authorisation, and an annual periodic fee, which recovers the costs of FCA regulation. We will be consulting on our proposed approach to fees for second charge firms as part of our annual consultation on fees in October.
- 3.130** Chapter 6 sets out more information on the authorisations process for second charge firms.

**Approved persons**

- 3.131** The controlled functions for second charge firms under our consumer credit regime are governing functions, systems and controls functions, and Money Laundering Reporting Officer functions. The controlled functions under the mortgage regime are wider than this, covering all governing functions, Apportionment and Oversight (CF8), Money Laundering reporting (CF11), and often Systems and Controls (CF28) and the Significant Management function (CF29).<sup>26</sup>
- 3.132** As second charge mortgages will be covered by the definition of a regulated mortgage contract, these additional controlled functions will apply unless we tailor our rules. However, we do not believe there is a case for applying different requirements to second charge mortgages. The approved persons requirements are a proven method of ensuring that firms have robust senior management controls that support consumer protection.

<sup>24</sup> Because the circumstances in which the customer is likely to suffer loss in the event of a provider default are limited, and there is potential scope for a market solution, such as a transfer of a portfolio to another lender, generally without loss to the borrower.

<sup>25</sup> Annual income is calculated in accordance with fee-block A18 in part 2 of FEES 4 Annex 1A R

<sup>26</sup> The controlled functions regime for deposit-takers is currently subject to consultation elsewhere – please see CP 14/13: [www.fca.org.uk/news/cp14-13-strengthening-accountability-in-banking](http://www.fca.org.uk/news/cp14-13-strengthening-accountability-in-banking)

### Draft rules

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- 3.133** The draft instrument that sets out the rule changes required to implement our proposals for second charge mortgages can be found in Appendix 1.<sup>27</sup> This should be read in conjunction with our existing MCOB rules, which can be found in our Handbook.<sup>28</sup>

**Q42: Do you have any comments on the draft rules in relation to second charge mortgages set out in the draft Mortgage Credit Directive Instrument 2014 at Appendix 1? Do you agree that the rules reflect the stated policy intention?**

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<sup>27</sup> Note that this draft instrument also includes the rule changes to implement the MCD for first charge mortgages

<sup>28</sup> See Mortgages and Home Finance: Conduct of Business sourcebook: [fshandbook.info/FS/html/FCA/MCOB](http://fshandbook.info/FS/html/FCA/MCOB)

## 4.

# Second charge data reporting requirements

### Context

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- 4.1** We gather and use a wide range of data, information and intelligence from across our organisation, firms and elsewhere to help us identify and assess risks in financial markets. In the mortgage market, we are particularly interested in indicators of irresponsible lending leading to consumer harm and a market that does not function well.
- 4.2** In our policy statement<sup>29</sup> that set out our consumer credit regime, we explained that second charge firms are exempt from product and activity-based data reporting requirements pending transfer to the mortgage regime.
- 4.3** We are now setting out our proposed regulatory reporting requirements for second charge firms to meet our objectives. We believe that our proposals will help us identify and assess risks to consumers, make robust quicker decisions so the market keeps functioning well, and enhance our ability to monitor the market.

### Summary of our proposals

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- 4.4** We are proposing to apply rules to second charge firms that are broadly similar to those that apply to first charge firms, given the risks inherent in secured lending irrespective of whether a mortgage is secured as a first or subsequent charge.
- 4.5** As a consequence, we are proposing to rely on established and recently refined reporting mechanisms to gather transaction level and aggregated data on the second charge market.
- 4.6** We propose applying the following reporting requirements to second charge firms from 21 March 2016.
- **Product Sales Data (PSD)** – applicable to second charge lenders.
    - **Sales data** – transaction level data on all regulated second charge mortgage sales made by a firm within the reporting period.
    - **Performance data** – transaction level data on the performance of second charge regulated mortgages, giving a snapshot of the mortgage characteristics and whether borrowers have experienced payment difficulties. This report would also apply to regulated firms that act as a lender, such as mortgage book purchasers.

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<sup>29</sup> PS14/3, *Final rules for consumer credit firms* (February 2014): [www.fca.org.uk/news/ps14-3-final-rules-for-consumer-credit-firms](http://www.fca.org.uk/news/ps14-3-final-rules-for-consumer-credit-firms)

- **Mortgage Lenders and Administrators Return (MLAR)** – applicable to second charge lenders, aggregated data covering a firm’s regulated mortgage activity, including second charge.
  - **Retail Mediation Activities Return (RMAR)** – applicable to second charge intermediaries, aggregated data covering a firm’s regulated mortgage activity, including second charge.
- 4.7** To accommodate both the nature of second charge activity and how we intend to regulate it, we are proposing some adjustments. Those adjustments are set out in more detail towards the end of this chapter and in our draft Handbook text in Appendix 1.
- 4.8** We are not proposing any further changes to the reporting requirements that apply to firms that undertake only regulated first charge mortgage activity.

### Why are we proposing to collect this data?

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- 4.9** As with the first charge market, the primary reason for collecting data from second charge firms is so that we can supervise our proposed rules as efficiently and effectively as possible. At present, we have no reliable or consistent data on second charge activity, nor any rules requiring firms to supply this to us on a regular basis. This would restrict our ability to regulate a market that poses risks of consumer harm.
- 4.10** We also want to be a more forward-looking and pre-emptive regulator, seeking to identify and head off risks or unintended consequences before they crystallise and cause consumer harm or damage market integrity. We want to maintain competitive markets and promote effective competition in the interests of consumers. The enhanced data will help us to identify if there are risks to these objectives.
- 4.11** In addition, aggregate data in particular is likely to inform our proposed review of whether and how prudential requirements could apply to second charge non-bank lenders, administrators and intermediaries.
- 4.12** Without the data we propose collecting, we would need to rely on alternative methods, such as ad hoc data requests and increased supervisory work. Past experience with manual data requests has shown that this is time and resource intensive for both us and firms. This approach would also give rise to data consistency issues and restrict our ability to construct robust analyses.

### Product Sales Data (PSD)

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- 4.13** Since 1 April 2005, product providers have supplied transaction-level data to us on all sales of regulated mortgage contracts through a report called Product Sales Data (PSD). From 1 January 2015, PSD will be amended to capture more detailed information on product sales (such as enhanced affordability data aligned to our responsible lending rules) and the performance of all regulated mortgage contracts.
- 4.14** We are proposing to apply broadly the same requirements to second charge lenders from 21 March 2016. Both the sales and performance reports will be used to capture information on all regulated second charge mortgages sold from 21 March 2016. We are not proposing to apply the performance report to back book second charge loans. We feel that data consistency issues would compromise any further analysis, placing a disproportionate burden on firms.

- 4.15** As detailed in Chapter 3 and our cost benefit analysis, arrears rates in the second charge market are significantly higher than in the first charge market. It is important that we capture detailed information on second charge mortgage sales and their performance at regular intervals to track customer outcomes.
- 4.16** We have considered whether it would be appropriate for second charge firms to supply a scaled down version of PSD. However, this would result in us receiving transaction-level data that is not aligned to our proposed conduct of business rules.
- 4.17** The affordability data we are proposing to collect closely mirrors the responsible lending rules we intend to apply to second charge firms. Collecting this information will enable us to undertake detailed analysis of how firms are determining whether a second charge mortgage is affordable.
- 4.18** Transaction-level data on the performance of second charge mortgages will enable us to track arrears and possessions cases back to the original sale. This can support our analysis of the mortgage characteristics and customer circumstances that can lead to payment difficulty and how forbearance has been deployed.
- 4.19** When we consulted<sup>30</sup> on the changes to PSD that come into effect for first charge firms from 1 January 2015, we included some proposed rule changes that could be brought into effect once second charge moves into the mortgage regime. These would enable us to differentiate second charge loans from other types of regulated mortgage contract and understand the purpose of each second charge loan.
- 4.20** Respondents were supportive, but in our subsequent policy statement<sup>31</sup> we said that “we cannot confirm if these data items will definitely be used for second charge mortgages” on the basis that we had not yet consulted on our conduct rules for second charge.
- 4.21** We have made some minor adjustments to those original proposals. All other PSD fields will apply to regulated second charge mortgages from 21 March 2016 in the same way as they will do for first charge from 1 January 2015.
- 4.22** Not all of these fields will need to be populated for every transaction. For a second charge loan where there is only one applicant who is employed with a basic salary, 16 of the 28 affordability fields would not need to be reported. In the performance data, none of the fields relating to forbearance would need to be reported if the account is not experiencing payment difficulties.
- 4.23** First charge firms are required to submit sales data every quarter and performance data every six months. To enable us to establish a regularly updated view of second charge transactions, we are proposing that second charge firms are subject to the same timeframes.
- 4.24** To reduce the burden on firms with lower levels of second charge business, and if we implement our reporting requirements from March 2016, we propose that firms reporting to us by manual data entry as opposed to XML files should submit performance data to us on an annual basis, rather than every six months. We are not proposing to specify an upper limit on the number of transactions to apply this exception. This approach would match the ongoing reporting efforts of each individual firm, which would not be the case if applying a strict limit on the size of the firm or its back book volumes. We do not believe that this would present any perverse incentives for larger second charge firms to report less frequently, given the time and cost involved in submitting high-volume manual returns.

<sup>30</sup> CP13/2, *Mortgage Market Review – Data Reporting* (May 2013): [www.fca.org.uk/your-fca/documents/consultation-papers/cp13-02](http://www.fca.org.uk/your-fca/documents/consultation-papers/cp13-02)

<sup>31</sup> PS13/12, *Mortgage Market Review: data reporting* (December 2013): [www.fca.org.uk/your-fca/documents/ps1312-mortgage-market-review-data-reporting](http://www.fca.org.uk/your-fca/documents/ps1312-mortgage-market-review-data-reporting)

**Q43: Do you agree with our proposed collection of transaction-level data on second charge mortgages?**

**Q44: Do you have any comments on the individual data items we intend to collect on sales and performance of second charge mortgages?**

**Q45: Do you have any comments on our proposed adjustment to reporting frequencies for second charge performance data where firms are submitting data manually?**

### **Mortgage Lenders and Administrators Return**

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- 4.25** Since 2007, regulated mortgage lenders and administrators have provided us with aggregated data on their regulated and non-regulated mortgage activities using the Mortgage Lenders and Administrators Return (MLAR).
- 4.26** To maintain a complete picture of the regulated mortgage sector, the PRA and FCA issue MLAR statistics as a joint publication.
- 4.27** Where a regulated lender undertakes both first and second charge activity, the second charge activity will currently be reported under the non-regulated fields in MLAR. However, this does not differentiate between second charge and other lending that does not result in a regulated mortgage contract (e.g. buy-to-let).
- 4.28** From 21 March 2016, second charge lending will constitute a regulated mortgage contract. We want to be able to identify second charge activity through MLAR, separate from first charge, to understand firms' lending profiles and, for analytical purposes, to subtract second charge activity from first charge where appropriate. However, we are conscious that making changes to the MLAR forms would cause disruption for firms that already submit returns.
- 4.29** We are therefore proposing to introduce a set of MLAR sub-forms to capture second charge lending. The main forms would remain unchanged, although 'regulated mortgage' fields would capture first and second charge from 21 March 2016.
- 4.30** The proposed MLAR sub-forms for second charge lending are:
- A(3)(a) – Balance sheet
  - D(a) – Business flow and rates
  - E(1)(a) – Income Multiple & LTV
  - E(2)(a) – Nature of loan and purpose
  - F(a) – Arrears analysis
  - H(a) – Arrears analysis (relevant only to mortgage administrators)
- 4.31** Firms that sell first charge mortgages and no second charge mortgages within a reporting period would only be required to submit data in relevant MLAR 'main' forms, as at present.

- 4.32** Firms that sell both first and second charge mortgages within a reporting period would be required to submit relevant MLAR 'main' forms, as well as relevant sub-forms.
- 4.33** As detailed in paragraph 3.114, we are proposing not to impose prudential requirements on second charge non-bank lenders and administrators, from March 2016. As a result, MLAR sections C, L and M (with effect from 1 January 2015) would not apply to firms engaged in second charge activity, but not first charge.
- 4.34** Regulated first charge mortgage lenders are currently required to submit MLAR returns on a quarterly basis. To ensure consistency of this important data source and to support our supervisory activity, we intend to apply the same reporting frequency to second charge lenders.

**Q46: Do you agree with our proposed treatment of second charge lending through MLAR?**

**Retail Mediation Activities Return**

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- 4.35** Firms with a permission to carry on home finance mediation activity are required to submit data on their regulated mortgage activities through the Retail Mediation Activities Return (RMAR).
- 4.36** As second charge mediation will fall within the definition of home finance mediation activity from 21 March 2016, we will need to be able to identify second charge activity through RMAR, separate from first charge. We therefore propose to capture this through amendments to the following RMAR forms:
- Section B – profit and loss
  - Section G – training and competence
- 4.37** RMAR sections C and D would not apply to intermediaries that mediate second charge mortgages, but do not mediate first charge, as we are not proposing to impose prudential requirements (other than the PII cover required by the MCD) on these firms from March 2016.
- 4.38** As with MLAR, we are proposing that second charge intermediaries are subject to the same quarterly reporting frequency to ensure data consistency.

**Q47: Do you agree with our proposed treatment of second charge mediation through RMAR?**

**Proposed implementation**

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- 4.39** Given our lack of data on a market that poses risks of consumer harm, we propose implementing our reporting requirements from March 2016, in line with the application of our mortgage regime.
- 4.40** We intend to publish our policy statement in Q1 2015, which would give firms a year to implement our proposed data reporting requirements. This is similar to the lead time firms had for the MMR data reporting requirements.

- 4.41** However, we are mindful of the cost burdens that our proposed requirements will place on firms. The estimated impact across the second charge market is set out in KPMG's report analysing the impacts of our proposals on the second charge market. Our cost benefit analysis summarises that report in Annex 1.
- 4.42** The cost impact will be less for those firms that also carry out first charge activities as they will already be subject to the proposed reporting requirements for that business. We have also tailored our proposals for second charge firms where appropriate to minimise the systems changes needed by firms that already report data to us.
- 4.43** We have considered delaying the implementation of regulatory reporting to ease the burden on firms. This would, however, adversely affect our ability to meet our objectives. We would not have the necessary information to supervise second charge firms effectively, nor would we be well placed to quickly identify issues and respond accordingly.
- 4.44** There may be benefits to firms working towards the same timetable for implementing our mortgage regime rules and regulatory reporting requirements. We are aware that some first charge firms incurred additional costs as a result of implementing our revised MCOB rules by April 2014 and regulatory reporting requirements by January 2015.
- 4.45** Firms would likely face similar challenges if we were to phase in regulatory reporting through the introduction of interim requirements.
- 4.46** However, we would welcome evidence from firms on whether and how our proposed implementation timetable would cause them difficulty, along with possible alternatives that would ensure that we can effectively supervise the second charge market and meet our statutory objectives.

**Q48: Do you agree with our proposed implementation timetable for second charge firms' regulatory reporting?**

**Q49: Do you have any alternatives to minimise any cost burdens on firms, while ensuring that the FCA can meet its statutory objectives?**

**Q50: Do you have any comments on the draft rules set out in Appendix 1? Do you think the rules reflect the stated policy intention?**

### Complaints reporting

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- 4.47** The Dispute Resolution: Complaints (DISP) module of our Handbook sets out the rules we expect firms to follow in reporting complaints to us. Where a firm is authorised by us, we expect second charge complaints to be categorised as 'Other regulated home finance products (including second and subsequent charge mortgages)' in the DISP complaints return form.
- 4.48** We will be consulting later in the year on our general approach to complaints reporting. As part of this, we are considering whether second charge complaints should be differentiated from other regulated home finance products.
- 4.49** In complaints data published by the Financial Ombudsman Service, second charge complaints are already captured under a distinct category of 'secured lending'.

## 5. Other Handbook changes applicable to first and second charge

### Introduction

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- 5.1** In this chapter, we propose further amendments to MCOB that would apply to both first and second charge firms. These are in addition and separate to the changes we are proposing to implement the MCD and transfer second charge activity into our mortgage regime.
- 5.2** The proposals in this chapter are designed to improve customer outcomes by ensuring that:
- as part of the sales process, all customers considering taking out a first or second charge mortgage are made aware that alternative finance options may be available
  - vulnerable customers with a payment shortfall are treated fairly and appropriately
  - information is shared between charge holders where a customer is at risk of losing their home

### Alternative finance options

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- 5.3** As part of the MMR, we introduced an advised sales rule requiring firms to notify customers applying to remortgage that a further advance with their existing lender may be more appropriate.
- 5.4** With the transfer of second charge into our mortgage regime, we have taken the opportunity to reconsider the scope of this rule and the point in the sales process when it should apply.
- 5.5** We believe that customers should be made aware of a wider range of alternative finance options when looking to increase their borrowing secured on their home. This would give customers the opportunity to explore the availability and appropriateness of those alternatives, which may be better suited to their needs and circumstances.
- 5.6** We are proposing to widen our existing rule so that, where a customer is considering raising additional monies through a remortgage of their first charge loan, the firm informs them that it may be possible or more appropriate to obtain a second charge mortgage or an unsecured loan, as well as a further advance.
- 5.7** We also propose introducing a similar rule where a customer is applying for a second charge mortgage. This would require the firm to inform the customer that it may be possible or more appropriate to obtain a further advance with their existing lender, a remortgage or an unsecured loan.

- 5.8** Firms will not be required to make customers aware of a further advance where it is known that the customer would be unable to obtain one, for example through previous conversations with the customer.
- 5.9** We would require these messages to be delivered in the same way as the rest of the sale. So, verbally where the initial contact with the customer is interactive, and, for non-interactive sales, separately from messages in the firm's written or electronic communication with the customer.
- 5.10** As with the current rule, we are not proposing that firms assess whether the alternative finance options are more appropriate for the customer, only that the customer should be made aware of those options. We consider it would be more appropriate for this requirement to form part of the disclosure at the start of the sale by introducing the rules into MCOB 4.4A. As a consequence, we would remove the existing requirement from our advised sales rules in MCOB 4.7A.
- 5.11** This would not only avoid possible confusion about what we expect of firms, but will also ensure that all customers, irrespective of whether the sale is progressing on an advised or execution-only basis, are made aware of alternative finance options that may better meet their needs.
- 5.12** If a firm wishes to advise a customer on the suitability of those alternative finance options, they would be free to do so, subject to meeting any relevant regulatory requirements. Our proposed initial disclosure requirements for all customers looking to increase the borrowing secured on their home will help facilitate this approach through building customer awareness of the wider range of alternatives.
- 5.13** As the method of disclosure correlates with nature of the sale – verbally for interactive sales or either electronically or in writing for non-interactive sales – the disclosure can form part of firms' existing processes. In addition, we are not prescribing the depth that firms need to go into to meet our requirements. We do not anticipate significant costs for firms.

**Q51: Do you agree with our proposed rules requiring firms to make customers aware of alternative finance options where they are looking to increase their secured borrowing?**

**Q52: Do you agree that these proposed rules should form part of the initial disclosure, applicable to both advised and execution only sales?**

### **Fair treatment of customers with a payment shortfall**

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#### **Customers in vulnerable circumstances**

- 5.14** The consideration of a customer's individual circumstances is integral to how we expect firms to treat fairly those customers experiencing a payment shortfall. Our specific requirements are set out in MCOB 13. Our proposed changes to MCOB 13 to transfer second charge mortgages into our existing regime are explained in chapter 3.
- 5.15** Following our recent thematic review into first charge firms' arrears management and forbearance practices, we see a case for strengthening MCOB 13 to help ensure that customers in vulnerable circumstances are treated fairly.

- 5.16** Our Handbook does not define customers in vulnerable circumstances. However, for the purposes of this chapter and proposed MCOB 13 rule, we are referring to customers who are known, or reasonably believed, to lack the capacity to make relevant financial decisions at a particular time. This could include, but is not limited to, customers with mental health problems.
- 5.17** Findings from our thematic review, published in February 2014<sup>32</sup>, set out a number of considerations for firms, including the importance of dealing sensitively with customers who may have vulnerabilities.
- 5.18** Our review highlighted that vulnerable customers were not consistently identified, nor their circumstances sufficiently probed by front-line staff in some firms even when they were explicitly referred to by customers. Although a number of firms have established specialist teams to deal with vulnerable customers, our review also identified that referrals to these teams were sometimes missed or made too late in the process to have any meaningful impact. This resulted in firms failing to treat some vulnerable customers sensitively.
- 5.19** CONC 7 contains an explicit requirement on firms to establish and implement clear, effective and appropriate policies and procedures for customers that the firm understands, or reasonably suspects, to be particularly vulnerable. In meeting that requirement, firms may wish to have regard to Money Advice Liaison Group guidelines on debt and mental health.<sup>33</sup> However, CONC 7 will not apply to regulated second charge mortgages from 21 March 2016.
- 5.20** Although MCOB 13 requires firms to have a written policy and procedures in place in order to treat all customers with a payment shortfall fairly, there is not the same explicit requirement in relation to vulnerable customers.
- 5.21** We propose transposing the CONC 7 rule and guidance on the fair treatment of vulnerable customers into MCOB 13, applicable to both first and second charge firms.
- 5.22** Second charge firms are already subject to these requirements and, through our thematic work, we are aware that first charge firms have taken steps to improve the fair treatment of vulnerable customers. We believe that setting out our expectations in MCOB 13 will support firms' progress and ensure that their policies and procedures are implemented consistently. The rule would not prescribe how firms should treat vulnerable customers, as this will need to be determined by the firms' assessment of individual circumstances.
- 5.23** We do not anticipate that first charge firms will incur significant costs in complying with our proposed requirement, but some firms exhibiting poor practice may incur costs in establishing policies and training front line staff.

**Q53: Do you agree with our proposal to transpose the CONC 7 provisions for vulnerable customers into MCOB 13?**

**Information sharing between charge holders**

- 5.24** The transfer of second charge into our mortgage regime presents an opportunity to mitigate risks where a customer faces losing their home on which more than one mortgage is secured. At present, there are very few obligations on firms to share information with other charge holders.

<sup>32</sup> TR14/3, Mortgage lenders' arrears management and forbearance, (February 2014): [www.fca.org.uk/static/documents/thematic-reviews/tr14-03.pdf](http://www.fca.org.uk/static/documents/thematic-reviews/tr14-03.pdf)

<sup>33</sup> [www.malg.org.uk/dmhddocuments/Mental%20Health%20Guidelines%20Ed%202%20Final%202009.pdf](http://www.malg.org.uk/dmhddocuments/Mental%20Health%20Guidelines%20Ed%202%20Final%202009.pdf)

- 5.25** Civil Procedure Rule Part 55.10(2)(c) requires a firm taking possession action to notify other charge holders of a court hearing date within five days of it being set. However, by this point in the process, a customer is likely to have already incurred costs as a result of the litigation action.
- 5.26** This lack of timely information sharing does not enable firms to work together in the best interests of the customer and increases the risk of a customer incurring additional costs as a result of firms starting separate litigation actions.
- 5.27** Guidance in CONC 15 states that, when taking possession action, a second charge firm should establish contact with higher priority charge holders to minimise adverse impacts on the customer. MCOB 13 does not contain any similar provision for first charge firms to engage with lower priority charge holders, and there is unlikely to be the same commercial incentive for first charge firms.
- 5.28** We are proposing to introduce new rules in MCOB 13 requiring the firm taking litigation action, or having consented to an assisted voluntary sale, to share information with other firms with a mortgage secured on the property as follows.
- Where a firm is taking litigation action against the borrower in order to obtain possession of the property:
    - notice of litigation action having started
    - notice of a scheduled court hearing date (in line with Civil Procedure Rule Part 55.10(2)(c))
    - details of the outcome of any court hearing
    - notice of the scheduled eviction date
  - Notice of a customer having voluntarily surrendered possession of the property.
  - Where a property in possession is sold:
    - notice of the sale and details of the method of sale
    - details of the accepted offer price
  - Where the firm is supporting some aspect of the customer's sale of the property through an assisted voluntary sales process:
    - notice that the customer has entered into an assisted voluntary sale process
    - notice of the sale and details of the method of sale
    - details of the accepted offer price
- 5.29** The timings of these notifications are set out in our draft Handbook text at Appendix 1.
- 5.30** We have opted to structure our information sharing proposals around set points in the litigation, sales and possession processes rather than upon request. This will enable firms to establish specific processes to issue the notifications, reducing both uncertainty and cost.

- 5.31** We have considered whether information should be shared even earlier in the process. However, under MCOB 13, firms are obliged to consider appropriate forbearance and we do not believe that a data sharing requirement at a stage earlier than what we have proposed would result in better customer outcomes.
- 5.32** We believe that our proposals will present several benefits when compared with current practice.
- 5.33** Consumer groups have told us that more consistent sharing of information, as we propose, could help minimise separate court actions and costs for the customer.
- 5.34** Similarly, the increased transparency on assisted voluntary sales brought about by our proposals could incentivise firms to work together to ensure good customer outcomes and reduce the possibility of lower priority charge holders withholding consent to a sale.
- 5.35** For possession sales, MCOB 13 already requires firms to market the property for sale as soon as possible and obtain the best sale price. Increasing the transparency of a sale will allow other charge holders to understand how the property is being sold and at what price it is being marketed. Where appropriate, other firms with a charge over the property will be able to challenge whether the method of sale and the asking price are in the best interests of the customer. However, it will remain for the firm effecting the sale to arrive at a final decision in meeting their regulatory obligations.
- 5.36** By placing an obligation on all first and second charge firms, we will be removing any incentives on higher ranking charge holders to withhold information where those firms have no commercial imperative to share it with lower ranking charge holders.

**Q54: Do you agree with the scope of our proposed information sharing requirements?**

**Q55: Do you agree that our proposed information sharing requirements should apply to all firms with a regulated mortgage secured against the property?**

### **Contract variations**

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- 5.37** We currently require firms carrying out rate switches or transfers of equity to give consumers a KFI. We propose to change our rules so that firms can use an ESIS instead if they prefer, for example if it is more efficient.

### **PERG**

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- 5.38** We have made amendments to our Perimeter Guidance (PERG) to reflect the changes in the legislation. These can be found in Appendix 1. We will consult separately in due course on further changes to reflect government's consumer buy-to-let legislation.

**Q56: Do you agree with the amendments made to PERG?**

**Q57: Are there any business models which need further consideration under PERG as we propose to amend it?**

## 6. Authorisation regime for second charge firms

### Applying for authorisation

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- 6.1** The Treasury propose that the implementation of the MCD on 21 March 2016 should be the date on which second charge mortgages are transferred from the consumer credit regime to the mortgage regime. This means that to carry on second charge mortgage business after that date, lenders, administrators and intermediaries have to be authorised and hold the correct mortgage permissions.
- 6.2** Firms and individuals carrying on regulated financial services activities in the UK must be authorised, unless they are exempt. To become authorised by us, firms apply using forms that we make available online.
- 6.3** We expect to begin accepting applications from second charge firms who wish to add regulated mortgage activities after 1 April 2015, and we aim to publish the final rules ahead of this.
- 6.4** We are currently reviewing our application process to ensure that as many firms as possible are able to have their applications determined in time.

### Statutory service standards

- 6.5** Firms should be aware that statutory standards apply to the determination of applications for corporate authorisation, which are set out in the Financial Services and Markets Act (FSMA).
- 6.6** We will make a decision within the earlier of:
- six months of receiving your complete application
  - 12 months of receiving an incomplete application
- 6.7** In practice, applications are usually determined well within these service standards.

### Alternatives to authorisation

- 6.8** There are alternatives to becoming authorised which allow for some unauthorised firms and individuals legally to carry on regulated activities. These include:
- Being an 'appointed representative' of an authorised firm
  - Being an 'exempt professional firm'

**Being an appointed representative**

- 6.9** An appointed representative has a contract with an authorised firm (known as a principal) under which the principal accepts responsibility for the appointed representative carrying on regulated activities. The appointed representative has no direct relationship with us.

**Being an exempt professional firm**

- 6.10** A professional firm that is a member of a Designated Professional Body (DPB) can carry on certain regulated activities under the regulation and supervision of its DPB, rather than us, if it fulfils certain criteria set out in FSMA. These firms are known as exempt professional firms.

**What this means for different groups of firms****Existing authorised firms holding regulated mortgage permissions**

- 6.11** The Treasury intends to change the definition of a regulated mortgage contract in the Regulated Activities Order (RAO) so that it extends to both first and second charge mortgages; the Treasury consultation document sets out how the RAO will change.<sup>34</sup> The Treasury are also proposing that firms with mortgage related permissions will be deemed to have the extended permissions. This means that firms already holding Part 4a permission for regulated mortgages contracts may not need to submit an application to vary their permission. Firms should review their existing permission profile to ensure they hold the correct permissions for the second charge business they undertake. If additional permissions are required, firms should submit an application to vary their permission in the usual way, once we are open to take applications relating to second charge mortgages.

- 6.12** To supervise firms effectively it is important that we know what types of business our authorised firms are undertaking. As there will be a single set of permissions for secured lending we will be asking firms to notify us as to whether they undertake first charge business only or both first charge and second charge business. The mechanism for this notification will be confirmed at a later date.

**Existing authorised firms with no regulated mortgage permissions but who do second charge business**

- 6.13** Existing authorised firms who need to add regulated mortgage permissions for their second charge business should apply to vary their permission by following the standard process once we are open to take applications relating to second charge mortgages. Failure to do so will mean that a firm's existing interim permission for second charge business will run out on 21 March 2016 and the firm would have to stop doing any second charge business after that date.

- 6.14** On our website we will set out what information and documentation should be submitted with the application so that firms will more easily be able to submit complete applications.

**Consumer credit firms whose only consumer credit activity is second charge broking or lending**

- 6.15** There are a small number of firms who have registered for interim consumer credit permission solely for second charge business. To continue second charge business after 21 March 2016, firms will need to be authorised (or exempt) for regulated mortgage business as their interim consumer credit permission will lapse at that date.

<sup>34</sup> Treasury consultation '*Implementation of the EU mortgage credit directive*' (September 2014).

- 6.16** Firms falling into this category, and wanting to be directly authorised by us, should submit an application form for financial services (rather than consumer credit). Details of the current application process and forms can be found on our website. The forms will be updated over the coming months for second charge business, but firms may find it helpful to review the existing application form now so they can familiarise themselves with the type of information we usually require from mortgage firms. We expect to accept applications after 1 April 2015. We will contact firms in this group later this year to set out the application process in more detail.

#### **Consumer credit firms who do second charge mortgage business and other consumer credit activities**

- 6.17** The majority of second charge firms also carry out other consumer credit activities. We are currently reviewing our application forms and processes to ensure we can make the application process as clear and straightforward as possible. We expect the review to be completed over the next few months, and we will update our website with details of the application process at the earliest opportunity.
- 6.18** Consumer credit firms will have already been given an application period sometime between August 2014 and March 2016. The timing of the MCD and the transfer of second charge mortgage business from consumer credit to the mortgage regime may mean that for some firms their previously confirmed application periods need to change to give firms the maximum time to apply for new mortgage permissions. Those firms with an application period before 1 April 2015 will have to amend an 'in flight' application or, if an authorised firm, submit an application to vary their permission to add mortgage permissions.
- 6.19** We will be writing to affected firms over the coming months.

#### **New consumer credit applications including second charge business**

- 6.20** Until 21 March 2016 second charge business remains a consumer credit activity and firms wishing to undertake second charge business before that date should apply to offer consumer credit in the usual way.
- 6.21** Firms applying before we are open to accept application for second charge mortgage permissions (not expected to be before 1 April 2015) will have to amend an 'in-flight' application, or submit an application to vary their permission if they are an authorised firm, to add the relevant mortgage permissions.
- 6.22** Firms applying after 1 April 2015 will also be able to apply for the relevant mortgage permissions.

#### **Support for firms new to the mortgage regime**

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- 6.23** Our website is the main source of information for firms. We will be updating the authorisation pages, forms, FAQs etc. in the coming months to reflect the changes for second charge firms. We would encourage firms to check the website regularly for information so they can be well prepared to submit an application for regulated mortgage business once we are open to accept applications.
- 6.24** We are also considering what other support we can offer to firms, such as webinars and authorisation workshops for lenders.

# Annex 1

## Cost benefit analysis

### Introduction

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1. FSMA, as amended by the Financial Services Act (2012), requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as ‘an analysis of the costs, together with an analysis of the benefits’ that will arise if the proposed rules are made. It also requires us to include estimates of those costs and benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.
2. We are consulting in this CP on a range of regulatory changes for the second charge market. Some of these changes derive from the MCD, while some proposals are initiated by us (in several cases drawing on our regulation of the first charge mortgage market). This chapter presents a CBA of:
  - **Responsible lending rules:** for which we conducted a detailed analysis because these were expected to have the most significant impact of all the proposals being considered for the second charge market. This analysis forms the core of this CBA chapter.
  - **The broader regulatory package being considered for the second charge market:** for which we engaged KPMG to conduct a cost benefit analysis. We present a summary of the KPMG analysis in this CBA chapter. The complete KPMG study has been published alongside this Consultation Paper on our website.
  - **Other proposals including administrative issues:** for some of which our internal analysis timeline began after the initiation of the KPMG study, and for some of which (issues we term collectively as administrative e.g. FSCS related proposals) we considered an in-house analysis was the preferable approach
3. Further to the package of regulatory changes being considered for the second charge market, this CP also covers the implementation of the MCD for the first charge market. The final section of this chapter presents a CBA of this. Since this is an area either where the FCA has little or no margin for discretion in implementing the MCD, or the FCA has assessed the discretion it has to minimise the impact of the MCD in both scope and extent of rule changes whenever possible, we have conducted a high level cost benefit analysis.

# Section 1

## Responsible lending proposals for second charge loans

### Summary

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4. Responsible lending proposals are being considered for the second charge mortgage market. The main elements of these proposals include introducing an affordability assessment and requiring an interest rate stress test. This section presents our analysis of the costs and benefits of these proposals.

### Data set

5. To conduct our analysis we collected loan level sales and performance data from a sample of ten loan providers covering the period 2005-13. We estimate that this data set of around 0.5 million transactions covers about 85% of all current second charge lending in the market, and around half of all lending during 2005-2007 when the market was at its peak. While the sales information we got from firms was fairly comprehensive, subsequent performance data had many gaps. We are able to build a market overview picture which we are confident about. However, in conducting our analysis of the impacts of responsible lending, which is heavily dependent on good quality performance data, we think our results should be taken to be indicative and not as precise estimates of impacts.

### Market overview

6. There has been a steep decline in lending in the second charge market since the start of the financial crisis. Current annual levels of lending (around £0.5bn) are perhaps a tenth or less of pre-crisis levels. Around two thirds of people who use second charge loans borrow for debt consolidation purposes. A smaller but still significant proportion of borrowers use such loans to make home improvements or for other consumption purposes. Median annual interest rates charged on loans in this sector typically ranged between 9-13% during 2005 to 2013, though median interest rates charged by some firms are closer to 18%. Average loan sizes over this period range between £25,000 and £30,000.
7. There is a clear shift in the profile of second charge borrowers since the start of the crisis, with the typical borrower post crisis being materially more affluent than in the past. We posit that this likely reflects both supply factors (credit rationing/ improved underwriting since the crisis), and demand factors (house price falls reducing the pool of potential borrowers with equity in their homes). The improved quality of underwriting hypothesis is supported by improvements observed in lender verification of income. Lender verification of income is now universal, which compares favourably with 2005-06 when in more than a fifth of cases income was self-certified.
8. Around half of all second charge loans used to go into arrears prior to the crisis. More than a third of all loans would go into arrears in the first year since origination. This has declined materially but a significant percentage (between 10-15%) still goes into arrears early. High arrears

percentages do not necessarily translate into high repossession rates. Of loans originating in the boom period 2005-08 around 2% led to repossession orders for borrowers' homes where action was initiated by second charge lenders.

9. The market is significantly less profitable than prior to the crisis. The largest drivers of profitability in this sector were the cross-selling of PPI, charges and margins, all of which have decreased. The new business model for firms currently appears to be based primarily on margins, targeting a more affluent group than before, who continue to need such loans primarily for debt consolidation. The changed customer profile has led to a consequent lowering of detriment, with arrear percentages falling to less than half of pre-crisis levels.

#### Market failures

10. The two main market failures in the second charge market that our responsible lending proposals are targeted at are behavioural biases and information asymmetries.<sup>35</sup>
  - **Behavioural biases:** Several biases in consumers' (and sometimes firms') behaviour are likely to be relevant to the second charge market, including borrowers overestimating their ability to repay the loan; and/or placing more emphasis on their current spending needs without sufficient emphasis on the likely consequences of living beyond their means.
  - **Information asymmetries:** Borrowers may also make ill-informed decisions because of informational asymmetries between customers and lenders/brokers about the range of alternative, potentially more suitable, products available and because they are likely to know less about the probability of their ending up in arrears than lenders and intermediaries (which the latter groups have some incentives to exploit).

#### Proposals and baseline

11. The affordability assessment and the interest rate stress test collectively are at the core of our responsible lending requirements:
  - **the affordability assessment:** the lender must verify income and be able to demonstrate that the loan is affordable, taking into account income and, as a minimum, the borrower's committed expenditure (which includes payments for their first charge mortgage and other outstanding debts), essential household expenditure, and basic quality of living costs
  - **the interest rate stress test:** the lender must consider the impact of expected future interest rate increases on affordability
12. The baseline that we use to estimate potential costs and benefits of the responsible lending proposals against is broadly the current position. Were we not to proceed with our responsible lending proposals, a similar (though less precisely defined) credit worthiness assessment would be required under the MCD. Thus this approach significantly overestimates the impacts of our proposals against the true counterfactual, i.e. a world where MCD requirements are implemented.

#### Methodology

13. Broadly speaking the largest benefit of the responsible lending proposals is expected to come from the avoidance of negative impacts associated with payment problems for borrowers refused loans. This needs to be balanced in particular against welfare losses for those who are refused or get smaller loans but would not have suffered problems.<sup>36</sup>

<sup>35</sup> The main additional justification for intervention in this market is around regulatory failure. However, this relates more to the overall package of regulation being proposed than to the responsible lending proposals specifically.

<sup>36</sup> This does not mean that all those who would have suffered payment problems and no longer would as a result of the proposal will be better off. Outcomes depend greatly on the alternative position in which impacted borrowers end up.

- 14.** To estimate the size of these impacts we follow a three step approach which is based on the methodology developed for the MMR in FSA CP11/31. Our approach works by modelling how past second charge loans would have been different if the responsible lending proposals had been in place. This requires some judgemental assumptions on the basis of imperfect evidence.
- As a first step we calculate the Debt Service Ratio (DSR) for each loan in the sample. The numerator of the ratio is monthly payments that need to be met to service a borrower's debt. The denominator is net monthly income
  - Our second step is to calculate an Underwriting Risk Score (URS) for each loan in the sample, which we do using a Quality of Underwriting approach which was developed for the MMR in FSA CP 11/31. The URS is constructed to capture the goal of the proposed responsible lending rules i.e. to improve affordability assessments so that loans are not unaffordable because of poor underwriting standards
  - For both measures (DSR and URS) we attempt to identify jumps (inflection points) which would demonstrate either a sharp increase in arrears associated with DSR, or rapidly reducing quality of underwriting. The idea being these would proxy the point at which an effective affordability assessment requirement would take effect. However neither method shows such jumps.<sup>37</sup>
  - In the absence of any observable inflection points we develop a scenario based on the MMR analysis to determine the impact of the proposed policy. As a third step, we assume that the proportion of borrowers impacted in the second charge market will be analogous to the percentage impacted in the MMR analysis, after accounting for the difference in arrears rates between the first and second charge markets.<sup>38</sup> This scenario is then overlaid on our DSR and URS measures for the second charge market to draw out impacts.
- 15.** This CBA is based on loan data for the period 2005-2011.<sup>39</sup> The period is informative because it includes years in which the second charge market was booming (2005-8) and years in which it was subdued (2009-2011). The current condition and medium term expectations of the second charge market are more reflective of the subdued period (2009-11), which we therefore focus on in our analysis.
- 16.** Data gaps mean we can only use information from two (out of the ten) firms in our sample for this analysis of impacts.<sup>40</sup> Even for these two firms there are data quality issues which make comparability difficult. Consequently our results can only be illustrative/ directional at best.

<sup>37</sup> Beyond any data issues, we think a primary reason for not observing inflection points in our analysis is because arrears rates are so high in the sample being investigated that impairment is the norm.

<sup>38</sup> We further account for the fact that a greater proportion of impacted borrowers in the first charge market would be excluded, while the dominant impact in the second charge market would be being lent less

<sup>39</sup> While we did collect data for 2012 and 2013 from firms as well, loans from these later years have had only a short period of time to go into arrears. Adding these to our data set for this analysis would have biased our results. We therefore truncate our analysis in 2011, but then use information we can glean from 2012-13 data to understand the scale of the immediate impact of our proposals.

<sup>40</sup> These two firms make up around 40% of the market by number of loans currently, and around 4% of the market during the boom period.

## Costs and benefits

**Table 1: Costs and benefits of responsible lending proposals**

<b>Impacted Group</b>	<b>Benefit</b>
For borrowers who would no longer suffer payment problems, arrears and repossessions (as a consequence of being refused or getting smaller second charge loans)	Avoidance of negative impacts (distress) associated with these events
	Avoidance of legal and administrative costs associated with these events
For borrowers whose homes would no longer be repossessed (as a consequence of being refused or getting smaller second charge loans):	Reduction of transfer (mainly from fire sale discounts) to consumers who would purchase their property
<b>Impacted Group</b>	<b>Costs</b>
For borrowers who are refused or get smaller second charge loans	Welfare loss from delayed, cancelled or reduced improvement in home or other consumption
	Welfare loss from lower possibility to consolidate previous debts using second charge loans
For firms	Compliance costs associated with carrying out more stringent affordability assessments Impacts on revenue and profitability as a consequence of reduced volumes of lending
For individuals who would have otherwise bought houses repossessed from second charge borrowers	Reduction of transfer (fire sale discounts) from not being able to buy houses repossessed from second charge borrowers

### **Borrowers impacted by the proposals**

- 17.** Based on the subdued period (2009-11), which is more reflective of the current and expected state of the second charge market in the medium term, we estimate<sup>41</sup>:
- Between 10% and 17% of consumers would no longer be able to borrow. Around a third of these would have gone into arrears on their second charge loans at least once, so they would benefit from the avoidance of distress associated with such events.
  - Between 22% and 30% of consumers would be lent less. We estimate an average reduction of between a quarter and a third in the amount this group would be able to borrow on their second charge loans. Their consequent probability of going into arrears on their second charge loans at least once is estimated to drop from around a third to between 15-19%. This group benefits from the reduction in this risk of distress associated with impairment.
- 18.** This does not mean that all those who would have suffered payment problems and no longer would as a result of the proposal will be better off. Outcomes depend greatly on the alternative position in which impacted borrowers end up. The two avenues that appear most likely are individuals either not borrowing, or those who are in significant difficulties with their debts finding a debt solution.

<sup>41</sup> The boom period (2005-08) analysis provides an upper bound of the scale of detriment that could potentially be impacted if rising house prices led to a refocus on equity in property and a return to previous behaviour. Based on the boom period we estimate between 9% and 17% of consumers would no longer be able to borrow, and between 29% and 37% of consumers would be lent less.

- Either outcome would reduce the cycle of taking up excess second charge loans (beyond the amount needed for debt consolidation), freeing up existing credit lines, and getting increasingly leveraged. This would likely lower the probability of getting into payment problems overall. In addition the risk of an individual's home being repossessed in action initiated by second charge lenders would be reduced.
  - There might also be an opposing impact with the lower price of second charge loans compared to the original credit (which is being consolidated) suggesting some borrowers could be better off without the policy proposal even if they got into payment problems. We posit on average this increased cost effect is likely to be smaller than the positive effects described above.
19. Further, not everybody who would no longer be able to borrow or who would be lent less as a consequence of our responsible lending proposals would have gotten into payment problems. For these individuals there would be welfare losses from delayed, cancelled or reduced ability to make home improvements or otherwise increase consumption and/or from a lower possibility to consolidate previous debts using second charge loans.
20. In an ideal world we would like to calculate the reduction in welfare or well-being for those losing out and balance these against estimated welfare or well-being gains for those who would benefit. We do not think this is reasonably practicable to do.<sup>42</sup>
21. We expect the immediate impact of our proposals to be considerably smaller than the scale of impacts estimated through our modelling. The market has moved towards adopting similar practices to our proposals, and arrears rates in the period after the end of our analysis have further lowered, indicating that materially less unaffordable lending now happens in the market compared to the period of our analysis.
- Reduction in cost of arrears and repossessions for consumers***
22. Borrowers who would not suffer payment problems as a consequence of being refused or getting smaller second charge loans would avoid the legal and administrative costs associated with these events. We estimate the value of resources saved through the proposal to be around £1m per year on the basis of the subdued period. In addition for borrowers whose homes would no longer be repossessed as a consequence of being refused or getting smaller second charge loans there would also be a reduction in transfer (mainly because of fire sale discounts) to consumers who would otherwise have purchased their property which we estimate to be around £6 million.
- Impact on firms and on competition***
23. There would be some compliance costs for firms arising from making changes to IT systems, developing new sales processes, HR / training costs and additional time to process loans. These are estimated to be around £330,000 one-off and £225,000 on-going annually for lenders, and around £85,000 one-off and £35,000 on-going annually for brokers.<sup>43</sup>
24. As a consequence of our proposals, using the subdued period as our basis our modelling would indicate a reduction in lending volumes of around 20%. This would imply (given 2013 levels in the market) a reduction in the volume of lending in the second charge market of around £100 million. However, we expect the actual reduction in volumes to be materially smaller because unaffordable lending has materially decreased since the cut-off point for our analysis (2011). This aligns with views expressed by firms responding to KPMG's survey.

<sup>42</sup> Since it is particularly difficult to assess consumer welfare in a comparable way where behavioural factors may distort consumer decision making, and data limitations act as a practical constraint on any credible analysis.

<sup>43</sup> The £35,000 on-going estimate excludes costs driven by a broker's response which appears to incorrectly include the impact of the reduction in volumes that might be associated with the introduction of the proposed requirements, and which otherwise inflates the on-going annual cost estimate for brokers to £640,000.

25. Any impact will not be equivalent across firms but dependent on differences in behaviour. Smaller firms (because of narrower profit margins) and in particular firms with worse post-lending outcomes may be at some risk of exit, though the ability to pass through costs through higher prices may temper this. It is further possible that a greater degree of regulatory equivalence between first and second charge lending could lead to some mainstream mortgage lenders entering the second charge market. This could counter the reduction in the quantity of lending our analysis otherwise indicates and also improve the quality of competition in the market, though the size of any such effects is difficult to predict.

### **Overall view**

26. We think the immediate impact of the responsible lending proposals will be considerably smaller than those estimated through our modelling. As explained the market has moved towards adopting similar practices to our proposals, and arrears rates in the period after the end of our analysis have further lowered.
27. However, it is important to remember that correction in the second charge market (lower observed detriment for customers) since the start of the financial crisis has not come about because of customers' ability to discipline firms. In other words, it is not the informed actions of customers in the market which have led to firms' changing behaviour. Therefore, the risk remains that in the absence of regulation, increasing house prices could shift lenders' focus lenders back on to borrowers' equity in their homes. This could consequently partly reverse the self-correction observed. It is in precisely this situation that our responsible lending proposals should be most effective.

### **Data**

28. There are four primary sources of information that we used for our analysis:
- Loan level sales and performance data collected from a sample of ten firms
  - Data sets linked to the sample of loan level information to build up a social class profile of second charge borrowers: Communities and Local Government Index for Multiple Deprivation and Experian's Financial Strategy Segments
  - KMPG and Ignition House's interviews and survey of second charge loan providers and intermediaries, and
  - Finance and Leasing Association (FLA) statistics<sup>44</sup>
29. The main data source for our analysis is transaction level sales and performance data that we collected from a sample of ten loan providers covering the period 2005-13. We estimate that our sample covers firms who account for about 85% of all current second charge lending in the market, and around half of all lending during 2005-2007 when the market was at its peak.
30. Because the FCA did not previously regulate second charge loans we did not have data for firms in this market. We asked for information on around 60 sales and performance variables for every second charge loan granted during 2005-13 from ten firms.

<sup>44</sup> In addition we carried out secondary research, talked with industry experts, and also met regularly with an industry group

- 31.** We received data covering about 0.5 million second charge loans. The sales information we got from firms was fairly comprehensive, but subsequent performance data had many gaps. We were consequently able to build a market overview picture which we are confident about. However, in conducting our analysis of the impacts of responsible lending, which is heavily dependent on good quality performance data, we think our results should be taken to be indicative and not as precise estimates of impacts.
- 32.** Most firms provided quite good sales data on prices, fees, applicant incomes, purpose of loans, and term and value of loans granted. Many also provided information on other debts including first charge mortgages. Around half further provided post code data which allowed us to link this loan level data with the Communities and Local Government Index for Multiple Deprivation and with Experian's Financial Strategy Segments. This allowed us to draw out a fairly comprehensive overview of the market.<sup>45</sup>
- 33.** On the performance side, data from firms had much larger gaps. Only four firms provided transaction level information on borrowers going into arrears and on borrowers' properties being repossessed.<sup>46</sup> These four firms make up around 85% of the sample (by number of loans) currently, but less than a fifth of the sample during the boom period (2005-07). We include all four in our market overview. However, only two of these firms provided information which could be used in our impact analysis of the responsible lending proposals.<sup>47</sup> These two firms cover around 45% of the sample (and around 40% of the market) by number of loans currently and less than a tenth of the sample (and around 4% of the market) during the boom period.
- 34.** We ran a series of quality checks on the data received from firms. In several cases we found information for specific variables to be inconsistent. We went back to firms in an attempt to build a clean data set. In some cases however, firms were unable to provide comparable data. We excluded questionable data series on specific variables for such firms. Because of data quality issues we recommend caution in interpreting outcomes presented in this chapter as precisely accurate.
- 35.** A further caveat to note is that all ten firms in our sample are FLA members. While FLA members are understood to make up the vast majority of the second charge market (an estimated 85%), our market overview and consequent analysis may not be representative of the non-FLA section of the market.
- 36.** In addition we used information from a survey and interviews conducted by KPMG and Ignition House. In-depth interviews were conducted with eight lenders, six brokers and an industry association. This was supplemented with an online survey to which 18 lenders and 16 brokers responded. Further details on these can be found in KPMG's "Cost benefit analysis of policy proposals for second charge lending". In carrying out our CBA of responsible lending proposals, we used this information primarily for four purposes:
- To confirm or nuance the understanding of the market we built based on our analysis of transaction level data
  - To understand participants' expectation of the future direction of the market

<sup>45</sup> On the sales side the category where firms provided little or no credible information was on the (adverse) credit history of applicants.

<sup>46</sup> A fifth firm also provided performance information but this was only for loans which had survived beyond several years, introducing a bias into the data.

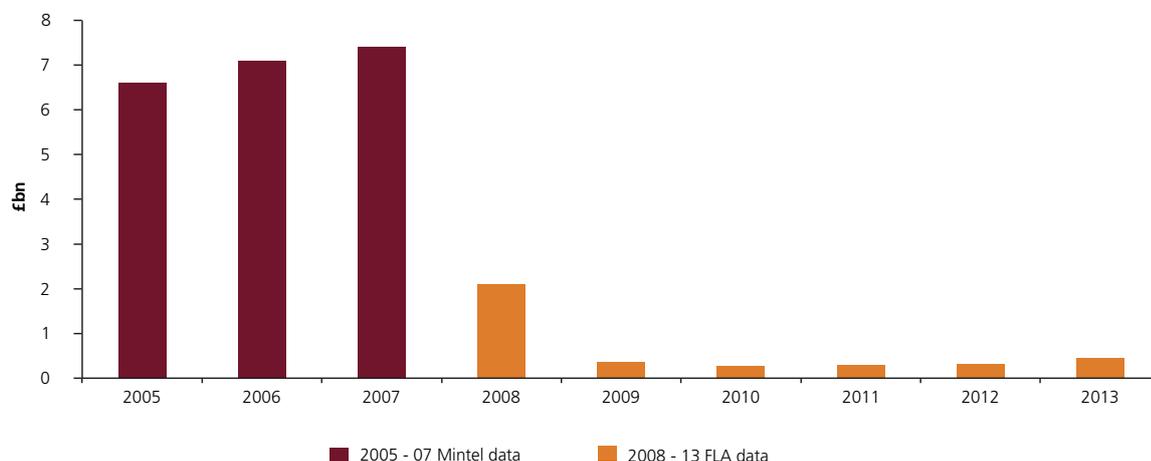
<sup>47</sup> On the two firms excluded: One is a recent entrant in this market with very little business conducted at the cut-off point for our impact analysis; the other did not provide a consistent data series on other debt payments, necessary for conducting our analysis.

- To gather information on compliance costs for firms as a consequence of our responsible lending proposals
- To understand the impact on competition as a consequence of the combined package of proposals (of which responsible lending proposals are expected to be the most significant aspect) for the second charge market

### Market overview

- 37.** We understand that there are perhaps 20 to 25 active lenders in the market today. We estimate that the four largest firms among these are responsible for around 80% of all current second charge lending. Around 1400 firms applied to the FCA for a second charge lending interim permission when we took over the regulation of the market from the Office of Fair Trading in April 2014. However, this is not an accurate reflection of the number of firms who intend to be active in the market.<sup>48</sup>
- 38.** Second charge loans were a significant source of lending prior to the start of the financial crisis. Around £7 billion of loans were originated in 2007. It is clear that there has been a steep decline in the market (Chart 1). Current annual levels of lending (around £500 million) are less than a tenth of pre-crisis levels.

**Chart 1: Estimate of new second charge mortgage market lending by year<sup>49</sup>**



- 39.** Median annual interest rates charged on loans in this sector typically ranged between 9-13% during 2005 to 2013, though median interest rates charged by some individual firms over this period are closer to 18%. While rates for most customers appear to be banded fairly tightly around each firms' median rate, there are a small number of loans where we observe interest rates exceeding 30%.

<sup>48</sup> Firms appear to have ticked multiple credit products in the interim permission process without necessarily intending to conduct business across all types of products applied for

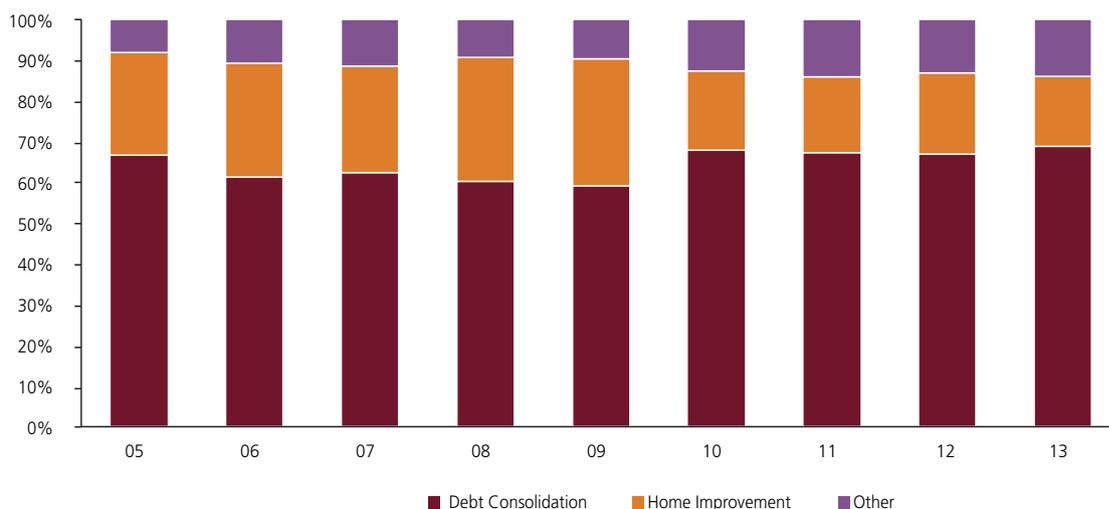
<sup>49</sup> Mintel, *Secured Lending Products* (2009) data covers a wider suite of products than just second charge mortgages (e.g. loans secured against vehicles) therefore the numbers for 2005-07 likely present an overestimate of the second charge market size. These numbers do not include first charge mortgages. FLA members are estimated to cover around 85% of the market therefore the numbers for 2008-13 likely underestimate the market size.

**Chart 2: Median interest rate initially charged**



40. We observe consistently across 2005-13 that the primary purpose for taking out second charge loans for around two-thirds of customers is to consolidate their debts. In line with this observation, around two thirds of the total amount lent goes towards debt consolidation as well. There is a nuance here though. Those whose primary purpose for borrowing is debt consolidation are typically lent an additional (top-up) amount. And for a significant proportion of cases where debt consolidation is not stated as the primary purpose, we still observe some portion of the loan being used for consolidation purposes. Home improvement is the second most common stated purpose for taking out such loans.

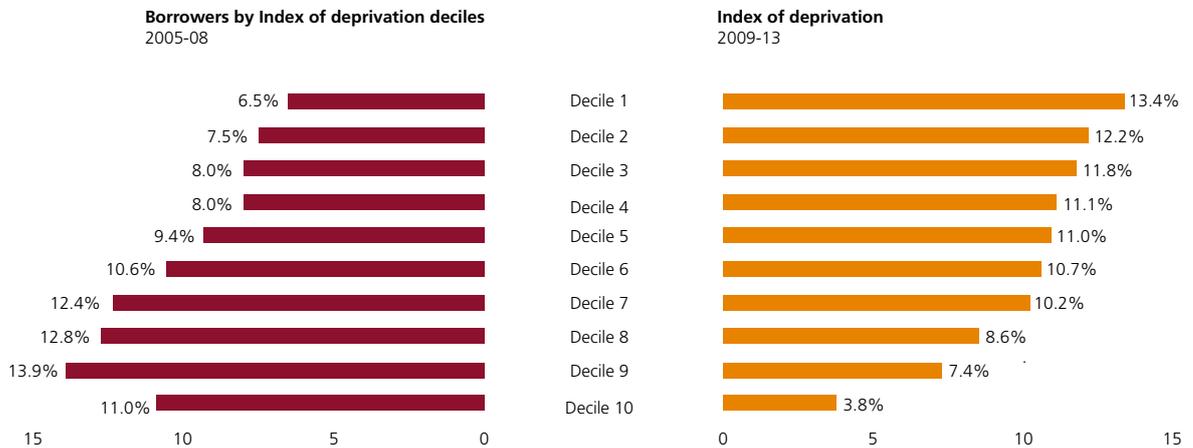
**Chart 3: Primary purpose of second charge loan<sup>50</sup>**



<sup>50</sup> Some firms only provided data in two categories “debt consolidation” and “other”. For these the “other” category includes home improvements. Therefore the split between the “home improvements” and the “other” category is not a clean one. Additional purposes in the “other” category include vehicles and business.

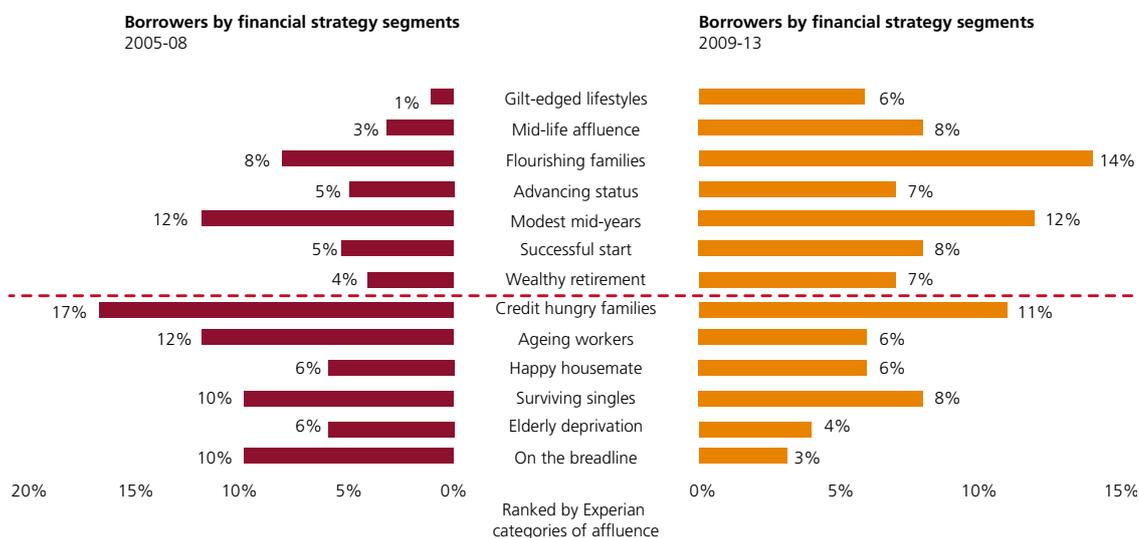
- 41. To examine customer characteristics we linked our sample of transaction level data with the Communities and Local Government Index for Multiple Deprivation and with Experian’s Financial Strategy Segments. We observe that there is a clear shift in the profile of second charge borrowers since the start of the crisis, with the typical borrower post crisis being materially more affluent than in the past. This is borne out across deprivation and social segment analyses.
- 42. The Index for Multiple Deprivation measures deprivation across income, employment, health, education, barriers to housing, crime, and the living environment for local areas. We match our sample of transaction data to this index using postcode information. Higher values on the index reflect greater deprivation. It is clearly observable (Chart 4) that prior to the crisis second charge customers were more heavily concentrated in higher deciles (signalling greater deprivation). This concentration has reversed since the crisis.

**Chart 4: Shift in profile of borrowers by Index of Multiple Deprivation**



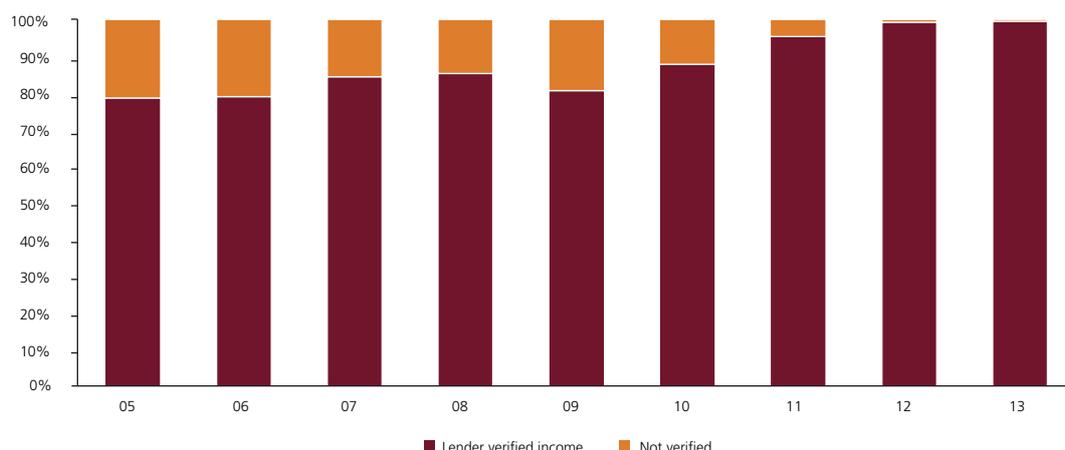
- 43. We observe a similar outcome when we link our transaction level data set with Experian Financial Strategy Segments using postcode information. Ranking the segments by affluence we see 61% of borrowers used to come from the 6 least affluent groups. This number has now dropped to 38%. Those on the breadline and credit hungry families make up smaller proportions of second charge borrowers, while the percentage of flourishing families using second charge loans has increased.

**Chart 5: Shift in profile of borrowers by Financial Strategy Segments**



44. We posit that this likely reflects both supply factors (credit rationing/ improved underwriting since the crisis), and demand factors (house price falls reducing the pool of potential borrowers with equity in their homes). The improved quality of underwriting hypothesis is supported by improvements observed in lender verification of income. This is now universal, which compares favourably with 2005-06 when in more than a fifth of cases income was self-certified.

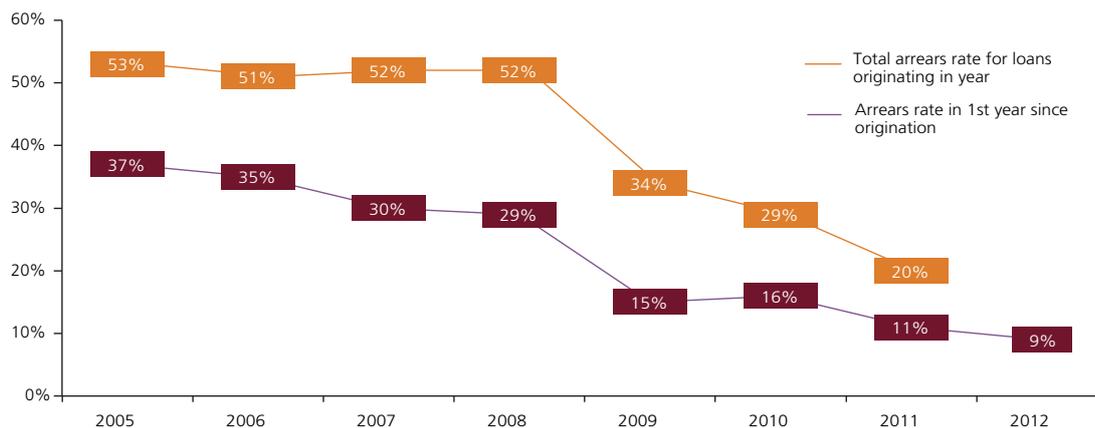
**Chart 6: Income Verification**



45. Examining detriment for customers, we find around half of all loans used to go into arrears prior to the crisis (Chart 7). Arrears is defined here as at least two payments being overdue. More than a third of all loans used to go into arrears in the first year since origination prior to the crisis. This has declined materially but a significant percentage of loans still go into arrears early. It is important to note that while one reason for the fall observed in the total arrears rate in Chart 7 is an actual

fall in arrears rates (as evidenced in the reduction in arrears in the first year after origination), the effect is exacerbated by fewer recent loans going into arrears because less time since origination has elapsed for these loans. This is why we cut off the total arrears series after 2011.

**Chart 7: Percentage of loans going into arrears (total and in first year since origination)**



- 46.** The arrears rates presented here are based on data from four firms who make up around 85% of the sample (and around 72% of the population) by number of loans currently, but less than a fifth of the sample (and less than a tenth of the population) during the boom period (2005-07). To examine how representative of the population these four firms are we compare the Index of Multiple Deprivation scores for their borrowers against the median scores across the sample. We find two of the firms whose data is used for these arrears figures have less deprived borrowers, and two firms have more deprived borrowers on average compared to the entire sample. We infer that this sub-sample is not heavily biased towards either end.<sup>51</sup>
- 47.** We also requested arrears information from the FLA, who provided aggregate data for members. The FLA data tells us that around 19% of all second charge loans were in arrears in August 2013 (the latest period in the data provided by the FLA). For loans originating prior to the start of 2009, 21% were in arrears in August 2013, while for loans originating since the start of 2009, around 6% were in arrears then. In absolute terms the arrears rates in the FLA data are lower than ours. This is because the FLA's measure is a point in time measure, i.e. it shows of all loans what percentage was in arrears at a point in time (August 2013 in this case). Our measure, presented in the chart above, in contrast measures the percentage of loans originating in a particular year ever going into arrears (or more precisely, going into arrears during the period our analysis covers). The overall story though, of declining arrears rates since the start of the financial crisis is consistent across both measures.
- 48.** High arrears percentages do not necessarily translate into high repossession rates. We estimate for loans originated in the boom period in our sample that perhaps around 2-3% led to repossession

<sup>51</sup> We were further provided arrears figures by a dormant player. These declined from 45% for loans originated in 2005, to 40% for 2006 loans, to 25% for 2007 loans. However, this performance data only included loans that survived beyond 2009. We can consequently only match sales data with performance data for around 60% of loans for this firm. It is possible that a significant proportion of loans which did not survive till 2009 were passed on. If so then the arrears rates calculated for the firm may be underestimates. Because of the bias introduced by the information only being available for surviving loans, we did not add this firm's data to the analysis of arrears in our market overview.

orders for borrowers' homes where action was initiated by second charge lenders.<sup>52</sup> On average repossession is found to happen 3-4 years after origination. Repossessions where the first mortgage provider initiates actions are not included in these numbers. In some such cases, had borrowers not unaffordably borrowed more through second charge loans, it is possible repossessions initiated by first charge providers might not have additionally occurred.

49. There is some evidence that second charge firms more aggressively threaten court action and take borrowers in arrears to court compared to first charge mortgage lenders.<sup>53</sup> However, this action is often taken with a view to compel payment rather than necessarily forcing repossession. This is because in any repossession event, the second charge lender is lower in priority relative to the first charge lender, and after a fire sale it is not certain a second charge lender would benefit.
50. As part of their analysis KPMG and Ignition House also conducted interviews with a small sample of customers who had taken out second charge loans to understand their borrowing experience. Given the very small London centric sample, responses cannot be taken to be representative of the market. However, there were some interesting results. When asked if they would recommend a second charge loan to family or friends only a third of respondents said yes, while 42% said no, and the remaining 25% were unsure. These responses could reflect borrowers getting into payment problems with second charge loans that they did not expect, and consequently suffering distress.
51. The market is significantly less profitable than prior to the crisis. PPI used to be a major profit driver, sold with two thirds of loans in 2006-7, with estimated profit margins of around 50%.<sup>54</sup> The product no longer contributes significantly to profits. Margins used to be high: interest rates charged were 9-13% while the cost of funding was cheap with bundling and securitisation common. While interest rates charged on loans remain high, since the financial crisis there has been a wholesale funding squeeze, reducing margins. Charges on arrears and early redemption charges are also no longer a primary driver of profit since the continuous cycle of loans (pass the parcel behaviour) reduced with house prices no longer rising as steeply and with CCA restrictions being introduced. Figure 1 details the cutting off and reduction in profit drivers in the second charge market since the crisis.
52. The new business model for firms appears to be based primarily on margins, targeting a more affluent group than before, who continue to need such loans primarily for debt consolidation. The changed customer profile has led to a consequent lowering of detriment, with arrear percentages falling to less than half of pre-crisis levels. As a whole the sector looks to remain less profitable than before and it is difficult to see it recovering to its pre-crisis peak. Firms responding to KPMG and Ignition House's interview similarly indicated they did not expect the second charge sector to return to levels near its peak period. The general expectation was of moderate growth in the sector into the medium term future.
53. It is important to remember that correction in the market has not come about because of customers' ability to discipline firms. In theory the risk remains that in the absence of regulation, increasing house prices (in a world of short-termism and myopia) could shift the focus of lenders back on to borrowers' remaining equity in their homes, partly reversing the self-correction

52 Including later years to the analysis makes comparisons over years relatively meaningless, since borrowers in later years have increasingly shorter periods to get into severe payment problems. We therefore only calculated these numbers for loans originating in 2005-08.

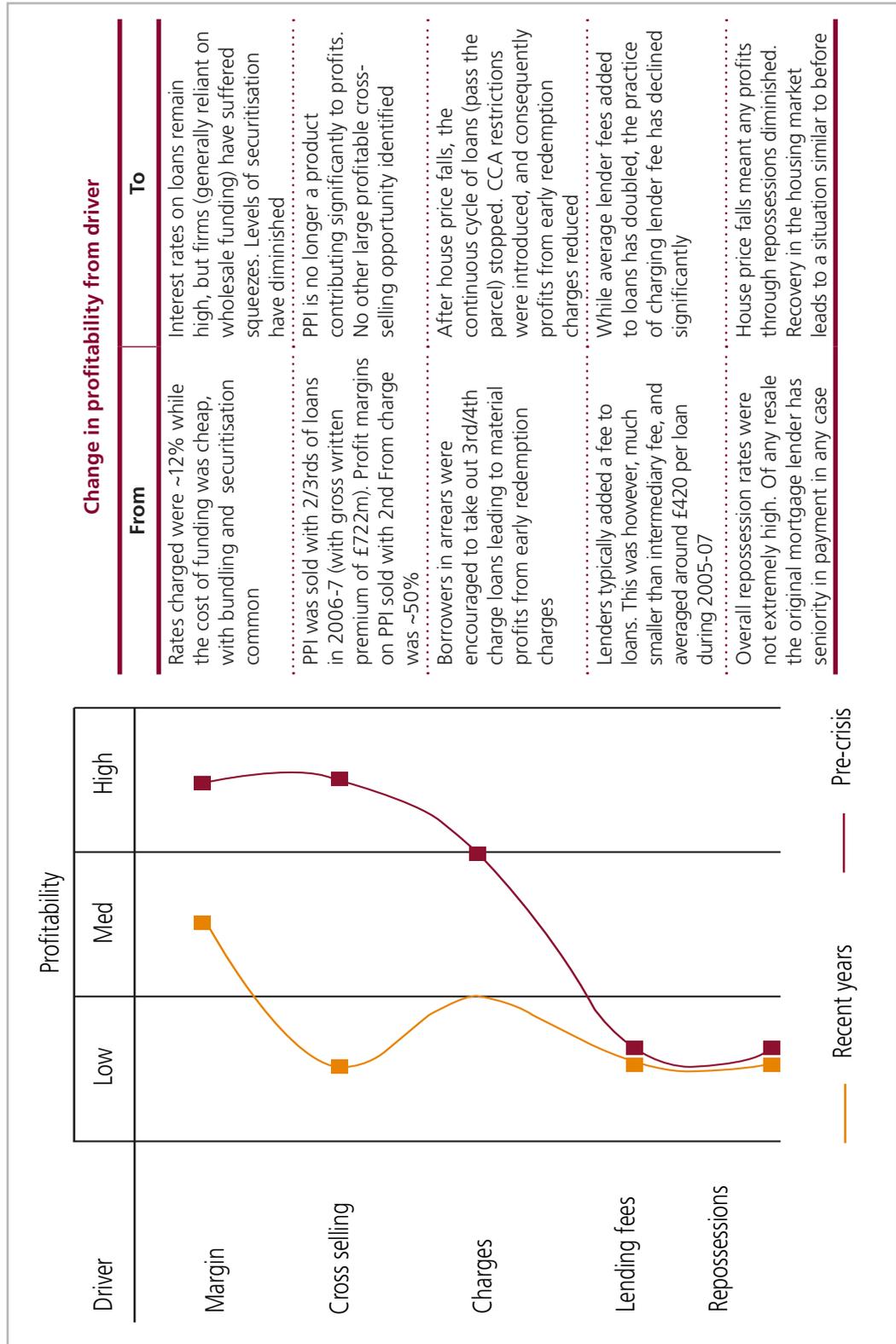
These figures are for repossession orders granted by courts, and will not equate exactly with actual repossessions (which may be lower).

53 Money Advice Trust (2008) *Report on a small scale survey into the impact of second charge mortgage loans and lenders on mortgage possession activity*

54 Source: Competition Commission (2009) *Market Investigation in to payment protection insurance*

observed. This is exactly where our responsible lending proposals should take effect, reducing the potential for exploitation of inherent behavioural biases and informational asymmetries (market failures which we discuss below).

Figure 1: Analysis of drivers of profitability



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### Summary of market failures

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54. The KPMG report discusses market and regulatory failures in the UK second charge market at length. We therefore only briefly summarise these here.
55. **Behavioural biases:** Several biases in consumers' (and sometimes firms') behaviour are likely to be relevant to the second charge market, including borrowers overestimating their ability to repay the loan; suffering over optimism about their future use of credit; and/or suffering present bias, placing more emphasis on their current spending needs without sufficient emphasis on the likely consequences of living beyond their means. Such behavioural biases are likely to already have contributed to high debt levels for individuals consequently consolidating debt using second charge loans. In further agreeing to borrow more than needed for consolidation purposes (behaviour observed in the second charge market), and in increasing their leverage after freeing up existing credit lines post-consolidation, these biases may further be in play for second charge borrowers. This may in part explain the historic high level of arrears observed in the market. Our occasional paper OP1 discusses behavioural biases in detail.<sup>55</sup>
56. **Information asymmetries:** In most cases, potential borrowers are likely to know less about the probability of their ending up in arrears than lenders and intermediaries do. The latter groups have some incentives to exploit this asymmetry to encourage consumers to over-borrow. In the second charge market such incentives in particular existed when "pass the parcel" behaviour was common. Lenders would encourage borrowers in arrears to borrow elsewhere and profit through early redemption charges. Meanwhile other second charge lenders were willing to grant further loans as long as borrowers' remaining equity in their property remained sufficient (driven by rising house prices). Borrowers may also make ill-informed decisions because of informational asymmetries between customers and lenders/brokers about the range of alternative, potentially more suitable, products available.
57. **Regulatory failures:** The further justification for intervention is around regulatory failure. The hypothesis is that regulation under the CCA, designed for a range of consumer credit markets, has influenced the range of players in the market and the products they provide. By moving to a regime tailored more to the second charge lending and one which is closer to that applied to first charge mortgages, it may be that some banks and building societies who have previously been reluctant to enter this market may do so, with consequent competition improving quality.
58. The problems that our responsible lending proposals primarily aim to address arise from behavioural biases and informational asymmetry.

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### Proposals and baseline

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59. We refer to the affordability assessment and the interest rate stress test collectively as the core of our responsible lending requirements. We expect these to result in the most significant impacts of all the proposals being consulted on for the second charge market. These requirements may be summarised as follows:
- **the affordability assessment:** the lender must verify income and be able to demonstrate that the loan is affordable, taking into account income and:

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<sup>55</sup> FCA (2013), *Applying behavioural economics at the Financial Conduct Authority*, Occasional Paper 1

- **committed expenditure** – credit and other contractual commitments which will continue after the loan is entered into;
  - **basic essential expenditure** – including housekeeping (food and washing) gas, electricity & other heating, water, telephone, council tax, buildings insurance, ground rent and service charge for leasehold properties and essential travel (to school or work); and
  - **basic quality of living costs** – hard to reduce expenditure which gives a basic quality of living beyond the absolute essential expenditure e.g. clothing, household goods (such as furniture and appliances), personal goods (such as toiletries), basic recreation and child care.
  - known changes to income and expenditure
- **the interest rate stress test:** the lender must consider the impact of expected future interest rate increases on affordability
60. These proposals are based on our existing mortgage conduct rules for first charge mortgages. The affordability assessment proposal is precisely the same as that for first charge mortgages. For affordability assessments conducted for second charge purposes committed expenditure will of course include payments going towards first charge mortgages. The interest rate stress proposal for the second charge market differs from the requirement for first charge mortgages through requiring second charge lenders to further take account of the impact of interest rate rises on higher ranking secured loans. Chapter 3 explains these proposals in detail. Since the changes proposed are so similar to those made in the first charge mortgage market, we are able to adapt much of the methodology used in the MMR (FSA CP11/31) for our analysis here.
61. The baseline that we use to estimate potential costs and benefits of the responsible lending proposals against is broadly the current world. There is a nuance here, in that we measure (the principal) impacts across both a boom period (defined here as 2005-8) and a subdued period (defined here as 2009-11) to understand better the incremental impacts across the cycle.
62. This approach overestimates the impacts of our proposals against the true counterfactual, i.e. a world where MCD requirements are implemented.<sup>56</sup> Were we not to proceed with our responsible lending proposals, a similar (though less precisely defined) credit worthiness assessment would be required under the MCD.

## Methodology

63. This CBA is based on loan data for the period 2005-2011. It assesses what would have happened to the second charge market over that period if our responsible lending proposals had been in place. The period is informative because it includes years in which the second charge market was booming (2005-8) and years in which it was subdued (2009-2011). While we analyse impacts across this cycle, our analysis of profit drivers (Figure 1) and expectations on the future of the market expressed by industry participants suggest the current condition and the medium term future in the second charge market is better reflected by the subdued period (2009-11) rather than the boom period. We therefore focus particularly on subdued period outcomes.

<sup>56</sup> We consider it an almost impossible task to conduct the CBA for our responsible lending proposals with the MCD requirement as a counterfactual. This would require predicting the impact of the MCD requirements and then measuring the incremental effect of our proposals beyond this. We do not think there is a credible way to do this.

64. Broadly speaking the largest benefit of the responsible lending proposals is expected to come from the avoidance of negative impacts associated with payment problems for borrowers refused loans. This needs to be balanced in particular against welfare losses for those who are refused or get smaller loans but would not have suffered problems. We summarise these and other impacts that might arise from our proposals and the methods we used to measure these in Table 2.

**Table 2: Impacts of responsible lending proposals**

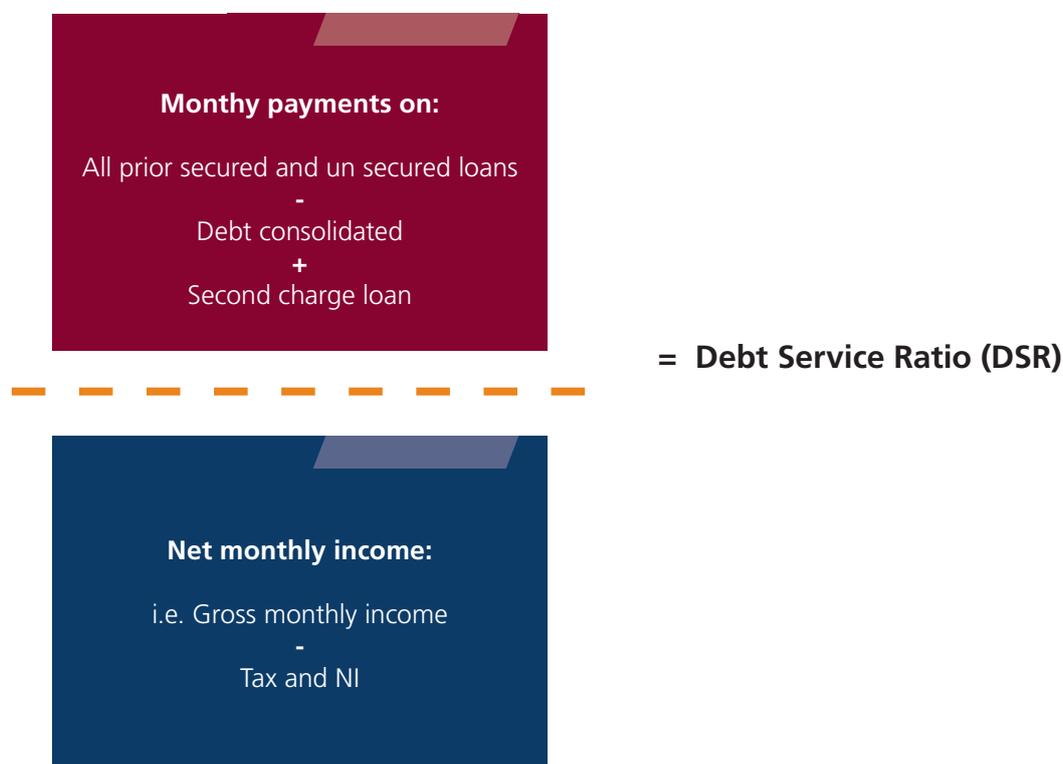
<b>Impacted Group</b>	<b>Benefit</b>
For borrowers who would no longer suffer payment problems, arrears and repossessions (as a consequence of being refused or getting smaller second charge loans)	Avoidance of negative impacts (distress) associated with these events
	Avoidance of legal and administrative costs associated with these events
For borrowers whose homes would no longer be repossessed (as a consequence of being refused or getting smaller second charge loans):	Reduction of transfer (mainly from fire sale discounts) to consumers who would purchase their property
<b>Impacted Group</b>	<b>Costs</b>
For borrowers who are refused or get smaller second charge loans	Welfare loss from delayed, cancelled or reduced improvement in home or other consumption Welfare loss from lower possibility to consolidate previous debts using second charge loans
For firms	Compliance costs associated with carrying out more stringent affordability assessments Impacts on revenue and profitability as a consequence of reduced volumes of lending
For individuals who would have otherwise bought houses repossessed from second charge borrowers	Reduction of transfer (fire sale discounts) from not being able to buy houses repossessed from second charge borrowers

65. In the rest of this section we describe in detail the approach we followed to identify how the responsible lending proposals might change borrowing in the market and the likely scale of this. This requires some judgemental assumptions because of imperfect evidence. It is, though, important to produce best estimates of what the impact of the responsible lending proposals might be, in order to inform and check our policy judgement.
66. Our approach to estimating impacts works by modelling how past second charge loans would have been different if the responsible lending proposals had been in place. This means we need a way to estimate which specific loans in our historical data would not have met the proposed rules. Since the affordability assessment is partly qualitative, however, its impacts will depend on how firms interpret and enact the rule and on the FCA's supervisory approach. As a result, there is a large element of judgement in our analysis about which loans the proposed rules will affect.
67. Additionally, data quality issues are a significant concern. As discussed in the data section earlier in this annex, data gaps mean we can only use information from two firms for our responsible lending analysis of impacts. Even here there are quality issues which make comparability difficult. Any extrapolation to the entire population requires very large assumptions. Consequently our results can only be illustrative/ directional at best.

68. The two firms which make up our sub-sample wrote around 55,000 loans during the period of our analysis (2005-11). These two firms make up around 45% of our wider sample (around 40% of the population) by number of loans currently, and less than a tenth of the sample (around 4% of the population) during the boom period.
69. In conducting our analysis we considered two possible approaches as measures of whether a loan was affordable. The first is a Debt Service Ratio (DSR) approach. This is the ratio of loan payments to income after tax. The approach was used in FSA CP10/16 when considering affordability in the context of the MMR. The second is a Quality of Underwriting approach. This measures affordability using the risk of impairment from poor underwriting (the basis of the rule) rather than from information on income and expenditure at origination. This approach was developed for the MMR and used in FSA CP 11/31.
70. For the second charge market we conducted both DSR and Quality of Underwriting analyses to try and identify points of inflection – i.e. observable jumps which would demonstrate either a sharp increase in arrears associated with DSR, or rapidly reducing quality of underwriting. The idea being these would proxy the point at which an effective affordability assessment requirement would take effect. However neither method was found to discriminate strongly between affordable and unaffordable loans. Beyond any data issues, a primary reason for this is because arrears rates are so high in the sample being investigated that impairment is the norm.
71. Since the analysis doesn't provide points of inflection, we constructed a scenario based on the MMR analysis to estimate the possible impacts of the responsible lending proposals. The percentage of borrowers impacted calculated in the MMR analysis as a consequence of responsible lending proposals is scaled up using the difference in arrears in the first and second charge mortgage markets to get to the percentage of borrowers impacted in the second charge market. This is then applied to our DSR and Quality of Underwriting analysis for the second charge market to draw out impacts. In addition to the difference in arrears rates used for the extrapolation, we further apply a different set of assumptions to account for the observation that while in the first charge market we might expect the main effect to be individuals not borrowing, in the second charge market the dominant effect may be individuals being lent less.
72. We explain our methodology in detail below.

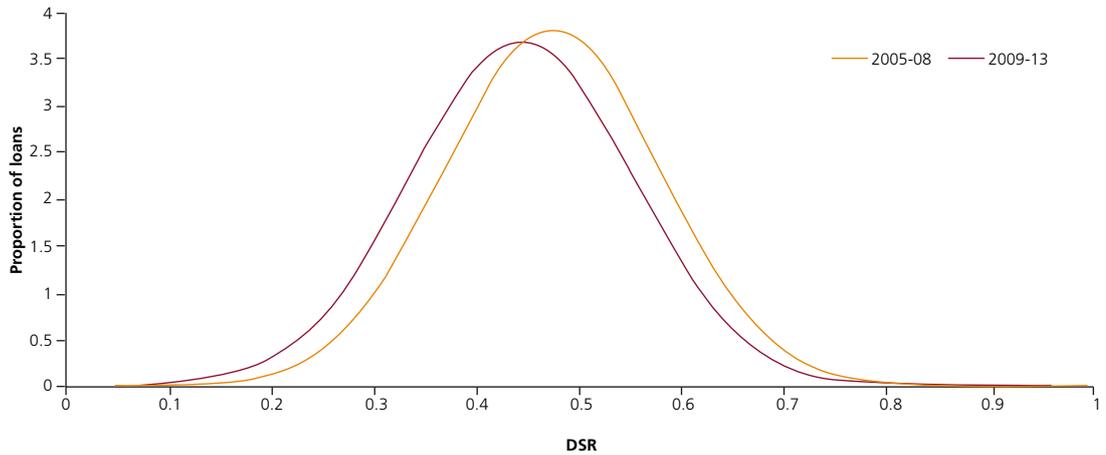
#### **Debt Service Ratio**

73. The DSR is a relatively simple measure of affordability. The numerator of the ratio is payments that need to be met to service a borrower's debt. The denominator is net monthly income. In the MMR the numerator used for the DSR was mortgage payments. For the second charge market we cannot simply use second charge loan payments as the numerator. A truer measure of affordability would consider payments to be made against all debt. A further nuance with second charge loans is that these are often used to consolidate debt. We therefore need to adjust the numerator of the DSR for the amount of debt consolidated. We consequently end up with the ratio defined in Figure 2.

**Figure 2: Debt Service Ratio**

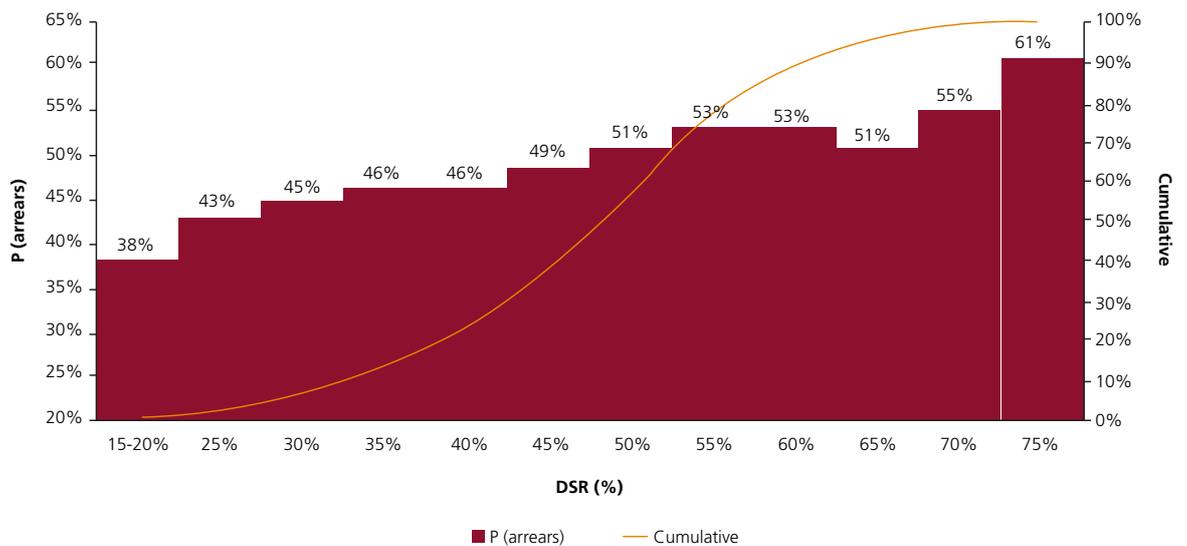
- 74.** We calculate the DSR for each loan in the sample, and observe any arrears events associated with each loan. Ideally we would like to observe a clear change in the probability of arrears visible above a certain DSR level. If such a clear point of inflection was visible we would assume this to be the threshold where responsible lending requirements would take effect. We would then use this threshold to estimate the number of potential borrowers impacted and among these those who would and wouldn't have experienced payment problems.
- 75.** One advantage of the DSR is its relative simplicity. Another benefit is the possibility of testing the interest rate stress proposal by adjusting the numerator. A principal issue with the DSR is that it is not informed by expenditure, while our proposal requires expenditure adjustments in the assessment of affordability. This raises the question of how reflective the simple DSR measure is of the outcome that would be achieved under our proposals. We considered building an expenditure-adjusted DSR for our analysis of the second charge market. This would have involved linking our sample of loan level data with an expenditure source (e.g. the Living Cost and Food Survey). Subjective judgements would then have to be made about what expenditure is essential and what is not. We did not proceed with this given the subjectivity involved, and the less than satisfactory experience of trying to build a similar measure in the MMR. Chapter 3 in FSA CP 11/31 describes the analysis carried out in depth.

**Chart 8: Frequency distribution of DSR 2005-08 and 2009-13**



- 76. When we calculate the DSR for our sample of two firms we observe some sensible results. The frequency of the DSR distribution shifts to the left after the crisis hits (Chart 8). This shows that second charge borrowers were more highly leveraged in the last housing market boom compared to more subdued recent conditions.
- 77. Plotting the DSR against arrears we observe the probability of going into arrears increases for the more highly leveraged as we would expect (Chart 9). However, there is no clear point where the probability of arrears increases sharply. Purely using the DSR approach then does not allow us to infer a threshold beyond which the affordability assessment proposals would take effect.

**Chart 9: Probability of second charge loan arrears and DSR (2005-11)**



### **Quality of Underwriting**

- 78.** The quality of underwriting approach was developed for the MMR and is described in detail in FSA CP 11/31. In this approach we estimate an underwriting risk score for each loan in our dataset. The underwriting risk score is constructed to capture the goal of the proposed affordability rule i.e. to improve affordability assessments so that loans are not unaffordable because of poor underwriting standards.
- 79.** Affordability is not the only driver of impairment. For example, life events (e.g. divorce, having children, illness, unemployment etc.) can lead borrowers to struggle with a loan that was affordable originally. The aim of the affordability assessment is to ensure lenders have good underwriting standards and subsequent impairment is only a concern where this has arisen because a lender did not exercise sufficiently robust checks on a borrower's ability to repay their loan, and not because of subsequent life events.
- 80.** Not being able to observe lenders' underwriting processes in detail, we measure underwriting standards indirectly, by trying to identify the impairment risk that could be attributed to poor underwriting. This is done through the following steps.

### ***Estimating the impairment risk for each loan in our data set***

- 81.** Every loan in our dataset either went into arrears or not. We construct "going back in time" a probability that the loan would have gone into arrears at the time of origination. This gives a measure of impairment risk relevant to the decision to grant the loan or not, since lenders do not know which loans in fact will go into impairment.
- 82.** We carry out a logit regression of actual impairment data on a range of factors to estimate the probability for each loan going into impairment. Explanatory factors used include: borrower, lender and mortgage data (at origination) and macroeconomic data (at and after origination).<sup>57</sup> These are detailed in Table 3.
- 83.** Our model yields a measure of impairment risk for each mortgage in our dataset. Almost all the explanatory variables chosen are found to be statistically significant and display the expected directional signs. Debt consolidation being the primary purpose of the loan, self-employment, higher leverage, higher interest rates, coming from a more deprived area, and an increase in regional unemployment rates after getting a loan are all associated with a greater probability of going into arrears.<sup>58</sup> For further explanation of the logit regression used here we recommend reading the CBA in the MMR analysis (CP11/31).

### ***Constructing a measure of risk due to poor underwriting***

- 84.** The first step estimated the overall impairment risk for each mortgage in our sample, and did not separate out the impact of factors that are the focus of our responsible lending proposals. To isolate the part of impairment risk due to poor underwriting we:
- estimate the contribution of individual risk factors to the probability of impairment using an ordinary-least-squares (OLS) regression
  - select factors clearly relevant to underwriting, and combine these to form an underwriting risk score (URS) for each loan

<sup>57</sup> Macroeconomic data post origination is used to avoid erroneously associating impairment due to subsequent macroeconomic events with factors at origination.

<sup>58</sup> We recognise that the interest rate charged variable is endogenous however we include this to reduce omitted variable bias.

- 85.** The OLS is necessary since the logit does not allow decomposition of impairment risk into parts associated with different factors. We use our OLS model to regress the probability of impairment estimated from the first (logit) regression on the impairment risk factors. The OLS regression estimates a constant marginal impact on impairment risk from each risk factor. This allows the decomposition of the probability of impairment into the parts associated with different risk factors.
- 86.** We apply judgement to select factors indicative of good/bad underwriting. This choice includes:
- whether or not a borrower is self-employed
  - whether or not the primary purpose for the loan is debt consolidation
  - DSR
  - a dummy variable identifying different lenders
- 87.** We would have further liked to include credit impairment data for borrowers, but the data we have is not of sufficiently good quality. Including a dummy variable to distinguish firms allows us to control for unobservable differences in underwriting standards between firms not captured by other explanatory factors.
- 88.** Based on these factors chosen as relevant to underwriting, we define our ‘underwriting risk score’ (URS) for a mortgage as the combined impact of the included factors on impairment risk. Loans with a higher (lower) underwriting risk score indicate poorer (better) underwriting.
- 89.** It is important to note that the factors chosen here do not define good underwriting by lenders for the purposes of the affordability assessment in the second charge market. The factors chosen provide a rough indication of good underwriting for the purposes of the CBA, and have been chosen in a context of limited data.

**Table 3: Explanatory factors for regressions**

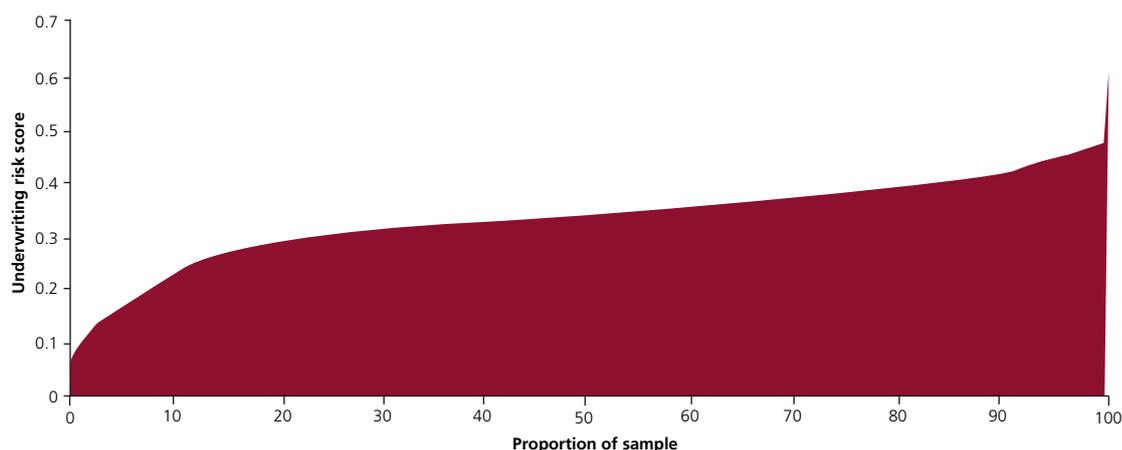
Type	Explanatory variable	Description
<b>Loan</b>	Sell Channel	Where intermediary = 1, direct = 0
	Interest Rate	Continuous. Rate charged at origination
<b>Customer</b>	Age	Continuous. Age at origination
<b>Quality of Underwriting</b>	Purpose	Where debt consolidation = 1, other = 0
	Employment Status	Where self-employed = 1, other = 0
	DSR	Continuous. Debt service ratio
	Firm dummy	1,0 to identify firm specific effects

<b>Macro</b>	IMD	Continuous. Index of Multiple Deprivation
	HPI change 18m later	Continuous. Regional change in house price index
	Unemp change 18m later	Continuous. Regional change in unemployment
	LIBOR change 18m later	Continuous. Change in LIBOR 18m after origination
<b>Period</b>	Period	Where 2005-08 = 0, 2009-11 = 1
<b>Constant</b>	Constant	

***Estimating borrowers affected by the affordability assessment proposal***

- 90. We calculate the URS for each loan as the combined impact of the factors relevant to underwriting. It is likely that the affordability assessment proposed (if in place) would have primarily impacted loans where underwriting was significantly poorer. We therefore sort our sample by URS and look for points where we see a marked deterioration in underwriting quality to set a threshold beyond which we postulate loans would be impacted by our responsible lending proposals.
- 91. We observe, as we did for our DSR analysis, that there is no clear point beyond which the URS measure sharply deteriorates. We think that we do not find a clear point of inflection using either approach because arrears rates are so high (around 49%) in the sample being investigated that impairment is the norm and because of underlying data issues.

**Chart 10: Underwriting Risk Score for second charge sample 2005-11**



### Building a scenario

92. Since neither the DSR nor the quality of underwriting approach discriminates strongly between affordable and unaffordable loans we instead rely on a scenario-based approach. We use a scenario based on outcomes estimated for the MMR, but in the development of our methodology we also considered three other possibilities:

- **Observed point of increase in the URS slope:** Near the right hand side of Chart 10 we observe a slight increase in the slope indicating worsening quality of underwriting. We considered using this as the starting point for an upper bound of the potential impact of our proposals. However, the increase in slope observed is marginal (with a lower gradient than on the extreme left hand side of the chart). We further think this would significantly underestimate the true impact of an effective set of responsible lending rules given the high level of arrears in the sample.
- **Consumer views on levels of arrears they would be comfortable with:** We considered asking a sample of second charge borrowers the level of the likelihood of arrears beyond which they would not be comfortable taking out second charge loans. Because of behavioural biases, and because we did not think these responses would necessarily equate well with actual outcomes we decided not to pursue such an approach.<sup>59</sup>
- **Outcomes similar to the best firm in the market:** We considered using outcomes for the best firm in the market (i.e. with lowest arrears rates) as a proxy for the outcomes that could be achieved with an effective set of responsible lending rules. However, such outcomes are driven not just by regulation but by firms' strategies. We think claiming that our proposals would lead to the entire market moving to a position similar to the best current firm would significantly overestimate the true impact.

93. Having considered and rejected three of these four possibilities, we build a scenario using the MMR as a starting point. We estimate the percentage of borrowers impacted in the second charge case due to the responsible lending proposals, extrapolating from the percentage of borrowers estimated to be impacted in the MMR analysis, using a multiple. We lay out the steps for this extrapolation below:

- Arrears rates in the first charge mortgage sample used for the MMR were 6.7%. Arrears rates in the two-firm second charge mortgage sample are 49%. From this we derive a multiple of 7.3 which is the ratio of second charge arrears to first charge arrears
- As a combined consequence of affordability assessment and interest rate stress proposals it was estimated in the MMR analysis that 6.14% of first charge mortgage borrowers would be impacted.<sup>60</sup> Multiplying this by the ratio of arrears in the two markets (7.3) suggests 45% of borrowers in the second charge market would be impacted as a result of the affordability assessment and interest rate stress proposals.

94. This scenario with 45% of borrowers being impacted enables us to calculate the threshold on the DSR and URS measures beyond which borrowing would be considered unaffordable. These scenario-based thresholds are then applied to the loan level data in our sample and used to take our analysis forward in the following ways:

<sup>59</sup> Responses by the small number of consumers questioned by Ignition House further indicated this approach was unlikely to allow us to build a credible scenario

<sup>60</sup> The MMR CBA indicates 7.6% of borrowers impacted during the boom period, and 0.3% during the subdued period. Since around 80% of loans in the MMR analysis are from the boom, and 20% from the subdued period, we apply this split in getting to an average for the total period. In the second charge sample there is a similar 80/20 split between the boom and subdued periods.

- We examine the types of customers estimated to be impacted by our proposals (using URS);
  - We measure the percentage of borrowers impacted in boom and subdued periods (using DRS);
  - We estimate how many of the borrowers who would be impacted would be excluded, and how many would be lent less (using DRS); and
  - We calculate how many of those impacted would have gone into arrears (using DRS)
95. The URS measure provides greater discrimination and we would prefer to use this for all these steps. However, for the drilldown specified in the last three steps we end up having to use the DSR rather than URS measure. We need to work out for borrowers affected their reduction in lending for this to be affordable. This can be established by backward engineering the DSR for each loan to equal the affordability threshold, which allows us to work out which borrowers would be excluded and for others affected what the reduction in their borrowing would be. There is no simple way to do this using the URS measure.
96. A borrower being impacted by our proposals does not necessarily mean they would not be lent any amount at all. While the full amount they had originally applied for may be unaffordable, a lower amount could still be affordable. For our analysis we need to make an assumption about the level of a loan if granted that a borrower would still take (and a lender would be willing to lend given administrative costs etc.). If only a very low percentage of the originally applied for amount was considered affordable it is unlikely that such a loan would be granted or in fact taken up. For the sake of our analysis we employ two assumptions:
- If less than 50% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up
  - If less than 25% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up
97. These levels differ from the MMR where it was assumed if less than 70% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up. The differences in these assumptions indicate one difference in outcomes that we would expect in the application of responsible lending rules. In the first charge market while we might expect the main effect to be individuals not borrowing, in the second charge market we might expect the dominant effect to be individuals being lent less.
98. The results of our analysis conducted using the scenario based approach applied to our URS and DSR measures are detailed in the next section. Also discussed are sources of over and under estimation in our calculations, and how our results might relate to impacts in reality.

### Costs and Benefits

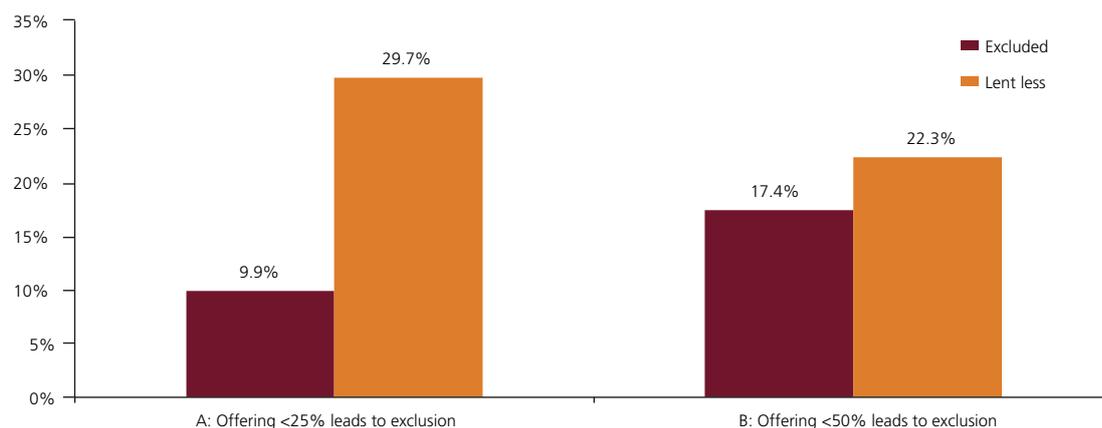
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- Borrowers impacted by the affordability assessment and the interest rate stress test**
99. We had started with a scenario where 45% of borrowers in the second charge market would be impacted through the combined effect of the affordability assessment and the interest rate stress proposal. We break out impacts into subdued and boom period here, and drill down into the type of borrowers likely to be impacted.

**100.** We estimate using the scenario based threshold calculated for the DSR measure that in the subdued period (2009-11) close to 40% of borrowers would be impacted.

- *Assuming if less than 25% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up:* We calculate that around 10% of borrowers would no longer be able to borrow through a second charge loan, while around 30% would be lent less. For those lent less we calculate a 34% reduction in borrowing
- *Assuming if less than 50% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up:* We calculate that around 17% of borrowers would no longer be able to borrow through a second charge loan, while around 22% would be lent less. For those lent less we calculate a 25% reduction in borrowing

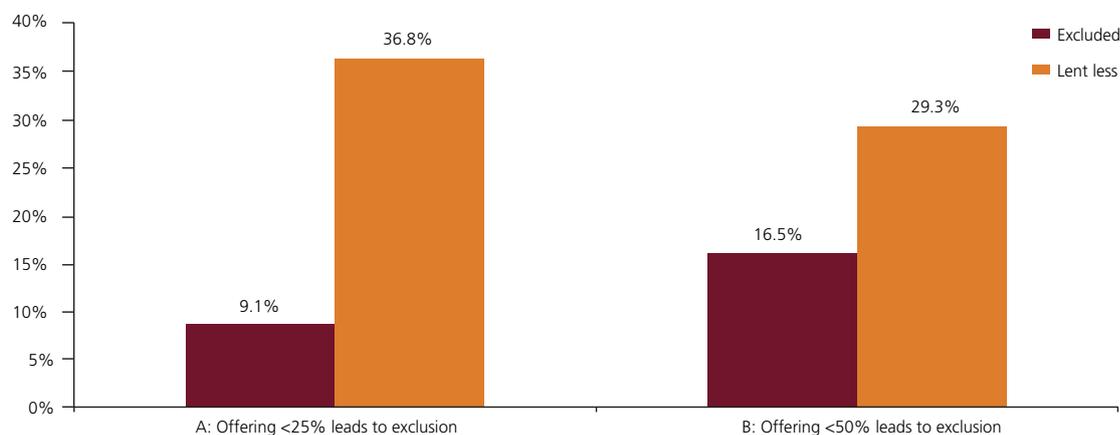
**Chart 11: Proportion of borrowers affected by our proposals in the subdued period (2009-11)**



**101.** We further estimate that in the boom period (2005-08) close to 46% of borrowers would be impacted.

- *Assuming if less than 25% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up:* We calculate that around 9% of borrowers would no longer be able to borrow through a second charge loan, while around 37% would be lent less. For those lent less we calculate a 31% reduction in borrowing
- *Assuming if less than 50% of the amount originally applied for passed the affordability threshold this would lead to a loan not being granted/ taken up:* We calculate that around 17% of borrowers would no longer be able to borrow through a second charge loan, while around 29% would be lent less. For those lent less we calculate a 23% reduction in borrowing

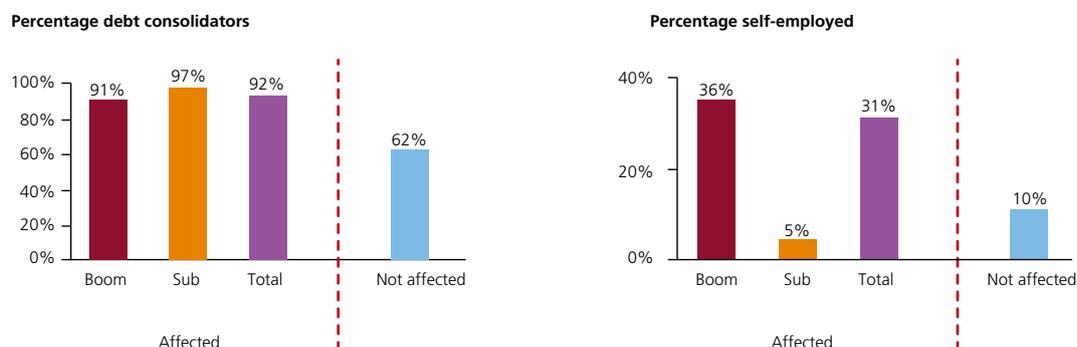
**Chart 12: Proportion of borrowers affected by our proposals in the boom period (2005-08)**



- 102.** A greater percentage of borrowers are estimated to be impacted in the boom period (46%) relative to the subdued period (40%) – which aligns with the observation of higher arrears in the boom period. However, the difference in impact between the two periods is not as stark as for the MMR analysis. This is because of three reasons. First because arrears rates are high in the subdued period as well, while there was a greater relative difference between the periods in the MMR. Across the entire period 2005-11 our sample has an arrears rate of 49%. In the boom period 58% of all loans go into arrears. In the subdued period this figure is 32%. Second, our models and particularly the DSR measure we are forced to use here do not provide enough discrimination power.<sup>61</sup> Third, data quality issues, in particular imprecisely comparable data across firms which the DRS approach cannot control for, leads to issues.
- 103.** Drilling down into the type of borrowers impacted using the scenario based threshold calculated for our URS measure we observe that borrowers impacted by our proposal are predominantly debt consolidators. In our sample of two firms around 75% of borrowers state debt consolidation as their primary purpose for taking out second charge loans. We estimate that 92% of those impacted (i.e. excluded or lent less) across the sample period are borrowing to consolidate debts.
- 104.** Further those who are self-employed appear to also be disproportionately impacted by our proposals. While 19% of borrowers in our sample are self-employed, of those impacted by our proposals we estimate that 31% fall in this category.

<sup>61</sup> The URS measure provides greater discriminatory power indicating 48% of borrowers would be impacted in the boom period and 34% in the subdued period. We think even this does not discriminate between the relative impacts in the periods enough.

**Chart 13: Types of borrowers impacted in particular by responsible lending proposals**



### Impacts for consumers no longer able to borrow and those lent less

**105.** As noted before, broadly speaking the largest benefit of the responsible lending proposals is expected to come from the avoidance of negative impacts associated with payment problems for borrowers refused loans. This needs to be balanced in particular against welfare losses for those who are refused or get smaller loans but would not have suffered problems. This does not mean that all those who would have suffered payment problems and no longer would as a result of the proposal will be better off, or in fact that all those who wouldn't have suffered payment problems and no longer would, will be worse off.<sup>62</sup> Outcomes depend greatly on the alternative position in which impacted borrowers end up. We posit that:

- while on the one hand the lower price of second charge loans compared to the original credit (which is being consolidated) suggests some borrowers might be better off without the policy proposal;
- this effect is on average likely to be smaller than the negative impact of being more leveraged having taken out a second charge loan (because firms oversell beyond the consolidation needs of borrowers, and because this also frees up previously tied up credit lines – at the extreme potentially doubling leverage ratios)

**106.** We expand on this argument further in this section.

**107.** Having estimated the proportion of borrowers likely to be impacted, the next step in assessing these positive and negative impacts is estimating how many of the borrowers impacted by our proposals would have experienced payment problems, and therefore the scale of the payment problems they might no longer suffer. This is simple to calculate for those who would no longer be able to borrow because we can observe in our sample whether or not these borrowers actually suffered any payment problems. We estimate:

- In the subdued period for those who would no longer be able to borrow, around a third would have been in arrears on their second charge loans at least once

<sup>62</sup> On the latter group i.e. borrowers who do not get into late or non-payments but would be impacted: some of these may nevertheless be cases of avoidable misunderstandings by borrowers, and the fact that a borrower does not get into late or non-payment problems does not mean that the borrower would take such a loan out again in the absence of informational and behavioural issues. There would be some well-being gain then of our proposal for this group, though our estimates of impacted borrowers do not capture this.

- In the boom period for those who would no longer be able to borrow, 52% would have been in arrears on their second charge loans at least once
- 108.** But estimating the reduction in the risk of impairment for those who would be lent less requires a further assumption. We can of course observe in our sample how many of those lent less went into arrears. We cannot observe however, the impact on impairment of being lent less.<sup>63</sup> We therefore need an assumption for the fall in arrears that would be associated with a fall in borrowing. We assume that a 1% fall in borrowing for those affected would lead to a 0.5% fall in arrears. This assumes a constant relationship between arrears and the amount borrowed (given our sample has an arrears rate of nearly 50%).<sup>64</sup> Using this assumption we estimate all else being equal:
- In the subdued period for those who would be lent less, their probability of going into arrears on their second charge loans at least once drops from around a third to between 15-19%
  - In the boom period for those who would be lent less, their probability of going into arrears on their second charge loans at least once drops from around 58% to between 42-46%
- 109.** Consumers who would no longer be able to borrow would avoid the risk of payment problems, while those lent less would reduce this risk. The negative impacts such payment problems can lead to include stress and effects on well-being and mental health.<sup>65</sup>
- 110.** To get to a more precise understanding of outcomes we need to better understand what would happen to individuals excluded or lent less. While there would be a reduction in their risk of getting into payment problems on second charge loans, might these borrowers suffer instead payment problems on other products as a consequence of being excluded, and if so what might the scale of this detriment be? Discussions with brokers and with customers suggest there are perhaps five potential alternative avenues for such individuals. We summarise these in Table 4.

**Table 4: Potential avenues for those excluded or lent less in the second charge market**

<b>Avenue</b>	<b>Probability</b>	<b>Rationale (for likelihood)</b>
<b>Not borrow</b>	<i>High</i>	Unsecured borrowing also likely to be refused if second charge borrowing not possible
<b>Debt solution</b>	<i>High</i>	As above. Difficulty in debt payments may lead to this avenue
<b>Guarantor loan</b>	<i>Medium</i>	Guarantor needed. Relatively small market
<b>Re-mortgage</b>	<i>Low</i>	Similar affordability tests might mean similar refusal
<b>Payday loan</b>	<i>Low</i>	Typical second charge loan is several multiples in size of payday loan

<sup>63</sup> If the DSR measure provided greater discriminatory power we could have used the lower probability of arrears associated with a consequent fall in DSR because of being lent less as a basis to estimate reduction in the risk of impairment. However, the lack of power in the measure prevents this.

<sup>64</sup> We conducted sensitivity analysis around this assumption, through looking at two alternatives: one where a 1% fall in borrowing for those affected would lead to a 0.33% fall in arrears, and one where there was a constant 10% reduction in arrears for those lent less. We found there was a 1-2 percentage point difference in the reduction in overall arrears calculated depending on the assumption used for the fall in arrears arising from the fall in borrowing. We decided to use the chosen approach because this is based on the overall arrears rate in the sample, and is also sensitive to differences in the reduction in borrowing.

<sup>65</sup> See for e.g. Gathergood, J (2012), Debt and depression: causal links and social norm effects, *Economic Journal*, 122(563), 1094-1114

- 111.** The two avenues that appear most likely are individuals either not borrowing, or those who are in significant difficulties with their debts using debt solutions.<sup>66</sup> We postulate that with these alternative outcomes the group of individuals who would otherwise borrow in the second charge market in an unaffordable manner are likely to be on average better off.
- Two-thirds of those who borrow using second charge loans do so primarily for debt consolidation reasons. We would expect these borrowers to only consolidate debt through this means if upfront prices indicated taking the second charge loan would be cheaper. One possible effect of our proposal might then increase the cost of getting into payment problems for those who would be excluded from the second charge market.
  - However, we think there is likely to be a larger impact through the reduction in overall debt levels for those affected. In the second charge market we observe firms oversell beyond the consolidation needs of borrowers, which would be reduced. Perhaps more significantly borrowers consolidating debts using second charge loans free up their previously tied up credit lines and increase their level of indebtedness – which again would be affected. In combination this would likely lower overall indebtedness, and so lower the probability of getting into payment problems (both on second charge loans and overall).
  - In addition the risk of an individual's home being repossessed in action initiated by second charge lenders would be reduced.
- 112.** Not everybody who would no longer be able to borrow or who would be lent less as a consequence of our responsible lending proposals would have experienced payment problems. For these individuals there would be welfare losses from delayed, cancelled or reduced ability to make home improvements or otherwise increase consumption and/or from a lower possibility to consolidate previous debts using second charge loans.
- 113.** In an ideal world we would like to calculate the reduction in welfare or well-being for those losing out and balance these against estimated welfare or well-being gains for those who would benefit. We do not think this is reasonably practicable to do, as we explain below:
- It is particularly difficult to assess consumer welfare in a comparable way where behavioural factors may distort consumer decision making. Consumers' revealed preference through consumption may not be a good indicator of actual welfare outcomes.
  - Data limitations for the second charge market prevent a well-being analysis similar to that conducted for first charge mortgages as part of the MMR.<sup>67</sup> In any case a well-being approach similar to that used in the MMR requires further judgement to be made on weighting negative and positive effects.
  - To understand outcomes more clearly we would want to observe outcomes for a control group of applicants rejected for second charge loans, and compare these against outcomes for a similar group of accepted applicants. Data to do such an analysis is not however

<sup>66</sup> This is not to say that debt solution "substitutes" function perfectly. The FCA for e.g. is also looking at problems in the Debt Management Plan market.

<sup>67</sup> The MMR analysis drew on the British Households Panel Survey (BHPS) and a range of other existing surveys. Information on the position for second charge applicants who would no longer get loans is not available in these or other sources available to us.

readily available.<sup>68</sup> We discuss instead in this section possible outcomes for individuals who would no longer get loans.

- The underlying estimates for the number of individuals affected are based on limited data, using a scenario based approach, applied on models which do not reveal strong discriminatory power, with further assumptions added on. There is a consequently a large degree of imprecision around these estimates (as we explain in greater detail in the following section). To try and estimate welfare or well-being impacts on top of this would adversely impact the accuracy of our analysis.

### Our expectation of the scale of impacts in practice

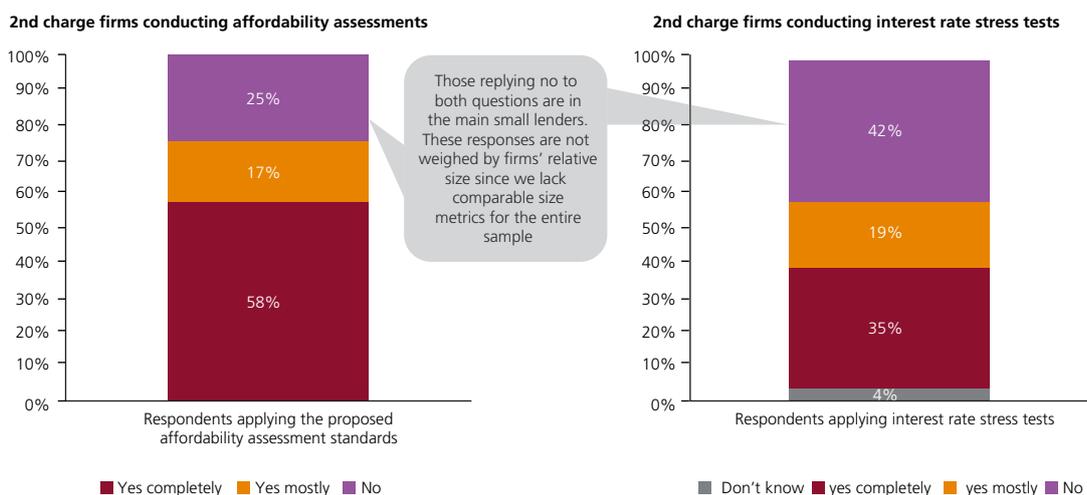
- 114.** Our method and modelling likely underestimate the true impact of the proposals. However, recent changes in firms' behaviour appear to us to more than balance this. We consequently expect the immediate impact of our proposals will be considerably smaller than the scale of impacts estimated through the modelling in our analysis.
- 115.** There are three reasons to think the impacts calculated in our analysis underestimate what the impact of our affordability proposals could be.
- **Extrapolation from MMR to second charge is imprecise:** Arrears in the first charge market are concentrated in the right hand side of DSR and URS distributions (i.e. where borrowers are highly leveraged, or where the quality of underwriting for loans appears to be quite poor). In our second charge sample arrears appear to be the norm (hence there are much flatter distributions). Extrapolating out from the first to the second using a multiple based on the difference in arrears rates therefore likely underestimates the percentage of borrowers who would be affected.
  - **Models/data don't provide adequate discrimination:** Because our analysis is based on limited data with comparability and quality issues, and because our models are not very effective in separating affordable from unaffordable lending, our results do not provide adequate discrimination. In reality we would expect those affected by our proposals to have a much greater likelihood of suffering payment problems relative to other borrowers not affected by our proposal
  - **Recent cut-off for sample period does not allow more arrears to manifest:** For the subdued period 2009-11 loans in our sample only have 2-4 years to go into arrears. Over their lifetime arrears rates would be higher, hence the harm that could be prevented would also be higher
- 116.** We think recent changes in the market more than balance these impacts. There are two reasons to think the impacts calculated in our analysis overestimate the actual impact of our proposals.
- **The market has moved towards adopting similar practice to our proposals:** Responses to Ignition House interviews (see Figure 3) indicate 75% of firms have already moved completely or mostly towards income and expenditure based affordability assessments, and 54% are now applying (variants of) interest rate stress tests. Firms not running such assessments are in the main small.

<sup>68</sup> Given the quality issues the transaction level data we gathered from lenders for borrowers had it is very likely that data on loan applicants (including those who did not get loans) would have even greater gaps.

- **Arrears rates in the period after the end of our analysis have further lowered:** Arrears rates for the first year after origination are lower in our sample data set in 2012 than over 2009-11 (the subdued period in the analysis). This indicates that less unaffordable lending now happens in the market, backing up the story of firms having moved towards income and expenditure based affordability assessments.

**117.** In combination these factors indicate the immediate impact of our proposals may not be very large, and almost certainly will be considerably smaller than the subdued period estimate of 10-17% of consumers no longer being able to borrow, and 22-30% being lent less. However, as discussed earlier recent correction in the second charge market has not come about because of customers’ ability to discipline firms. So, in the absence of regulation, the risk of behavioural biases and informational asymmetries being exploited in future boom periods would remain. This is where our responsible lending proposals should have most effect.

**Figure 3: Current practice around affordability assessments and interest rate stress tests<sup>69</sup>**



**Reduction in cost of arrears and repossessions for consumers**

**118.** Borrowers who would not suffer payment problems (arrears and repossessions) as a consequence of being refused or getting smaller second charge loans, avoid legal and administrative costs associated with these events. While part of this may simply be a transfer from firms to consumers, part can be thought of as a social benefit as a result of a reduction in friction and because of the saving in resources that would have been spent on administration of arrears and repossession otherwise.

<sup>69</sup> Source: Responses to Ignition House/ KPMG survey of firms conducted in May 2014 on behalf of the FCA. These two results are based on responses from 12 active second charge lenders

- 119.** Using the subdued period (2009-11) as more reflective of the second charge market both now and in the medium term future, we estimate the amount from avoided arrears charges to be around £1m per year.<sup>70</sup> Were we to also include the boom period and calculate savings across our sample period, the estimated annual benefit would be more than ten times this amount. However, as discussed earlier in this chapter there is no realistic medium term expectation of the second charge market returning to its pre-crisis peak levels.
- 120.** For borrowers whose homes would no longer be repossessed as a consequence of being refused or getting smaller second charge loans there would also be a reduction in transfer (mainly because of fire sale discounts) to consumers who would otherwise have purchased their property.<sup>71</sup> The fire-sale discounts are a transfer from the repossessed borrower to the buyer of the repossessed house, so reducing them per se is neither an economic cost nor an economic benefit. In the MMR we used a 20% discount on the property's value because of fire-sales. Using the same discount, and employing the subdued period (2009-11) as more reflective of the second charge market both now and in the medium term future, we estimate these transfers to be reduced by around £6 million a year.<sup>72</sup>

#### **Compliance costs for firms**

- 121.** As part of the parallel CBA KPMG conducted of other second charge policy proposals we asked them to calculate compliance costs of our affordability assessment and interest rate stress test proposals. While the complete details of this can be found in KPMG's study, we summarise their estimates here.
- 122.** As shown in Figure 3 earlier in this chapter, 58% of respondents indicated that they met the affordability assessment requirements completely already, with a further 17% indicating that they mostly met the requirements. A lower but still material 54% of respondents said they also met the interest rate stress requirement completely or mostly. Most firms who did neither are small in size.
- 123.** Based on responses by firms, KPMG estimate the following compliance costs from our proposals for the entire market:
- For lenders due to the affordability assessment: One-off costs of around £215,000, and on-going annual costs of around £170,000
  - For lenders due to the interest rate stress test: One-off costs of around £115,000, and on-going annual costs of around £55,000
  - For intermediaries due to the affordability assessment: One-off costs of around £15,000
  - For intermediaries due to the interest rate stress test: One-off costs of around £70,000, and on-going annual costs of around £640,000

<sup>70</sup> This calculation is based on a central estimate of £325 as the average cost per case in arrears quoted in the MMR. We apply this to the number of second charge loans impacted in our subdued period that go into arrears, which leads to an estimated resource saving of around £400,000 per year. This is an underestimate because this does not account for a loan potentially going into arrears multiple times. To obtain a more realistic estimate we therefore adjust this figure upwards.

<sup>71</sup> In this case, the 'transfer' arises because the fire sales typically associated with repossessions lead repossessed property sellers to lose the amount by which their property is discounted and the buyers to gain the discount. The amount of the discount is the amount of the transfer.

<sup>72</sup> We note that while the subdued period (2009-11) is more reflective of the current state of the market than the boom period, more recent information suggests the market is materially "cleaner" than over the subdued period in our sample. This suggests both the estimate of the benefit from saved resources and of the transfer calculated here overestimate the impact of our proposals in the immediate future.

**124.** KPMG explain that the £640,000 estimate of annual on-going costs for intermediaries is largely driven by an estimate from a single intermediary who quoted the “cost of lower conversion rates to the business as a consequence of stress testing” as the reason for this cost.<sup>73</sup> We think the intermediary’s response reflects the impact of the reduction in volumes that might be associated with the introduction of the proposed requirement. This is captured elsewhere in our CBA and is not a pure compliance cost. We consider therefore KPMG’s estimate without this answer (incremental on-going costs of around £35,000 for intermediaries due to the interest rate stress test) to be closer to the actual compliance cost that should be expected.

**125.** Firms report that the costs of complying with these proposals is focused around making changes to IT systems, developing new sales processes, HR / training costs and additional time to process loans. Of these, on average, the largest one-off cost is that of making changes to existing IT systems. The highest on-going cost for the majority of lenders was that of spending additional time processing each loan.

#### **Impact on firms and on competition**

**126.** A wide package of regulation (much of which is driven by the MCD) is being considered in this Consultation Paper. The range of this is considerably broader than the responsible lending proposals discussed in this chapter. We think it a more valid approach to consider the impact on competition of our collective package of proposals rather than break this down for individual policies. The KPMG report discusses in detail these overall impacts on competition. In this section we briefly discuss some of the main points particularly related to responsible lending covered in the KPMG study, and add some further inferences drawn from our analysis.

**127.** As detailed earlier in this chapter the responsible lending proposals would lead to some individuals no longer being able to borrow and some individuals being lent less. We estimate using the subdued period as our basis, that this implies a reduction in lending volumes of between 20% and 23%. Based on current lending levels in the second charge market (£0.5 billion in 2013) this would mean a reduction in the volume of lending of about £100 million. However, given unaffordable lending in the market appears to have materially decreased since the cut-off point for our analysis (2011) and because many firms (particularly larger players) have already adopted practices which go significantly towards meeting our responsible lending proposals, we expect the actual reduction in volume to be materially smaller than these 20-23% (and £100 million) estimates.

**128.** This aligns with views expressed by firms responding to KPMG’s survey. When asked what change in volume they expected as a consequence of the package of rules proposed for second charge firms (much wider than only the responsible lending proposals):

- 57% said they expected a reduction in volume (14% said this fall in volumes would be less than 10%, 21% said the fall would be between 11-20%, and 21% said the fall would be greater than 20%)
- 36% said the proposals would have no significant impact on volume, and
- 7% said they expected a small increase in volume

**129.** Analysing the potential impact on industry profits of the costs of the entire package of proposed regulations the KPMG study suggests that large lenders (who account for the vast majority of the market) are likely to be able to absorb the increase in costs of regulation whilst maintaining

<sup>73</sup> This cost was over a 100 times larger than the second highest estimate for an intermediary.

a profit, but smaller lenders may not be able to do so. This could potentially lead to some exit of smaller firms from the market. We further observe that any impact of responsible lending proposals will not be equivalent across firms but dependent on differences in behaviour. The data submitted to us by our sample indicate that one medium sized firm continues to have materially higher arrear rates relative to the market. This indicates poorer underwriting standards (which our responsible lending proposals would address), and suggests reduction in lending volumes and revenues as a consequence of the proposed responsible lending rules are likely to be concentrated more in this firm. This also implies that our proposals put this firm at risk of exiting the market. We further observe however, both in the case of this one firm, and the smaller lenders the KPMG study indicates might be at risk of exit, firms might be able to pass (at least part) of the increased cost of regulation on to consumers (particularly because of a lack of viable substitutes).

- 130.** It is possible that with the second charge market being regulated in a similar manner to the first charge market, and with better outcomes in the market (e.g. lower detriment for consumers driven by responsible lending proposals) leading to reputational improvement for such products, some mainstream mortgage lenders may start offering second charge loans alongside re-mortgages and future advances. This could counter the reduction in the quantity of lending our analysis otherwise indicates, though the size of any such effect is difficult to predict. Such entry of mainstream players may also improve the quality of competition in the market.
- 131.** In overall terms we note respondents to KPMG's interviews and survey were generally upbeat about the second charge market, and most expected modest growth over the next three to five years as more lenders enter the market and existing lenders slowly expand their funding lines. We recommend reading the KPMG report for a more detailed discussion of the expected impacts on competition of the rules proposed in this Consultation Paper including those around responsible lending.

## Section 2

# Regulatory package of changes for the second charge market

### Introduction

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- 132.** To estimate the impacts of bringing second charge activity into our mortgage regime, we commissioned KPMG to conduct a cost benefit analysis of our key proposals. KPMG's full report can be found on our website. In this chapter, we summarise key findings from the study and state our view about this analysis.

### KPMG's approach and methodology

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- 133.** In conducting its analysis, KPMG drew on six main sources of data and information:
- interviews with a sample of lenders and intermediaries – qualitative;
  - an online survey of lenders and intermediaries – quantitative;
  - interviews with a small sample of customers – qualitative;
  - sales and loan performance data collected by the FCA – quantitative;
  - the FCA's policy proposals; and
  - other publicly available sources of data.
- 134.** KPMG used a largely quantitative approach to estimating the costs of the regulations, supplemented by qualitative insights. Due to a lack of existing data, KPMG surveyed firms to estimate the costs of our proposals and to inform the analysis of potential benefits. KPMG, via Ignition House, a specialist research consultancy, sent an online survey to 641 industry contacts. 54 firms involved with the second charge lending market responded to the survey: 15 active second charge lenders; 3 dormant second charge lenders; 16 intermediaries/packagegers; and 20 other organisations (including introducers and service organisations). Ignition House also conducted qualitative surveys with lenders and intermediaries.
- 135.** KPMG's analysis tests our proposals against a baseline of the current regulatory framework. KPMG recognises that, for some areas where we are proposing to apply the mortgage regime to second charge, the true counterfactual would be where the FCA is otherwise required to rely on implementing MCD provisions. Some of the estimated costs and benefits therefore overestimate the truly incremental impacts of our proposals.

### Potential market failures

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- 136.** KPMG identified a series of potential failures in the second charge market that may to some extent be addressed through our proposed regulatory approach. These market failures can lead to undesirable market outcomes, for example, poor lending and borrowing decisions resulting in higher arrears rates. Potential market failures identified in the study include:
- Behavioural biases among second charge consumers, which may contribute to the historic high arrears rate in the market.
  - Information asymmetries where borrowers may have poor information about the specific risks associated with a second charge loan and so do not make a fully informed decision.
  - A possible lack of effective competition between firms in the second charge market may result in customers being given bad advice or provided with insufficient information to make informed decisions.
  - Principal agent problems where intermediaries' incentives are geared around sales targets or commission and are unlikely to be aligned to customers' best interests.
  - Regulatory failures where the market has been shaped, to some extent, by the historic regulatory regime.

### Costs

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- 137.** ESIS-based disclosure required by the MCD is estimated to be the largest cost resulting from the proposals, with one-off costs approximately £5.3 million for active lenders and approximately £1 million for intermediaries respectively. Ongoing annual costs are estimated to be approximately £1.9 million for lenders and approximately £1 million for intermediaries.
- 138.** KPMG estimate that the costs associated with the implementation of other MCD requirements through existing MCOB requirements and MCD copy-out would be significantly lower than those driven by the ESIS. KPMG estimate these one-off costs at approximately £1.4 million for active lenders and approximately £0.7 million for intermediaries. They further estimate ongoing cost of approximately £1.2 million for active lenders.
- 139.** KPMG estimate the one-off costs associated with the implementation of the FCA's mortgage regime requirements to be approximately £1.4 million for active lenders and approximately £100,000 for intermediaries. KPMG estimates ongoing annual costs of approximately £0.6 million for both active lenders and intermediaries. KPMG have explained that the ongoing costs for intermediaries are inflated by one firm's estimates which may not be credible.<sup>74</sup>

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<sup>74</sup> These cost estimates include incremental costs associated with responsible lending rules.

### Benefits

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- 140.** KPMG analysed the benefits of the set of regulation proposed for the second charge market, using information received from firms and consumers. This does not include an assessment of responsible lending rules which we provide in Section 1 of this CBA chapter. Some of KPMG's key conclusions on benefits are as follows:
- The ESIS may enable customers to make better-informed decisions about borrowing and comparing products. However, this could be tempered by behavioural biases.
  - Our proposals on arrears management and charges could lower costs to consumers and result in firms offering a wider range of forbearance options.
  - Our proposal that sales staff are subject to a Level 3 qualification, coupled with the proposed move to our MCOB sales standards, may improve the quality of information and advice given to potential borrowers to help them better understand the product being offered, its risks and the potential alternatives. Requiring firms to assess the suitability of a product as part of an interactive sale is likely to help mitigate the risk of customers taking out second charge loans that do not meet their needs and circumstances.
  - There may be improved transparency on post contractual fees resulting in customers being able to make better informed decisions. However, the balance between those customers that may pay higher and lower Early Redemption Charges (ERCs) when they are calculated based on costs is unclear.
  - Data reporting requirements should help to support the realisation of benefits from the set of proposed regulations by increasing compliance through ensuring that the FCA is able to effectively monitor firms' behaviour and market outcomes.

### Market impacts

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- 141.** KPMG also analysed potential market impacts of our proposals. The majority of survey respondents stated that the proposed regulations were likely to lead to a decline in new lending volumes. KPMG consider this could result in some firms exiting the market, although competition may be stimulated by an alignment of the regulatory regimes and first charge firms entering the market.

### Our view of KPMG's CBA

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- 142.** While we may differ slightly on some matters of detail, we agree with the major findings of the CBA produced by KPMG. For example:
- We would expect the ESIS requirement being introduced by the MCD to have major cost implications. KPMG find this to be the most significant contributor to incremental compliance costs

- Ex-ante we thought the responsible lending proposals would have the most significant impact of the discretionary set of proposals, and we consequently conducted an in-depth CBA into these. That these were likely to have the greatest impact on business volumes is borne out by responses to KPMG's survey
  - Our analysis of profit drivers in the market suggested the market was unlikely to reach former peaks in the short to medium term future, though some growth from the current low base was likely. This was confirmed to be in line with market expectations by the KPMG study
- 143.** Comparing with cost estimates for the first charge mortgage market as a result of the MMR, and for all firms in Europe as a consequence of the MCD (as estimated by the European Commission), it appears the compliance cost estimates reached by KPMG for the second charge market may be on the high side. In overall terms though, we do not significantly disagree with the conclusions reached by KPMG in their analysis.

## Section 3

# Other mortgage conduct of business and administrative proposals

### Rolling-up of fees and charges (applicable to second charge firms)

- 144.** We are proposing only allowing fees and charges to be rolled-up into the loan where a customer has given their express consent. This is explained in greater detail in Chapter 3.
- 145. Costs:** This would lead to some compliance costs for firms arising from systems and controls requirements. Extrapolating from the 2010 estimate Oxera made as part of the MMR, we estimate one-off costs of the proposal of around £150,000 across all second charge lenders in the market.<sup>75</sup> There may additionally be small on-going costs from ensuring explicit consent for each loan, but these are not expected to be material.
- 146. Benefits:** In the second charge market, it is common practice for loan origination fees and charges incurred by the customer to be automatically 'rolled-up' into the loan. This results in interest being charged on such fees for the duration of the agreement. Our proposal would ensure that customers have a choice of whether to pay fees and charges up-front or have them rolled into the loan.
- 147.** In theory, the application of our rules will increase price transparency as part of an advised sale, where the firm assesses the suitability of how fees should be paid, and reduce the risk of commercial imperatives outweighing what is the customer's best interests. In practice, since around two-thirds of second charge mortgages are taken out for debt consolidation purposes, we would not expect the majority of borrowers to change their current practice. However, for a minority of borrowers, in particular among those borrowing for home improvement or other consumption/ investment reasons, this may lead to more informed decisions.

### Information sharing between charge holders (applicable to first and second charge firms)

- 148.** When a customer is in financial difficulty, there are very few obligations on firms to share information with other charge holders. We are proposing new requirements on mortgage lenders to share information with other firms holding a charge over the property at set points in the litigation, possession and assisted voluntary sales processes. Details on our information sharing proposals are set out in Chapter 5.

<sup>75</sup> Oxera estimate the one-off cost for first charge lenders to comply with this requirement to be approximately £6,000 per firm. Accounting for inflation, this would now amount to around £7,000 per firm. We believe that this is a suitable approximation of the one-off cost for second charge firms. Given our estimate of 20-25 active second charge lenders we estimate the £150,000 figure across the market. See: [http://hb.betterregulation.com/external/oxera\\_report\\_mmr.pdf](http://hb.betterregulation.com/external/oxera_report_mmr.pdf)

- 149. Costs:** The impacts on second charge firms are set out in KPMG's report. These costs would only be incurred where an account is in arrears deep enough to warrant a charge holder starting litigation action or progressing an assisted voluntary sale. KPMG estimate incremental costs of around £100,000 for second charge firms from these requirements. In theory, first charge firms should be subject to the similar compliance costs. However, we discussed our information sharing proposals with our industry working group prior to consulting. Firms have recognised that the costs associated with meeting our proposed information sharing rules costs should be minimised by factoring the requirements into existing processes.<sup>76</sup>
- 150. Benefits:** The KPMG report summarises and quantifies the benefits of firms sharing information at specified points in the process. These include reduced costs for consumers and, at the point of a property being repossessed, greater transparency over the sale price. Our discussions with consumer groups have supported our view that the current lack of co-ordination between charge holders poses risks of customer harm. The industry has previously recognised these risks by establishing an information sharing process through first charge and second charge trade bodies. However, we are aware that there has been inconsistent application of this process. Our proposals will ensure that first and second charge firms share information in their customers' best interests, reducing costs for customers at risk of losing their home.

### Approved Persons (applicable to second charge firms)

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- 151.** The controlled functions under our consumer credit regime for fully authorised firms are governing functions, systems and controls functions, and Money Laundering Reporting Officer functions. Second charge firms will be subject to more extensive requirements under the mortgage regime, covering all governing functions, Apportionment and Oversight (CF8) and AML functions (CF11), and often Systems and Controls (CF28) and Significant Management (CF29). Detail on our proposed application of the Approved Persons regime to second charge firms is set out in Chapter 3.
- 152. Costs:** Compared to the requirements under the consumer credit regime, the compliance costs to firms of securing the relevant permissions for a greater range of functions will be smaller. Europe Economics on our behalf conducted analysis in 2013 on the costs to a comparable subset of consumer credit firms (approximately 3,500 non-bank lenders and 15-17,000 intermediaries) in adopting the controlled functions required by the consumer credit regime.<sup>77</sup> By averaging those costs across the relevant lender population, we estimate potential incremental one-off costs of around £500 per second charge lender and £150 per second charge intermediary. This is an upper cost bound for firms being required to authorise the additional controlled functions required under the mortgage regime, as governing and systems and controls functions should already be in place.

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<sup>76</sup> For example, generating additional letters in the event of contacting the borrower where litigation action has commenced or contacting the local authority in the event of taking possession.

<sup>77</sup> Europe Economics estimated one-off costs of £1.7m-£2.8m and ongoing costs of £0.1m-£0.3m across all non-bank lenders and consumer hire firms. The same report estimated that, for 15-17,000 credit intermediaries, there would be one-off costs of £2.0m-£2.9m and on-going costs of £0.2m-£0.4m. See: p.61 [http://www.europe-economics.com/publications/final\\_europe\\_economics\\_report\\_03-10-13.pdf](http://www.europe-economics.com/publications/final_europe_economics_report_03-10-13.pdf)

- 153. Benefits:** The approved person requirements in the mortgage market are a means of ensuring that firms undertaking business that results in debt secured on a customer's home have robust senior management controls to support consumer protection from poor lending or sales practices. They impose personal accountability, and aim to ensure the propriety of individuals carrying out key functions.

### Financial Services Compensation Scheme

- 154.** Second charge firms are not currently in scope of the Financial Services Compensation Scheme (FSCS). Our proposals to bring them in scope are set out in Chapter 3.
- 155. Costs:** Bringing second charge firms within scope will result in some cost increase for second charge firms. Second charge lenders will be in FSCS Class I, and intermediaries in Class E2. All firms will pay a share of the base costs levy, and whether firms pay additional levies will depend on the level of claims in a particular year.
- 156.** As an illustration, using the 2014/15 FSCS levy rates as a basis:
- A larger second charge lender, writing 5,000 loans in the reporting period and administering a back book of 50,000 loans would pay an FSCS levy of around £600.
  - A smaller second charge lender, writing 200 loans in the reporting period and administering a back book of 4,000 loans would pay an FSCS levy of around £50.
  - A larger second charge intermediary with £500,000 of eligible income in the reporting period would pay an FSCS levy of around £1,100.
  - A smaller second charge intermediary with £30,000 of eligible income in the reporting period would pay an FSCS levy of around £70.
- 157. Benefits:** At present, second charge customers are not protected against risks relevant to taking out a mortgage, such as receiving incorrect advice, where a firm ceases trading. Bringing second charge firms into scope will ensure that their customers are protected in the event of a firm exiting the market, subject to the usual FSCS eligibility criteria. As an illustration since its inception, the FSCS has upheld over 200 first charge mortgage claims, with £2.95m paid out to consumers in respect of claims against 79 different firms in default.
- 158.** To some degree the consequence of this proposal is a transfer from all firms in the market (and their customers to the extent the FSCS levy is passed on in price increases) to a smaller subset of customers who would have lost out in the event of their firm exiting the market. However, this may also lead to increased social welfare through two mechanisms:
- the detriment for the smaller subset of consumers affected could have a larger total impact on utility than for the consumers and owners of all firms from the cost of the FSCS levy
  - knowledge of FSCS protection could lead to increased consumer confidence and hence greater activity in the market

### Direct costs to the FCA

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- 159.** To implement the MCD and our proposed approach to second charge regulation, we expect to incur one-off costs of between £3 million and £4.5 million. These costs are primarily expected to arise from IT and systems related expenditure and from authorisation processes needed for second charge firms. We expect the proposed regulatory regime for second charge firms to lead to incremental on-going annual costs to the FCA of around £400,000. The most significant part of this is expected to arise from our supervisory approach going forward.

## Section 4

# Mortgage Credit Directive applied to first charge mortgages

### Market and regulatory failures in the European mortgage market

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- 160.** In its impact assessment the European Commission identifies the following market failures in EU mortgage markets<sup>78</sup>:
- information asymmetries; and
  - misaligned incentives (conflicts of interest)
- 161.** This analysis overlaps significantly with the market failures the FSA identified in relation to the UK mortgage market (as discussed for the MMR – see FSA CP 11/31). The information asymmetry argument is the same as the FSA made in the MMR. The conflicts of interest problem arises for instance when creditors or credit intermediaries' interests may be skewed by their remuneration structures, which may lead to the provision of inappropriate products to borrowers.
- 162.** The Commission further presents a regulatory failure justification for intervention. The Commission argues:
- mortgage conduct of business regulation at the EU in and in member states is patchy and inconsistent; and
  - there are gaps and inconsistencies in the regulatory framework for non-credit institutions providing mortgages and for credit intermediaries
- 163.** This, it is argued, can lead to opportunities for regulatory arbitrage, gaps in consumer protection, and fragmentation creating barriers to cross-border activity.
- 164.** The Commission considers that in combination these market and regulatory failures drive irresponsible lending and behaviour in EU mortgage markets, leading to the threat of unsustainable household debt. This can have a severe impact on the economy. In economic terms this is the externality argument the FSA made in the MMR.

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<sup>78</sup> European Commission (2013) Impact Assessment: Accompanying document to the Proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property

### Cost benefit analysis

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- 165.** In the case of European Directive implementation, with little or no margin for discretion, the FCA might consider it a disproportionate use of resources and therefore ‘not reasonably practicable’ to spend substantial resources on estimating the costs or benefits of something which in practice does not really involve an exercise of discretion or significant decision-making by the FCA and the matter is not something that would be influenced by responses to the public consultation. Since this section covers issues either where the FCA has little or no margin for discretion in implementing the MCD, or the FCA has exercised the discretion it has to minimise the impact of the MCD in both scope and the extent of rules changing whenever possible, we have decided to conduct a high level cost benefit analysis here.
- 166.** As noted above, our mortgage conduct rules (as amended by the MMR) and the MCD are both largely trying to address the same set of issues, with the MCD further attempting to address regulatory failures across EU mortgage markets. Consequently our existing mortgage conduct rules mean many of the solutions being introduced by the MCD already apply in the UK market for first charge mortgages. For such policies there is no incremental impact.<sup>79</sup>
- 167.** There are some limited areas where our implementation of the MCD goes beyond our existing mortgage conduct rules. Where this is likely to have material impacts we analyse costs and benefits at a high level in the section below.
- 168.** Additionally the CBA conducted by KPMG considers the incremental impact of the MCD on second charge mortgages. Our existing mortgage conduct rules did not apply to this business, though we are now as part of this CP consulting on applying a tailored regime to second charge mortgage providers. The analysis of this discretionary regime is further covered in the KPMG CBA. Finally, the costs and benefits of responsible lending proposals for second charge mortgages are separately analysed earlier in this chapter.

### Where the MCD goes beyond our mortgage rules and is likely to have material impacts

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- 169.** In nine areas we think the implementation of the MCD is likely to lead to material incremental impacts. We conduct a high level cost benefit analysis for these areas in this section.

#### Advertising

##### 1. *Most advertising will need to include a ‘representative example’ – MCD Article 11*

- 170. Costs:** Additional information requirements when advertising may increase compliance costs for firms, primarily through the cost of larger/ longer advertising space in for e.g. print media or on television. Some firms might avoid the need for including representative examples through choosing to advertise more generically.
- 171. Benefits:** The Commission’s intended benefit here is greater clarity and comparability of mortgage advertising reducing the risk of consumers being misled and purchasing unsuitable products. The Commission considers its package of marketing and advertising policies in the MCD as a whole may consequently have a weak positive impact on default rates (0.5-1 basis

<sup>79</sup> While there is no incremental impact relative to now, our mortgage rules in this category do imply an incremental impact relative to the MCD. Since a thorough CBA was conducted as part of the recently implemented MMR we do not think re-running such an analysis is justified (or would in fact lead to materially different policy outcomes).

point reduction). Since only this one part of the overall advertising and marketing package is incremental for the UK mortgage market, we do not expect significant consequent benefits.

- 172.** This expectation of little benefits is borne out by the Mortgage Effectiveness Review<sup>80</sup>, and subsequent research feeding into the MMR, which suggested that mortgage advertising played only a very limited role in purchasing decisions. At best, consumers use promotions to identify lenders or products that might be of interest. These were prompts for further exploration, and seemed to have little influence on the ultimate purchase.
- 173.** We are additionally proposing to simplify our advertising requirements where the MCD permits, which may lead to some cost savings for firms.

### Knowledge and Competency

- 2.** *Knowledge and competency requirements will have to be expanded – both in terms of staff covered (e.g. product manufacturers) and areas of knowledge (e.g. operation of land registers) – MCD Article 9*

- 174. Costs:** The requirements apply to a broader set of staff than existing rules, namely those involved in product design and underwriting. This will impact both lenders and intermediaries.<sup>81</sup> While we might reasonably expect the individuals affected to be competent, there will be some costs for firms in being able to clearly demonstrate this.
- 175. Benefits:** The Commission's intended benefit through introducing knowledge and competence requirements is to decrease the proportion of unsuitable/ irresponsible sales made, improve customer confidence, and facilitate cross border operations. The Commission considers, among all the pieces of regulation proposed by the MCD, the package of registration, authorisation and supervision requirements for credit intermediaries and lenders is likely to have the smallest impact on default rates. Since knowledge and competence requirements for the broader set of staff captured here is a small subset of this, and because through our existing rules we already targeted professional qualifications at the group where we think standard setting would lead to most benefits (sales staff), we do not expect this to lead to very large incremental benefits in the UK mortgage market.

### Disclosure

- 3.** *There will be new prescribed, and maximum harmonising, product disclosure (subject to a 5 year transitional period) – MCD Article 14 & Annex II*
- 4.** *Variable rate mortgages will have to be illustrated with two APRCs – the second showing the worst case over the last 20 years – MCD Article 17 & Annex II*
- 5.** *Where lending is in a foreign currency there will be additional disclosure requirements and consumer rights – MCD Article 23*
- 176. Costs:** The Commission estimates compliance costs for firms arising from its ESIS disclosure requirements across the EU will be €185m one-off and €151m on-going. The Commission further estimates compliance costs for firms arising from the requirement to illustrate variable rate mortgages with two APRCs across the EU will be €96m one-off and €78m on-going.

<sup>80</sup> FSA (2008) *Mortgage Effectiveness Review*

<sup>81</sup> The Directive sets out principles but allows Member States to specify how firms should meet these. We already specify formal training requirements for sales staff through existing mortgage market rules. Were we to specify similar professional qualification requirements for product design and underwriting staff, there would be significant compliance costs. We have chosen, however, to copy out the Directive here with firms having the choice to demonstrate compliance without further professional qualification requirements.

- 177.** While much of the content of the ESIS will be familiar to UK mortgage lenders, the new information requirements and the format of the ESIS are different from the KFI. Incremental compliance costs, including systems costs, to meet the new formatting and variable fields, are expected for UK mortgage lenders. As part of the options being considered in CP11/31 Oxera estimated the incremental compliance costs of changing the format of the KFI. A total UK industry one-off cost of approximately £23 million was estimated. We consider that this provides a comparable sense of the scale of the incremental costs for firms in the UK mortgage market of the change to the ESIS from the KFI.
- 178.** Disclosure and new consumer rights where lending in a foreign currency can lead to further incremental costs in terms of systems changes and risk transfer. However, this would impact only a relatively small segment in the UK mortgage market offering foreign currency loans. Industry feedback indicates that such lenders may re-write their contracts (in effect stop writing foreign currency loans) to ensure that loans aren't subject to additional requirements.
- 179. Benefits:** The Commission's intended benefit from standardised disclosure is for customers to be able to make more informed decisions leading to a fall in unaffordable lending/ borrowing and consequently a positive impact on financial stability. The Commission expects its proposals on pre-contractual information to have a medium impact on default rates (an estimated fall of 2.5-3.5 basis points).
- 180.** In the UK, through the KFI we already have standardised disclosure in place that was designed specifically for the UK mortgage market. We do not expect therefore significant incremental benefits in the UK of this requirement to harmonise product disclosure.

#### Reflection period

#### **6. A 7 day reflection or withdrawal period has to be introduced, extending the UK sales process – MCD Article 14**

- 181.** Member states can choose between introducing a 7 day reflection or withdrawal period in the sales process. While there is a narrow discretion here in the choice of approach, there is no broader discretion (e.g. in terms of other choices, or the possibility of not applying this requirement). The FCA have chosen the reflection period which firms confirm is the less burdensome of the two options.
- 182. Costs:** There will be compliance costs for firms from having to design systems that provide notice of the right to customers and captures the exercise of this. Discussions with firms confirm this would impose a lower burden than applying the withdrawal period option.
- 183. Benefits:** The Commission's main intended benefit is customers making better decisions through being allowed more time for reflection, shopping around, and comparing offers, before they are bound. The Commission considers this will improve customer mobility enhancing competition, and further expects this to have a small positive impact on default rates.
- 184.** Although currently there is no prescribed reflection period in the UK, mortgage sales typically take several days, if not weeks, to conclude. There will be a number of reasons for this, from the delays while a consumer provides required details to support their application (e.g. if their lender asks for additional evidence of income), through to the carrying out of legal conveyancing checks and the instruction of a property valuation. We do not therefore expect the requirement to change outcomes materially in the UK.

### Pre-sale explanation

7. *There will be a new obligation for an 'adequate explanation' pre-sale, with this explanation to focus on the content of the required disclosures. This requirement is most likely to impact on execution-only sales – MCD Article 16.*

185. **Costs:** The Commission estimates compliance costs for firms arising from having to provide adequate explanations across the EU will be €25m one-off and €13-25m on-going. One-off costs are expected to arise from training and the changes to systems and standard operating procedures, while the on-going part comes from the incremental cost of providing explanations.
186. Our existing mortgage conduct requirements for advice make this a trivial change for many sales in the UK. But where the sale is execution-only, rules currently do not require the equivalent of such an explanation. In the UK the bulk of mortgage sales are advised. So the proportion of mortgages impacted will be relatively small. There will be compliance costs for these execution-only mortgages.
187. **Benefits:** The Commission finds that information given by banks to customers on the way their mortgages work and the risks involved is considered by 59% of European customers as difficult to understand. This aggravates the information asymmetry problem in this market. The Commission's intended benefit is to improve consumer understanding of the product being offered, leading to improved consumer mobility and better decisions.
188. In the UK we would not expect large benefits since, the execution-only channel is for use primarily where consumers signal the view that they have sufficient understanding.

### Prudential requirements for intermediaries

8. *Mortgage credit intermediaries will be required to hold an increased level of PII cover (amount to be specified by the European Banking Authority - EBA) – MCD Article 29*

189. **Costs:** The regulatory technical standard (RTS), being consulted on by the EBA, states a preferred option with a minimum level of PII cover for credit intermediaries of €460,000 per claim and €760,000 in aggregate per year.<sup>82</sup> The Commission estimated that its prudential requirements for credit intermediaries might lead to on-going costs of around €18m per year across Europe. Costs are expected to be concentrated in countries with no or low PII requirements. The EBA as part of its analysis received detailed responses from 22 Member States. Of these, seven reported that PII is an existing mandatory requirement for mortgage credit intermediaries, whereas 15 others had no such requirements.
190. In the UK, the minimum limit of indemnity currently required is the higher of 10% of annual income up to £1 million and £100,000 for a single claim or £500,000 in aggregate.<sup>83</sup> There are therefore likely to be incremental compliance costs for firms from having to pay higher premiums, where their current level of PII cover does not meet the minimum standard specified by the EBA's RTS. However, given current minimum requirements we do not expect incremental compliance costs to be very large.

<sup>82</sup> The provision does not apply where the intermediary is also the creditor.

<sup>83</sup> A firm does not require PII if it has net tangible assets of at least £1 million.

**191. Benefits:** The Commission has identified issues including misconduct, excessive risk-taking or poor advice by mortgage credit intermediaries. In response, the Commission is introducing the requirement for intermediaries to take out PII or a comparable guarantee. The Commission's intended benefits are assumed to derive from more prudent intermediaries providing more suitable advice leading to improved market outcomes. Since we already have PII standards in place in the UK we do not expect significant benefits from this application.

#### **Remuneration**

**9. Firms will be subject to additional detail on remuneration arrangements, especially in terms of how such arrangements must avoid conflicting with the interests of the customer – MCD Article 7**

**192. Costs:** The Commission estimates one-off compliance costs for firms arising from its remuneration requirements across the EU will be around €3m. In the UK, we think existing mortgage rules in MCOB (2.3, 2.4, 2.5) read in combination with Principles 3 and 6 go some way towards meeting the MCD requirements. The main addition will be the introduction of a new requirement prohibiting the use of sales targets in remuneration structures where advice is given. There will be a cost for firms of switching remuneration structures. As implied by the Commission's overall incremental cost figure for Europe, the requirement should not lead to very large compliance costs for firms in the UK.

**193. Benefits:** The Commission's intended benefit is to reduce the risk of remuneration structures misaligning incentives and leading to customers (particularly vulnerable groups) being sold inappropriate products given their needs and circumstances. In the UK the effect of the combination of our mortgage rules and Principles is already intended to achieve this. We think therefore incremental benefits are not likely to be large.

**Q58: Do you agree with the costs and benefits identified?**

# Annex 2

## Compatibility statement

### Introduction

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1. This Annex explains how we satisfy the requirements set out in section 138BI of the Financial Services and Markets Act (FSMA). When consulting on new rules, we are required by FSMA to include an explanation of why we believe making the proposed rules is compatible with our strategic objective, advances one or more of our operational objectives, and has regard to the statutory principles in s.3B FSMA. We are also required by section 138K(2) of FSMA to state our opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
2. This Annex also sets out our view of how the proposed rules are compatible with the duty on us to carry out our general functions (which include rule making) in a way that promotes effective competition in the interests of consumers (s.1B(4)). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.
3. This Annex must be read in conjunction with the rest of the consultation paper and the cost benefit analysis (in Annex 1) in demonstrating that we meet our statutory duties and objectives.

### Compatibility with our statutory objectives

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4. The policy proposals and draft rules in this CP primarily advance our operational objective of 'securing an appropriate degree of protection for consumers'.
5. We consider these proposals to be compatible with our strategic objective of ensuring that the relevant markets function well.

### Consumer protection

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6. We have made a robust assessment of the requirements of the MCD and we believe it adds little to consumer protection beyond our existing mortgage regime. We have therefore sought to rely on our existing rules where possible for implementation. We have considered how to extend the level of consumer protection afforded to second charge customers, and we believe that by applying many of the protections of our existing mortgage rules we will enhance consumer protection in a number of ways, to address harm arising from areas such as poor sales practices, poor affordability assessments and unfair treatment of consumers in payment difficulties.

7. As previously discussed in this consultation paper, the arrears rates in the second charge market are materially higher than those in the first charge market. Our proposed rules on arrears charges aim to protect consumers suffering payment difficulties, for example by preventing them from unfair charges such as costs that exceed the cost of the firm's administration, and to ensure they are provided with an appropriate range of forbearance options.

#### **Promoting effective competition in the interests of consumers**

8. In preparing the proposals as set out in this consultation, we consider we have met our duty under s.1B(4) FSMA, which provides that we must, so far as is compatible with acting in a way that advances the consumer protection objective or the integrity objective, carry out our general functions in a way that promotes effective competition in the interests of consumers.
9. Each of our proposals has been subject to an assessment about the likely impact on competition in the market, and we are satisfied that there will be no harm to competition that cannot be justified, on balance, by our objective to secure an appropriate degree of protection for consumers.
10. We believe that the majority of our proposals will not have a material adverse impact on competition. We have also sought to ensure that we do not burden firms with unnecessary regulatory changes, e.g. by relying on our existing rules rather than copying out those of the Directive. We recognise that the increase in incremental costs for firms does lead to some chance of exit from the market, particularly for smaller firms; however, this may be reduced through the ability of firms to pass higher costs in part to customers.
11. Additionally, bringing a greater level of equivalence in first and second charge mortgage regulation may result in more first charge lenders entering the second charge market, which could have residual positive impacts on competition.
12. This statement should be read together with the cost benefit analysis.

#### **Compatibility with the principles of good regulation**

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13. In preparing the proposals set out in this consultation, we have had regard to the regulatory principles set out in s.3B FSMA. We set out below how our proposals demonstrate such regard for each of the regulatory principles.

#### **The need to use our resources in the most efficient and economic way**

14. Member States are required to implement the MCD by March 2016. Given our belief that the MCD adds little to existing protection for UK consumers, we have sought to be proportionate and rely primarily on our existing rules to implement where possible, avoiding additional regulatory costs and costs to industry.
15. In addition by applying similar consumer protections to second charge mortgages as first charge mortgages we anticipate that we may achieve efficiencies in the supervision of firms.

#### **The principle that a burden or restriction which is imposed should be proportionate to the benefits**

16. The proportionality of our approach is addressed in the cost benefit analysis at Annex 1. Our conclusion is that the costs of our proposals are proportionate to the associated benefits. More broadly, we have sought to ensure that our approach towards implementation of the MCD is proportionate to the associated benefits to consumers and we believe our proposals for implementation will produce the least possible disruption for firms.

**The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term**

17. Our proposals have regard to the desirability of sustainable growth in the medium and long term. We do not expect the proposals to have a material impact on growth in the UK. The proposals set out in this consultation primarily affect the second charge market, a small market that has seen a significant reduction in size since the financial crisis. Those proposals that have an impact on first charge mortgages which may have a broader economic impact are mandatory provisions originating from the maximum harmonisation elements of the Directive.

**The general principle that consumer should take responsibility for their decisions**

18. Our proposals are founded in the principle that consumers should take responsibility for their decisions. Our proposals to enhance sales standards across the second charge market puts responsibility on firms and their management to ensure that consumers are only presented with mortgages that meet their particular needs and circumstances. This will ensure that the consumer is better informed when making lending decisions, enhancing consumer protection and mitigating adverse outcomes.

**The responsibilities of the senior management of persons subject to requirements imposed by or under FMSA, including those affecting customers in relation to compliance with those requirements.**

19. As a result of second charge lending being brought into our mortgage rules, we are proposing to apply the wider requirements around approved persons that currently apply to first charge mortgage firms to second charge firms. As part of the authorisation process firms will have to identify the individuals who will be performing controlled functions, and so must be approved by us.

**The desirability where appropriate of the FCA exercising its functions in a way which recognises differences in the nature and objectives of the business it regulates.**

20. We have designed our proposals in a way that recognises the similar risks to consumers in both the first-charge and second-charge markets, but also the differences between the two markets. We have engaged with industry to ensure we have tailored our proposed regulatory regime where appropriate to accommodate the nuances of second charge lending. We are also proposing to use available exemptions where we can, so we will not apply the requirements of the MCD to credit union mortgage lending.

**The desirability of publishing information relating to persons**

21. We have the power to publish information relating to investigations into firms and individuals. However as set out in the Enforcement Guide we will not normally make investigations or our findings or conclusions public except in exceptional circumstances.

**The principle that we should exercise our functions as transparently as possible**

22. We are an open and transparent regulator. As we have developed our proposals we have met extensively with industry and consumer groups to explain our approach.

**Any impact of changes in our proposals on mutual societies**

23. Section 138K of FSMA requires us to prepare a statement about the impact of proposed rules on mutual societies. In particular, we are required to set out whether this will be significantly different from their impact on other authorised persons and if so, details of that difference.
24. We have considered the potential impact of our proposals in relation to building societies, credit unions, industrial and provident societies, friendly societies and EEA mutual societies. As we have decided not to apply the requirements of the MCD to credit union mortgage lending (see 2.3) we do not anticipate any substantial impact to these firms as a result of these proposals. We are not aware of any mutual societies currently providing second charge loans.

25. We welcome any comments or information respondents may have on any issues relating to mutual societies arising from our proposals.

### **Legislative and Regulatory Reform Act 2006 (LRR)**

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26. We are required under the LRR to have regard to the principles in the LRR and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but this duty does not apply to regulatory functions exercisable through our rules).
27. We have had regard to the principles in the LRR and the Regulators' Compliance Code for the parts of the proposals that consist of general policies, principles or guidance. We have engaged with firms throughout this process, and consider that the proposals are proportionate and result in an appropriate level of consumer protection, when balanced with impacts on firms and on competition.

### **Equality Impact Assessment**

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28. We are required under the Equality Act 2010 to consider whether our proposals could have a potentially discriminatory impact on groups with protected characteristics (age, gender, disability, race or ethnicity, pregnancy and maternity, religion, sexual orientation and gender reassignment). We are also required to have due regard to the need to eliminate discrimination and advance equality of opportunity when carrying out our activities.
29. We have conducted an initial equality impact assessment (EIA) of our proposals to ensure that the equality and diversity implications are considered. This included a full assessment of potential impacts arising from each of our policy proposals undertaken during our internal governance process.
30. The main outcomes of our initial assessment are that:
- the proposals in this paper do not result in direct discrimination for any of the groups with protected characteristics
  - the measures introduced for first charge lending will have a small impact on anyone seeking to take out a mortgage as the new requirements are broadly in line with our existing mortgage rules. There are no differential effects on any affected groups.
  - although we do not currently hold any data on the gender, ethnicity, sexual orientation or faith of second charge borrowers, we have not had any indication from consumer groups or other bodies that any group with protected characteristics may be affected by these proposals more than the general population
31. The EIA process is still ongoing, and will not be completed until we develop and publish our final policy. As a result, we are seeking additional input from all stakeholders to help us further investigate and establish the extent of any potential impacts of the proposals in this paper. We would also welcome any comments or information respondents may have on any equality and diversity issues arising from our proposals.

## Annex 3

# Where we are not making changes to our rules

1. Several MCD obligations are features of our existing regulation. In such cases we have not needed to make rule changes. Directive obligations that fall into this category include:
  - Rules on the customer's best interests.
  - Advice, where we have only recently significantly raised standards.
  - Arrears and foreclosure.
  - Early repayment charges. We think our regulatory expectations here are already clear. Any charges a firm chooses to make should only reflect the costs incurred from early repayment. This is an approach shared with our rules on arrears charges (see MCOB 12.4). On those rules we have seen some firms failing to meet the required standard. We found some seeking to recover costs not linked to the consumer's position (for example marketing costs). In other cases firms didn't have a clear idea of the actual costs they faced and simply matched the charges levied by their competitors. We have changed the arrears charges rules as a result to make plainer still the costs should only be those legitimately incurred. Firms will want to ensure, when planning for implementing the MCD, the charges they impose on early repayment are no more than their actual costs. When doing this they are able to look at the considerations we set out in the MMR responsible lending CP<sup>84</sup> and the changes subsequently made to our arrears rules.
  - The admission and supervision arrangements for credit intermediaries.
  - The admission and supervision arrangements for non-credit institutions.
  - The sanctions that can be applied to ensure effective compliance.
2. Firms using a Combined Initial Disclosure Document (CIDD) will need to make further changes to that document to satisfy the new MCD obligations. At this stage we are not proposing further amendments to the CIDD template. Instead we propose to wait for the outcome of this consultation and current policy work intended to help firms improve the disclosures they make.
3. We know there can be limits to the information that consumers are able to absorb and understand. But we believe that it is possible to provide appropriate information in line with our requirements, in a consumer-focused way that increases engagement. This is why, we committed in our 2014/15 Business Plan, to work with firms to explore whether disclosures can be smarter, simpler and work better for consumers. As part of this work, we are also reviewing the requirements in our Handbook to ensure they are genuinely supporting customers to understand what they are buying. This includes reviewing the requirements for the IDD and the CIDD. We will publish the outcome of this work later this year.

<sup>84</sup> [www.fca.org.uk/your-fca/documents/consultation-papers/fsa-cp10-16](http://www.fca.org.uk/your-fca/documents/consultation-papers/fsa-cp10-16)

4. There are also several discretionary powers in the MCD to introduce additional regulation, which we have chosen not to use. We haven't proposed:
- a ban on commissions
  - a ban or restriction on the consumer being required to make pre-contractual payments
  - to require all intermediaries to make available general information on mortgages, and the costs and risks involved
  - a standard risk warning in advertisements, or other warnings in general information
  - a reflection period of longer than seven days, a ban on the waiving of the consumer right, or any right of withdrawal
  - a ban on using the term 'advice' or 'adviser' where, the firm is not independent, or more onerous restrictions on who can use the description independent adviser'
  - a requirement for advisers to provide a warning of specific risks
  - to constrain the permitted options for firms to address foreign currency risks, or otherwise imposed additional constraints on such lending
  - additional conditions on the exercise of the early repayment right, or a cap on the fair and objective charge a lender can recover
  - to allow notification of the impact of interest rate changes to be by public notice
  - that lenders can impose additional charges on default.

## Annex 4

# List of questions

- Q1:** Do you agree with our proposed approach to implementing the transitional arrangements by requiring 'top-up' disclosure?
- Q2:** What, if any, might be the alternative approaches that would allow us to meet our legal obligations when implementing the transitional?
- Q3:** What difficulties, if any, can you see with using the ESIS instructions and template (see MCOB 5A Annex 1R and 2R) to prepare pre-sale mortgage illustrations?
- Q4:** Do you have views on whether the ESIS instructions should be drafted in standard Handbook format?
- Q5:** Do you agree with the proposed approach to implementing the MCD requirement for a binding offer?
- Q6:** Do you agree that the MCD consideration period is better enacted as a pre-sale reflection period, rather than a post-sale cooling-off period?
- Q7:** Would it simplify matters, for example in terms of the compliance obligations for firms, to apply the MCD approach to the APRC calculation to all lending rather than just that covered by the directive?
- Q8:** Do you agree with our proposed approach to specifying a benchmark that firms may need to use when calculating a second APRC?
- Q9:** Do you agree with our proposed approach to transposing the MCD requirements on financial promotions and the wider simplification of our rules in this area?
- Q10:** What challenges do you see in providing consumers with an adequate explanation, for example in an execution-only sale?
- Q11:** What do you consider will be the impact of the new MCD rules on the availability of foreign currency mortgages?

- Q12:** What do you think will be the impact of this approach on firms and consumers?
- Q13:** What, if any, might be alternative approaches that would allow us to meet our legal obligations when implementing the Directive for this type of lending?
- Q14:** Do you consider that the proposed transitional approach is effective in allowing firms to prepare early for the implementation of the MCD?
- Q15:** Do you have any comments on the draft rules in relation to implementation of the MCD set out in the draft Mortgage Credit Directive Instrument 2014 at Appendix 1? Do you agree that the rules reflect the stated policy intention?
- Q16:** Are there any particular elements that you think should be implemented on a different timetable to MCD requirements? If so, which elements, and why, and to what timetable?
- Q17:** Do you agree with our proposals for sales disclosure for second charge mortgages?
- Q18:** Do you agree with our proposals for post-sales disclosure for second charge mortgages?
- Q19:** Do you agree with our proposal to extend our mortgage advice and selling standards to second charge mortgages?
- Q20:** Do you agree that all borrowers looking to increase their borrowing should be made aware that a second charge or unsecured loan may be more appropriate, during initial disclosure at the start of the sale?
- Q21:** Do you agree that we should apply MCD creditworthiness assessment requirements to second charge mortgages through our MCOB affordability rules?
- Q22:** Do you agree that we should apply the MCOB interest rate stress test to second charge mortgages?
- Q23:** Do you agree with the proposed approach to stress testing higher priority loans against expected interest rate increases?
- Q24:** Do you agree that we should apply the MCOB debt consolidation requirement to all second charge debt consolidation mortgages?

- Q25:** Do you agree that we should apply the MCOB interest-only rules to second charge mortgages?
- Q26:** Do you agree with our proposed approach to contract variations for second charge mortgages?
- Q27:** Do you agree with our proposal to prohibit the automatic rolling-up of fees and charges into a second charge loan?
- Q28:** Do you have any comments on how our proposed approach to implementing the MCD requirements on ERCs will affect the second charge market?
- Q29:** Do you agree with our proposal to apply MCOB 12.5 to second charge firms?
- Q30:** Do you agree with our proposed approach to fees and charges relating to payment difficulties?
- Q31:** Do you agree with our proposal to require interest to be charged on default fees only on a simple basis for second charge mortgages?
- Q32:** Do you agree with our approach to protecting second charge mortgage customers in payment difficulties?
- Q33:** Do you agree with our proposal to apply the general conduct of business standards set out in MCOB 2 to second charge mortgages?
- Q34:** Do you agree with our proposed approach to shared equity loans?
- Q35:** Do you agree with our proposed approach to second charge business loans?
- Q36:** Do you agree with our proposed approach to second charge bridging loans?
- Q37:** Do you agree with our proposed approach to high net worth individuals taking a second charge mortgages?
- Q38:** Do you agree with our proposal to defer consideration of whether prudential requirements should apply to second charge firms?
- Q39:** Do you agree with our proposed timetable for deferral?
- Q40:** Do you agree with our proposed approach to training and competency?

- Q41:** Do you agree with our proposal to include second charge advising and arranging activities into the scope of FSCS?
- Q42:** Do you have any comments on the draft rules in relation to second charge mortgages set out in the draft Mortgage Credit Directive Instrument 2014 at Appendix 1? Do you agree that the rules reflect the stated policy intention?
- Q43:** Do you agree with our proposed collection of transaction-level data on second charge mortgages?
- Q44:** Do you have any comments on the individual data items we intend to collect on sales and performance of second charge mortgages?
- Q45:** Do you have any comments on our proposed adjustment to reporting frequencies for second charge performance data where firms are submitting data manually?
- Q46:** Do you agree with our proposed treatment of second charge lending through MLAR?
- Q47:** Do you agree with our proposed treatment of second charge mediation through RMAR?
- Q48:** Do you agree with our proposed implementation timetable for second charge firms' regulatory reporting?
- Q49:** Do you have any alternatives to minimise any cost burdens on firms, while ensuring that the FCA can meet its statutory objectives?
- Q50:** Do you have any comments on the draft rules set out in Appendix 1? Do you think the rules reflect the stated policy intention?
- Q51:** Do you agree with our proposed rules requiring firms to make customers aware of alternative finance options where they are looking to increase their secured borrowing?
- Q52:** Do you agree that these proposed rules should form part of the initial disclosure, applicable to both advised and execution only sales?
- Q53:** Do you agree with our proposal to transpose the CONC 7 provisions for vulnerable customers into MCOB 13?
- Q54:** Do you agree with the scope of our proposed information sharing requirements?

- 
- Q55:** Do you agree that our proposed information sharing requirements should apply to all firms with a regulated mortgage secured against the property?
- Q56:** Do you agree with the amendments made to PERG?
- Q57:** Are there any business models which need further consideration under PERG as we propose to amend it?
- Q58:** Do you agree with the costs and benefits identified?

# Appendix 1

## Draft Handbook text

## **Mortgage Credit Directive Instrument 2014**

### **Powers exercised by the Financial Conduct Authority**

- A. The Financial Conduct Authority makes this instrument in the exercise of the powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
    - a) section 137A (The FCA’s general rules);
    - b) section 137R (Financial promotion rules);
    - c) section 137T (General supplementary powers);
    - d) section 139A (Power of the FCA to give guidance);
    - e) section 213 (The compensation scheme);
    - f) section 214 (General);
    - g) section 226 (Compulsory jurisdiction); and
    - h) paragraph 19 (Establishment) and 20 (Services) of schedule 3 (EEA Passport Rights);
  - (2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers listed above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

### **Commencement**

- C. This instrument comes into force as follows:
- (1) on 21 December 2015 as follows
    - a) Part 1 of Annex C;
    - b) Part 2 of Annex C but only for the purposes of Part 1 of Annex C;
    - c) Part 1 of Annex D;
    - d) Part 2 of Annex D but only for the purposes of Part 1 of Annex D;
    - e) Part 1 of Annex E but only to the extent that is needed to enable the Financial Conduct Authority to treat a consent notice or a regulator’s notice as effective for the purposes of paragraphs 13(1) or 14(1) of Schedule 3 (as amended) of the Act or a notice of intention as effective for the purposes of paragraphs 19(2) or 20(1) of Schedule 3 (as amended) of the Act and nothing in this paragraph gives a person a right to carry on, before 21 March 2016, any of the activities covered by the changes set out in Part 1 of Annex E;

f) Annex A but only for the purposes of a), b), c), d) and e);

(2) the remainder of this instrument comes into force on 21 March 2016.

### **Amendments to the Handbook**

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary of definitions	Annex A
Training and Competence (TC)	Annex B
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)	Annex C
Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)	Annex D
Supervision manual (SUP)	Annex E
Dispute Resolution: Complaints (DISP)	Annex F
Compensation (COMP)	Annex G

### **Amendments to the material outside the Handbook**

E. The Perimeter Guidance Manual (PERG) is amended in accordance with Annex H to this instrument.

### **Citation**

F. This instrument may be cited as the Mortgage Credit Directive Instrument 2014.

By order of the Board of the Financial Conduct Authority

*date*

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

<u>ADR Directive</u>	<u>Alternative Dispute Resolution Directive, Directive 2013/11/EU on alternative dispute resolution for consumer disputes</u>
<u>advising on regulated credit agreements the purpose of which is to acquire land</u>	<u>the regulated activity, specified in article 53E of the Regulated Activities Order, which is in summary: advising a person if the advice:</u>  (a) <u>is given to the person in his capacity as a recipient of credit, or potential recipient of credit, under a regulated credit agreement;</u>  (b) <u>the person intends to use the credit to acquire or retain property rights in land or in an existing or projected building; and</u>  (c) <u>the advice consists of the provision of personal recommendations to the person in respect to f one or more transations relating to regulated credit agreements.</u>

[Note: article 4(21) of the MCD.]

<u>APRC</u>	<u>the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit, where applicable, including the costs referred to in MCOB 10A.1.2R and equates, on an annual basis, to the present value of all future or existing commitments (drawdowns, repayments and charges) agreed, or which would be agreed if the MCD credit agreement is entered into, by the MCD creditor and the consumer.</u>
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[Note: article 4(15) and 17(2) of the MCD]

<u>arranging (bringing about) regulated mortgage contracts</u>	<u>the regulated activity, specified in article 25A(1) and 25A(2A) of the Regulated Activities Order, which is in summary: making arrangements for another person to:</u>  (a) <u>for another person to ...</u>  (b) <u>for another person to .....; or</u>  (c) <u>to enter into a regulated mortgage contract with a borrower on behalf of a lender.</u>
--	--

.....  
article 3(1)(b)  
credit agreement

a credit agreement:

- (a) under which A is a consumer,
- (b) the purpose of which is to acquire or retain property rights in land or in an existing or projected building; and
- (c) which is not a MCD regulated mortgage contract.

[Note: articles 3(1)(b) and 4(3) of the MCD]

assisted  
voluntary sale  
process

a process whereby a firm which is a mortgage lender, a mortgage administrator, a home purchase provider or a home purchase administrator assists a customer in any way to sell voluntarily property which is subject to a regulated mortgage contract or home purchase plan with the firm, over and above allowing the customer to remain in possession for a reasonable period to effect a sale.

borrowing rate

(in MCOB), the interest rate expressed as a fixed or variable percentage applied on an annual basis to the amount of credit drawn down

[Note: article 4(16) of the MCD and article 3(j) of the Consumer Credit Directive]

bridging loan

- (1) a MCD exempt bridging loan; or
- (2) (other than in (1)) ...

consumer

[Note: . . . , ~~and~~ article 3 of the Consumer Credit Directive, ~~and~~ article 4(1) of the MCD]

credit

- (B) ...
  - (1) (except . . . ~~and~~ . . . a MCD credit agreement)
  - (3) (in relation to . . . a MCD credit agreement) ...

customer

- (1) (except in relation to ICOBS, a credit-related activity, MCOB 3~~2~~3A, a MCD credit agreement and CASS 5) ...
- (2) (in relation to MCOB 3~~2~~3A) ...
- (2A) (in relation to a MCD credit agreement) a consumer.

Data Protection  
Act

the Data Protection Act 1998

EEA firm

...

- ~~(hh)~~(i) an *AIFM* which is authorised (under article 6 of *AIFMD*) by its *Home State regulator*;
- (j) a *MCD credit intermediary* or a *MCD article 3(1)(b) credit intermediary* admitted in accordance with article 29(1) of the *MCD* by its *home state regulator* to carry out all or part of the activities set out in article 4(5) of the *MCD* or to provide advisory services (as defined in article 4(21) of the *MCD*);

...

*ESIS*

*European Standardised Information Sheet*

*European Standardised Information Sheet*

The pre-contractual disclosure document, the template for which is contained in *MCOB 5A Annex 1R*, provided to a *consumer* in accordance with *MCOB 5A*.

*exempt MCD credit agreement*

*an exempt MCD regulated mortgage contract or an exempt article 3(1)(b) credit agreement*

*exempt article 3(1)(b) credit agreement*

*an article 3(1)(b) credit agreement that is:*

- (a) *a MCD exempt bridging loan;*
- (b) *a MCD exempt credit union loan;*
- (c) *a MCD exempt overdraft loan; or*
- (d) *a lifetime mortgage.*

*exempt MCD regulated mortgage contract*

*a regulated mortgage contract that is:*

- (a) *MCD exempt bridging loan;*
- (b) *a MCD exempt credit union loan;*
- (c) *a MCD exempt overdraft loan; or*
- (d) *a lifetime mortgage.*

*financial promotion*

....

(3) (in *MCOB 3A*), in addition to (1), any advertising or marketing communications within the meaning of articles 10 or 11 of the *MCD* made by a *MCD firm* in relation to a *MCD credit agreement*.

[Note: articles 10 and 11 of the *MCD*.]

*financial  
promotion rules*

....

- (3) (in relation to *MCOB*) ~~*MCOB-3*~~ any or all of the *rules* in *MCOB 3A* that impose requirements in relation to a *financial promotion* but only to the extent that they apply to a *financial promotion*.

*first charge legal mortgage*

a legal mortgage ranking in priority ahead of all other mortgages (if any) affecting the land in question, where “mortgage” includes charge and (in Scotland) a heritable security.

*first charge regulated mortgage contract*

a regulated mortgage contract in which the mortgage on which the obligation to repay is secured is a *first charge legal mortgage*.

*foreign currency loan*

a *MCD credit agreement* here the *credit* is:

- (a) denominated in a currency other than that in which the *consumer* receives the income or holds the assets from which the *credit* is to be repaid; or
- (b) denominated in a currency other than that of the *EEA State* in which the *consumer* is resident.

[Note: article 4(28) of the *MCD*]

*group*

- (6) (in *MCOB*) a group of *MCD creditors* which are to be consolidated for the purposes of drawing up consolidated accounts, as defined in *Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings*.

[Note: article 4(6) of the *MCD*]

*lifetime mortgage*

**[The existing definition is deleted and replaced with the following. The deleted text is not shown]**

a regulated mortgage contract or an *article 3(1)(b) credit agreement*, under which the lender:

- (a) contributes a lump sum, periodic payments or other forms of credit disbursement in return for a sum deriving from the future sale of residential immovable property or a right relating to residential immovable property; and
- (b) will not seek repayment of the credit until the occurrence of one or more of the following, unless the *customer* breaches his contractual

obligations (which can include any obligation to pay interest during the term) which allows the lender to terminate the agreement:

- (i) the death of the *customer*; or
- (ii) the *customer* leaves the mortgaged land to live elsewhere and has no reasonable prospect of returning (for example by moving into residential care); or
- (iii) the *customer* acquires another dwelling for use as his main residence; or
- (iv) the *customer* sells the mortgaged land; or
- (v) the lender exercises its legal right to take possession of the mortgaged land under the terms of the contract.

[Note: article 3(2)(a) of the *MCD*]

*MCD* Mortgage Credit Directive, Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property

*MCD article 3(1)(b) credit agreement* an article 3(1)(b) credit agreement which is not an exempt article 3(1)(b) credit agreement.

*MCD article 3(1)(b) credit intermediary* (a) a *MCD credit broker*; or

(b) a *MCD credit adviser*

[Note: article 4(5) and (21) of the *MCD*]

*MCD article 3(1)(b) credit intermediation activity* the activity of acting as a *MCD article 3(1)(b) credit intermediary*.

[Note: article 4(5) and 4(21) of the *MCD*]

*MCD article 3(1)(b) creditor* a firm with permission for entering into a regulated credit agreement as lender which, by way of business and for remuneration (which may take a pecuniary form or any other agreed form of financial consideration), grants or promises to grant *MCD article 3(1)(b) credit agreements*

[Note: article 4(2) of the *MCD*]

*MCD contingent liability or guarantee* a *MCD credit agreement* which acts as a guarantee to another separate but ancillary transaction and where the capital secured against an immovable property is only drawn down if an event or events specified in the contract occur.

[Note: Article 4(24) of the *MCD*]

*MCD credit adviser*

a firm with permission (or which ought to have permission) to carry on the activity, by way of business, of advising on regulated credit agreements the purpose of which is to acquire land.

[Note: article 4(21) of the *MCD*]

*MCD credit agreement*

a MCD regulated mortgage contract or a MCD article 3(1)(b) credit agreement

[Note: article 3(1) of the *MCD*]

*MCD credit broker*

a credit broker who:

(a) for remuneration (which may take a pecuniary form or any other agreed form of financial consideration), carries out an activity of the kind specified in article 36A(1)(d), (e) or (f) of the Regulated Activities Order in relation to MCD article 3(1)(b) credit agreements; and

(b) is not merely introducing, either directly or indirectly, a consumer to a MCD firm.

[Note: article 4(5) of the *MCD*]

*MCD credit intermediary*

in relation to a MCD regulated mortgage contract:

(a) a MCD mortgage arranger; or

(b) a MCD mortgage adviser

[Note: article 4(5) and 4(21) of the *MCD*]

*MCD credit intermediation activity*

the activity of acting as a MCD credit intermediary

[Note: article 4(5) of the *MCD*]

*MCD creditor*

a MCD mortgage lender or a MCD article 3(1)(b) creditor

[Note: article 4(2) of the *MCD*]

*MCD exempt bridging loan*

a regulated mortgage contract or an article 3(1)(b) credit agreement either of no fixed duration or which is due to be repaid within 12 months, used by the consumer as a temporary financing solution while transitioning to another financial arrangement for the immovable property.

[Note: Article 4(23) of the *MCD*]

MCD exempt credit union loan a regulated mortgage contract or an article 3(1)(b) credit agreement where the lender is a credit union.

[Note: articles 3(3)(e) and 4(2), (3) of the MCD, and article 2(5) of the Consumer Credit Directive]

MCD exempt overdraft loan a regulated mortgage contract or an article 3(1)(b) credit agreement in the form of an overdraft facility and where the credit has to be repaid within one month.

[Note: articles 3(2)(d) and 4(3), (23) of the MCD]

MCD firm any of the following:

- (a) a MCD creditor;
- (b) a MCD credit intermediary;
- (c) a MCD article 3(1)(b) credit intermediary;
- (d) a MCD mortgage administrator.

[Note: articles 4(2), (5) and (21) of the MCD.]

MCD mortgage administrator (in MCOB 7A and MCOB 14) a mortgage administrator who administers MCD regulated mortgage contracts

MCD mortgage adviser a mortgage adviser who, by way of business, provides a personal recommendation to a consumer in respect of MCD regulated mortgage contracts

[Note: article 4(21) of the MCD]

MCD mortgage arranger a mortgage arranger who:

- (a) by way of business and for remuneration (which may take a pecuniary form or any other agreed form of financial consideration), carries out an activity of the kind specified in article 25A(1)(a) or 25A(2A) of the Regulated Activities Order in relation to MCD regulated mortgage contracts; and
- (b) is not merely introducing, either directly or indirectly, a consumer to a MCD firm.

[Note: article 4(5) of the MCD]

MCD mortgage lender a mortgage lender who, by way of business and for remuneration (which may take a pecuniary form or any other agreed form of financial consideration), grants or promises to grant MCD regulated mortgage contracts

[Note: article 4(2) of the *MCD*]

*MCD regulated mortgage contract* a regulated mortgage contract under which the borrower is a consumer and which is not an exempt MCD regulated mortgage contract

[Note: article 3(1)(a) of the *MCD*]

*member of staff* any individual:

- (a) working for a firm who is directly engaged in the activities specified in TC 4.1.6 R;
- (b) working for a firm or its appointed representative who has contact with a consumer in the course of those activities; or
- (c) directly managing or supervising an individual referred to in (a) or (b) above.

[Note: article 4(11) of the *MCD*]

*mortgage mediation activity* (as defined in article 26 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 1) Order 2003 (SI 2003/1475) any of the following *regulated activities*:

- (a) arranging (bringing about) regulated mortgage contracts (article 25A(1) and 25A(2A));

...

*overdraft facility* (1) (in CONC App 1.2) ...

(2) (in MCOB 10A) an explicit agreement whereby a MCD creditor makes available to a consumer funds which exceed the current balance in the consumer's current account

[Note: Annex I Part II of the MCD and article 3(d) of the Consumer Credit Directive]

*price information* ...

- (b) the presence or absence of any payments, fees or charges ~~(other than the fees for advising on or arranging a regulated mortgage contract as required by MCOB 3.6.27R);~~ or

(c) ....

*regulated activity* .....

(B) in the *FCA Handbook*:

.....

(ga) ..... (article 25A(1) and 25(2A));

.....

(pd) .....

(pe) advising on regulated credit agreements the purpose of which is to acquire land (article 53E);

*regulated mortgage activity*

....

(a) .... (article 25A(1) and 25(2A));

*regulated mortgage contract*

(a) ....

(i) ...

(A) ...

(B) the obligation of the borrower to repay is secured by a ~~first legal mortgage on land (other than timeshare accommodation)~~ in the *United Kingdom* , at least 40% of which is used, or is intended to be used, as or in connection with a dwelling; and by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a person who is in relation to the borrower or (in the case of credit provided to trustees) a beneficiary of the trust:

(I) ~~that person's spouse or civil partner; or~~

(II) ~~a person (whether or not of the opposite sex) whose relationship with that person has the characteristics of the relationship between husband and wife; or~~

(III) ~~that person's parent, brother, sister, child, grandparent or grandchild; and~~

(ii) is not a home purchase plan, a limited payment charge bridging loan, a second charge business loan or an exempt consumer buy-to-let mortgage contract within the meaning of article 61A(1) or (2) of the Regulated Activities Order.

(b) ...

[Note: articles 3(1)(a) and 4(2) of the MCD]

second charge lender a mortgage lender who grants or promises to grant second charge regulated mortgage contracts

second charge regulated mortgage contract a regulated mortgage contract which is not a first charge legal mortgage.

shared equity credit agreement a MCD credit agreement where the capital repayable is based on a contractually set percentage of the value of the immovable property at the time of the capital repayment or repayments.

[Note: article 4(25) of the MCD]

Single Market Directives ...

(B) In the FCA Handbook

...

(da) MCD;

tied MCD article 3(1)(b) credit intermediary a MCD article 3(1)(b) credit intermediary who acts on behalf of and under the full and unconditional responsibility of:

- (a) only one MCD article 3(1)(b) creditor;
- (b) only one group; or
- (c) a number of MCD article 3(1)(b) creditors or groups which does not represent the majority of the market.

[Note: article 4(7) of the MCD]

tied MCD credit intermediary a MCD credit intermediary who acts on behalf of and under the full and unconditional responsibility of:

- (a) only one MCD mortgage lender;
- (b) only one group; or
- (c) a number of MCD mortgage lenders or groups which does not represent the majority of the market.

[Note: article 4(7) of the MCD]

total amount of credit (1) ...

(2) (in MCOB) the ceiling or the total sums made available under a

MCD credit agreement.

[Note: article 4(12) of the MCD]

total amount payable

(1) (except in *CONC* or *MCOB*) ...

...

(3) (in MCOB) the sum of the total amount of credit and the total cost of the credit to the consumer

[Note: article 4(14) of the MCD]

total cost of the credit to the consumer

(in MCOB) all costs, including interest, commissions, taxes, valuation fees, and any other kind of fees which are required to be paid by, or on behalf of, the consumer in connection with the MCD credit agreement, whether payable to the MCD creditor or to any other person, and which are known to the MCD creditor, and, in calculating the APRC, including the costs referred to in MCOB 10A.1.2R and any fee payable by the consumer to a MCD credit intermediary for its services in connection with the MCD credit agreement, except for notarial costs, property transfer registration fees and any charges payable by the consumer for non-compliance with obligations under the MCD credit agreement.

[Note: article 4(13), 15(4) and 17(2) of the MCD]

tying practices

the offering or the selling of a MCD credit agreement in a package with other distinct financial products or services where the MCD credit agreement is not made available to the consumer separately.

[Note: article 4(26) of the MCD]

## Annex B

### Amendments to Training and Competence sourcebook (TC)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

#### 2.1 Assessing and maintaining competence

...

##### **Knowledge and competence requirements before starting MCD credit agreement activities**

2.1.5A.1 **R** A firm acting as a MCD creditor, a MCD credit intermediary, a MCD article 3(1)(b) credit intermediary or a MCD article 3(1)(b) creditor must ensure that an employee does not carry on any of the activities 23A to 23E in TC Appendix I without having an appropriate level of knowledge and competence which includes the following:

- (1) an appropriate knowledge of MCD credit agreements and any ancillary services offered by the firm with them;
- (2) an appropriate knowledge of the laws relating to MCD credit agreements for consumers (in particular consumer protection);
- (3) an appropriate knowledge and understanding of the property purchasing process;
- (4) an appropriate knowledge of security valuation;
- (5) an appropriate knowledge of the organisation and functioning of land registers;
- (6) an appropriate knowledge of the market;
- (7) an appropriate knowledge of business ethics standards;
- (8) an appropriate knowledge of the process of assessing a consumer's creditworthiness or, where applicable, competence in assessing the consumer's creditworthiness; and
- (9) an appropriate level of financial and economic competency.

**[Note: article 9 and annex III (1) of the MCD]**

2.1.5A.2 **R** A firm acting as a MCD creditor, a MCD credit intermediary, a MCD article 3(1)(b) credit intermediary or a MCD article 3(1)(b) creditor must not assess knowledge and competence based solely on relevant professional experience. It should also take into account relevant professional qualifications such as diplomas and degrees, training and

competency tests.

[Note: annex III (3) of the MCD]

2.1.5A.3 G For the purposes of assessing the knowledge and competence, professional experience means their years of employment in areas relating to the origination, distribution or intermediation of MCD credit agreements.

[Note: annex III (3)(b) of the MCD]

2.1.5A.4 R A firm must, for the purposes of TC 2.1.5A.1R take into account the nature of the employee's role and their level of responsibility within the firm and decide the appropriate level of knowledge and competence for that employee.

[Note: annex III (2) of the MCD]

2.1.5A.5 G Where an employee, carrying on an activity in relation to a regulated mortgage contract, has attained the appropriate qualification required by TC Appendix 1, a firm may for the purposes of TC 2.1.5A.1R assess that employee as having knowledge and competence. Additionally firms will need to meet the separate requirements in this sourcebook such as the assessment of competence in TC 2.1.1R.

## **Maintaining competence**

...

2.1.12 R ...

[Note: article 9(1) of the MCD]

## **3.1 Record-keeping requirements**

3.1.1 ...

[Note: article 9(4) of the MCD]

**TC App 1.1 Activities and Products/Sectors to which TC applies subject to TC Appendices 2 and 3**

TC App 1.1.1	R				
		<b>Activity</b>	<b>Products/Sectors</b>		<b>Is there an appropriate qualification requirement?</b>
		...	...	...	...
		Mortgage Activity and <i>reversion activity</i> carried on for a <i>customer</i>			
		...	...	...	...
		<u>MCD credit agreement activities carried on for consumers</u>			
		<u>manufacturing</u>	<u>23A</u>	<u>a MCD credit agreement</u>	<u>No</u>
		<u>entering into a regulated mortgage contract or entering into a regulated credit agreement as lender</u>	<u>23B</u>	<u>a MCD credit agreement</u>	<u>No</u>
		<u>arranging (bringing about) regulated mortgage contracts or acting as a MCD credit broker</u>	<u>23C</u>	<u>a MCD credit agreement</u>	<u>No</u>
		<u>advising on regulated mortgage contract or acting as a MCD credit adviser</u>	<u>23D</u>	<u>a MCD credit agreement</u>	<u>No</u>
		<u>Directly managing or supervising employees who carry on any of the MCD</u>	<u>23E</u>	<u>a MCD credit agreement</u>	<u>No</u>

		<u>credit agreement activities 23A to 23D</u>			
		<b>[Note: article 9(1) of the MCD]</b>			
		...			
		<u>Notes:</u>			
		...			
		<u>4.</u>	<u>In the Appendix paragraphs 23A, 23B, 23C, 23D and 23E relate to the implementation of article 9(1) of MCD. Firms need to consider and satisfy the requirements specified under the heading “mortgage activity and reversion activity carried on for a customer, where applicable.</u>		

**TC App 2.1 TCs Territorial Scope subject to the limitation in TC Appendix 3**

TC App 2.1.1	R				
			<i>UK domestic firm</i>	<i>Incoming EEA firm</i>	<i>Overseas firm (other than an incoming EEA firm)</i>
			...	...	...
		<i>Any other activity in Appendix 1</i>	...	... <b>[Note: article 9(3)(i) of the MCD]</b>	...

**TC App 4 Appropriate Qualification tables**

<b>4.1</b>	<b>Appropriate Qualification tables</b>	
App 4.1.1	E	<b>Part 1: Activities</b>
		<b>Note:</b> The activity numbers in this table relate to the activities in TC Appendix 1.1.1R. These tables do not cover activities 1, 5, 13A, 13B, 13C, 20A, 21B, <u>23A, 23B, 23C, 23D, 23E</u> , 24, 25 or 26 as these activities do not have a qualification requirement.

**TC TP 9 – Transitional Provisions relating to MCD credit agreement activities**

(1)	(2)	(3)	(4)	(5)	(6)
	<b>Material to which the transitional provision applies</b>		<b>Transitional provision</b>	<b>Transitional provision: dates in force</b>	<b>Handbook provisions: coming into force</b>
<u>9.1</u>	<u>2.1.5A.1</u>	<u>R</u>	<u>A firm acting as a MCD credit intermediary, a MCD article 3(1)(b) credit intermediary, a MCD article 3(1)(b) creditor may comply with the TC rules as they were in force at 20 March 2016.</u>  <u>[Note: article 43(3) of the MCD]</u>	<u>From 21 March 2016 to 21 March 2017</u>	<u>21 March 2016</u>
<u>9.2</u>	<u>2.1.5A.2</u>	<u>R</u>	<u>A firm acting as a MCD creditor, a MCD credit intermediary, a MCD article 3(1)(b) credit intermediary or a MCD article 3(1)(b) creditor may until 21 March 2019 assess the knowledge and</u>	<u>From 21 March 2016 to 21 March 2019</u>	<u>21 March 2016</u>

			<p><u>competency of the relevant <i>employee</i> solely on the basis of their professional experience.</u></p> <p><u>[Note: annex III (3) of the MCD]</u></p>		
--	--	--	---	--	--

**TC TP 8 Transitional provisions relating to time limits for attaining qualifications**

...	...	...
8.2	R	An <i>employee</i> who is carrying on the activities specified in TC App 1 of:
		...
8.3	R	<u>An <i>employee</i> who is carrying on the activities specified in TC App 1 in relation to a second charge regulated mortgage contract, of:</u>
		(1) <u>advising; arranging (bringing about) regulated mortgage contracts or home reversion plans or (for a mortgage lender or home reversion provider) an activity which would be arranging (bringing about) but for the exclusion in article 28A Regulated Activities Order (Arranging contracts to which the arranger is a party) for a non-business purpose; or</u>
		(2) <u>designing scripted questions for execution-only sales of regulated mortgage contracts for a non-business purpose;</u>
		<u>as at 21 March 2016 will, for the purposes of TC 2.2A.1R, be regarded as carrying on only such activities with effect from that date; and, in relation to such an <i>employee</i>, a firm need not (in relation to such activities only) comply with TC 2.1.6R until 21 September 2018. TP 8.1 does not apply in respect of such an <i>employee</i>.</u>

## Annex C

### Amendments to the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

#### Part 1: Comes into force on 21 December 2015

##### TP 1 Transitional Provisions

###### TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
4	<u>MIPRU 1.3.2 R and MIPRU 1.3.4 R</u>	<u>R</u>	<u>A firm to which MIPRU 1.3.2 R will apply from 21 March 2016 may elect to comply with MIPRU 1.3.2 R from 21 December 2015.</u>  <u>If a firm elects to comply with MIPRU 1.3.2 R it must also comply with MIPRU 1.3.4 R.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>

#### Part 2: Comes into force on 21 March 2016

After MIPRU 1.2 insert:

### 1.3 Remuneration and property valuation requirements for MCD creditors

#### Application

1.3.1 R MIPRU 1.3 applies to a MCD creditor.

Property valuation requirements

1.3.2 R In respect of the valuation of residential immovable property for the purposes of entering into a MCD credit agreement:

(1) a MCD creditor must use reliable standards for the valuation where the valuation is carried out by the MCD creditor; or

(2) where the valuation is carried out by a third party, the MCD creditor must take reasonable steps to ensure that reliable standards are used.

[Note: article 19(1) of the MCD]

1.3.3 G For the purposes of MIPRU 1.3.2R, reliable standards for the valuation of residential immovable property include internationally recognised valuation standards, in particular those developed by the International Valuation Standards Committee (IVSC), the European Group of Valuers' Associations (EGoVA) or the Royal Institution of Chartered Surveyors (RICS) as well as the standards set out in BIPRU 3.4.77R to 3.4.80R.

[Note: recital 26 of the MCD]

1.3.4 R A MCD creditor must:

(1) ensure that internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation; and

(2) ensure that property valuations are documented in a durable medium.

[Note: article 19(2) of the MCD]

.....

2.1 ...

Application

2.1.1 R This chapter applies to a firm with Part 4A permission to carry on insurance mediation activity or mortgage intermediation activity

Purpose

2.1.2 R The main purpose of this chapter is to implement in part the provisions of the Insurance Mediation Directive and the MCD as these apply to firms regulated by the appropriate regulator.

**2.2 Allocation of the responsibility for insurance mediation activity or mortgage intermediation activity**

Responsibility for insurance mediation activity or mortgage intermediation activity

- 2.2.1 R A *firm*, other than a sole trader, must allocate the responsibility for the *firm's insurance mediation activity or the firm's mortgage intermediation activity*, as applicable to a director or senior manager.

**Note:** Article 3(1), fourth paragraph, of the *Insurance Mediation Directive* and Article 29(4)(a), first sentence of the *MCD*.

- 2.2.2 R The *firm* may allocate the responsibility for its *insurance mediation activity or the firm's mortgage intermediation activity*, as applicable to an *approved person* (or *persons*) performing:

...

- 2.2.3 G (1) Typically a *firm* will appoint a *person* performing a *governing function* (other than the *non-executive director function*) to direct its *insurance mediation activity or the firm's mortgage intermediation activity*, as applicable. Where this responsibility is allocated to a *person* performing another function, the *person* performing the *apportionment and oversight function* with responsibility for the apportionment of responsibilities must ensure that the *firm's insurance mediation activity or the firm's mortgage intermediation activity*, as applicable is appropriately allocated.
- (3) In the case of a *sole trader*, the *sole trader* will be responsible for the *firm's insurance mediation activity or mortgage intermediation activity*, as applicable.

- 2.2.4 G Where a *firm* has appointed an *appointed representative* to carry on *insurance mediation activity or mortgage intermediation activity* on its behalf, the *person* responsible for the *firm's insurance mediation activity or the firm's mortgage intermediation activity* will also be responsible for the *insurance mediation activity or the mortgage intermediation activity*, as applicable carried on by an *appointed representative*.

- 2.2.5 G The *FCA* will specify in the *Financial Services Register* the name of the *persons* to whom the responsibility for the *firm's insurance mediation activity or the firm's mortgage intermediation activity* has been allocated by inserting after the relevant *controlled function* the words "(insurance mediation)" or "(mortgage intermediation)". In the case of a *sole trader*, the *FCA* will specify in the *Financial Services Register* the name of the *sole trader* as the 'contact person' in the *firm*.

....

### 3 Professional indemnity insurance

#### Application

3.1.1 R This chapter applies to a *firm* with *Part 4A permission* to carry on any of the activities:

...

(4) in relation to *home finance mediation activity*, this chapter does not apply to a *firm* if:

~~(a) it has net tangible assets of more than £1 million; or~~

any firm which is a MCD credit intermediary exclusively advising on or arranging second charge regulated mortgage contracts (except for MIPRU 3.2.9AR);

~~(b) the comparable guarantee provisions of (3) apply (as if the firm was carrying on insurance mediation activity) but substituting £1 million for £10 million in (3)(a) and (b);~~

a firm which is not a MCD credit intermediary if:

~~(a)~~ (i) it has net tangible assets of more than £1 million; or

~~(b)~~ (ii) the comparable guarantee provisions of (3) apply (as if the firm was carrying on insurance mediation activity) but substituting £1 million for £10 million in (3)(a) and (b);

...

(6) in relation to *home finance mediation activity*, this chapter does not apply to an *authorised professional firm* which is not a MCD credit intermediary:

...

(7) in relation to home finance mediation activity, this chapter does not apply to a MCD credit intermediary if it holds a comparable guarantee (as specified in (4)(b)(ii)) against liability arising from professional negligence.

[Note: article 29(2) of the MCD]

3.1.1A R In addition, MIPRU 3.2.9A R applies to MCD article 3(1)(b) credit intermediaries.

[Note: article 29(2)(a) of the MCD]

...

Minimum limits of indemnity: home finance intermediary that is not a MCD credit intermediary

3.2.9 R If the *firm* is a *home finance intermediary* that is not a MCD credit intermediary, then the minimum *limit of indemnity* is the higher of 10% of *annual income* up to £1 million, and:

...

Minimum limits of indemnity: MCD credit intermediaries and MCD article 3(1)(b) credit intermediaries

3.2.9A R If the *firm* is a *home finance intermediary* that is a *MCD credit intermediary*, or a *MCD article 3(1)(b) credit intermediary*, then the *minimum limit of indemnity* is the amount set out in Article 1 of the Commission Delegated Regulation (EU) No XX/XX which is reproduced in MIPRU 3.2.9B.

[Note: article 29(2) of the MCD]

3.2.9B EU The minimum monetary amount of the professional indemnity insurance or comparable guarantee required to be held by credit intermediaries as referred to in the first subparagraph of Article 29(2)(a) of Directive 2014/17/EU shall be:

(a) EUR 460 000 for each individual claim;

(b) in aggregate EUR 750 000 per calendar year for all claims.

[Note: article 1 of the Commission Delegated Regulation (EU) No XX/XX]

...

## **4 Capital Resources**

...

Application: social housing firms

4.1.13 G ...

Application MCD firms

4.1.13A R This chapter does not apply to a *firm* to whom this chapter would otherwise apply pursuant to *MIPRU 4.1.1 R* because it carries on one of the following:

(1) *home finance mediation activity* exclusively in respect of *second charge regulated mortgage contracts*; or

(2) *home financing* exclusively in respect of *second charge regulated mortgage contracts*; or

(3) *home finance administration* exclusively in respect of *second charge regulated mortgage contracts*.

4.1.13B R For a firm that carries on a combination of home finance mediation activity, home financing and home finance administration this chapter will only apply to the extent its activities relate to specified investments other than second charge regulated mortgage contracts.

...

### 4.3 Annual Income

...

4.3.3 G For a firm which carries on insurance mediation activity or home finance mediation activity, annual income is the amount of all brokerage, fees, commissions and other related income (for example, administration charges, overrides, profit shares) due to the firm in respect of or in relation to those activities. But it does not include income generated from carrying on any home finance mediation activity in respect of second charge regulated mortgage contracts.

...

#### Annual income for home finance administration

4.3.7 R ...

4.3.7A R For the purposes of the calculation of the capital resources of a firm that carries on any home finance administration activity the annual income does not include annual income from second charge regulated mortgage contracts.

...

## Annex D

### Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

#### Part 1: Comes into force on 21 December 2015

##### MCOB TP1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
<u>20</u>	<u>TPs 22, 24, 26, 28, 30, 32, 34, 36, 38 and 40</u>	<u>G</u>	<u>The purpose of TPs 22, 24, 26, 28, 30, 32, 34, 36, 38 and 40 is to allow <i>firms</i> to apply certain sets of provisions that implement <i>MCD</i> requirements early. A <i>firm</i> may adopt any set of provisions, it need not adopt all of the sets at the same time.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>
<u>21</u>	<u>TPs 22, 24, 26, 28, 30, 32, 34, 36, 38 and 40</u>	<u>R</u>	<u>An election to apply any of TP 22, 24, 26, 28, 30, 32, 34, 36, 38 and 40 does not imply an election to apply any other of TP 22, 24, 26, 28, 30, 32, 34, 36, 38 and 40.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>
<u>22</u>	<u>MCOB 2A.1</u>	<u>R</u>	<u>A <i>firm</i> to which <i>MCOB</i> 2A.1 will apply from 21 March 2016 may elect to comply with <i>MCOB</i> 2A.1 from 21 December 2015. If the <i>firm</i> elects to comply with <i>MCOB</i> 2A.1, it must comply with <i>MCOB</i> 2A.1 and any related provisions in full.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>
<u>23</u>	<u>TP 22</u>	<u>G</u>	<u>TP 22 allows a <i>firm</i> to apply the <i>MCD</i> requirements relating to remuneration early.</u>		
<u>24</u>	<u>MCOB 2A.3,</u>	<u>R</u>	<u>A <i>firm</i> to which these</u>	<u>21 December</u>	<u>21 March</u>

	<u>MCOB 7A.4</u> <u>MCOB 5A,</u> <u>MCOB 6A,</u> <u>MCOB 7B and</u> <u>MCOB 10A</u>		<u>provisions will apply from 21</u> <u>March 2016 may elect to</u> <u>comply with them all, in full,</u> <u>and any related provisions,</u> <u>from 21 December 2015; and</u> <u>accordingly the rules and other</u> <u>provisions in MCOB 5, MCOB</u> <u>6, MCOB 7.6.7 R to MCOB</u> <u>7.6.17 R and MCOB 10 as in</u> <u>force prior to 21 March 2016</u> <u>will cease to apply from the</u> <u>date of the election.</u>	<u>2015 to 20</u> <u>March 2016</u>	<u>2016</u>
<u>25</u>	<u>TP 24</u>	<u>G</u>	<u>TP 24 allows a firm to apply</u> <u>the MCD requirements relating</u> <u>foreign currency early.</u>		
<u>26</u>	<u>MCOB 3A,</u> <u>and MCOB</u> <u>10A</u>		<u>A firm to which these</u> <u>provisions will apply from 21</u> <u>March 2016 may elect to</u> <u>comply with them all, in full,</u> <u>and any related provisions,</u> <u>from 21 December 2015; and</u> <u>accordingly the rules and other</u> <u>provisions in MCOB 3 and</u> <u>MCOB 10 as in force prior to</u> <u>21 March 2016 will cease to</u> <u>apply from the date of the</u> <u>election.</u>	<u>21 December</u> <u>2015 to 20</u> <u>March 2016</u>	<u>21 March</u> <u>2016</u>
<u>27</u>	<u>TP 26</u>	<u>G</u>	<u>TP 26 allows a firm to apply</u> <u>the MCD requirements relating</u> <u>to advertising early.</u>		
<u>28</u>	<u>MCOB 3B</u>	<u>R</u>	<u>A firm to which MCOB 3B will</u> <u>apply from 21 March 2016</u> <u>may elect to comply with</u> <u>MCOB 3B from 21 December</u> <u>2015. If the firm elects to</u> <u>comply with MCOB 3B, it</u> <u>must comply with MCOB 3B</u> <u>and any related provisions in</u> <u>full.</u>	<u>21 December</u> <u>2015 to 20</u> <u>March 2016</u>	<u>21 March</u> <u>2016</u>
<u>29</u>	<u>TP 28</u>	<u>G</u>	<u>TP 28 allows a firm to apply</u> <u>the MCD requirements relating</u> <u>to general information early.</u>		
<u>30</u>	<u>MCOB</u> <u>4.4A.4R(1)(a),</u> <u>MCOB</u>	<u>R</u>	<u>A firm to which these</u> <u>provisions will apply from 21</u> <u>March 2016 may elect to</u>	<u>21 December</u> <u>2015 to 20</u> <u>March 2016</u>	<u>21 March</u> <u>2016</u>

	<u>4.4A.4R(1)(c), MCOB 4.4A.8R(1)(c), MCOB 4.4A.8R(1)(d), MCOB 4.4A.8R(2)(e) and MCOB 4A.1</u>		<u>comply with them all, in full, and any related provisions, from 21 December 2015; and accordingly the <i>rules</i> and other provisions in MCOB 4.4A.8R, MCOB 4.4A.9R, MCOB 4.4A.12R, MCOB 4.4A.18R and MCOB 4.4A.21R as in force prior to 21 March 2016 will cease to apply from the date of the election.</u>	<u>March 2016</u>	
<u>31</u>	<u>TP 30</u>	<u>G</u>	<u>TP 30 allows a <i>firm</i> to apply the MCD requirements relating to intermediary disclosure early.</u>		
<u>32</u>	<u>MCOB 4.7A.14A R, MCOB 4.7A.21 R, MCOB 4.8A.7 R and MCOB 11A</u>	<u>R</u>	<u>A <i>firm</i> to which these provisions will apply from 21 March 2016 may elect to comply with them all, in full, and any related provisions, from 21 December 2015; and accordingly the <i>rules</i> and other provisions in MCOB 4.7A.21 R, and MCOB 4.8A.7 R as in force prior to 21 March 2016 will cease to apply from the date of the election.</u>	<u>21 December 2015 to 20March 2016</u>	<u>21 March 2016</u>
<u>33</u>	<u>TP 32</u>	<u>G</u>	<u>TP 32 allows a <i>firm</i> to apply the MCD requirements relating creditworthiness early.</u>		
<u>34</u>	<u>MCOB 4A.2</u>	<u>R</u>	<u>A <i>firm</i> to which MCOB 4A.2 will apply from 21 March 2016 may elect to comply with MCOB 4A.2 from 21 December 2015. If the <i>firm</i> elects to comply with MCOB 4A.2it must comply with MCOB 4A.2 and any related provisions in full.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>
<u>35</u>	<u>TP 34</u>	<u>G</u>	<u>TP 34 allows a <i>firm</i> to apply the MCD requirements relating to adequate explanations early.</u>		
<u>36</u>	<u>MCOB 4.4A.4R(1)(c) and MCOB</u>	<u>R</u>	<u>A <i>firm</i> to which these provisions will apply from 21 March 2016 may elect to</u>	<u>21 December 2015 to 20</u>	<u>21 March 2016</u>

	<u>4A.3</u>		<u>comply with them all, in full, and any related provisions, from 21 December 2015; and accordingly the <i>rules</i> and other provisions in <i>MCOB 4.4A.4 R(1)(c)</i> as in force prior to 21 March 2016 will cease to apply from the date of the election.</u>	<u>March 2016</u>	
37	<u>TP 36</u>	<u>G</u>	<u>TP 36 allows a <i>firm</i> to apply the <i>MCD</i> requirements relating to advice early.</u>		
38	<u><i>MCOB 5A, MCOB 6A and MCOB 10A</i></u>	<u>R</u>	<u>A <i>firm</i> to which these provisions will apply from 21 March 2016 may elect to comply with them all, in full, and any related provisions, from 21 December 2015; and accordingly the <i>rules</i> and other provisions in <i>MCOB 5, MCOB 6 and MCOB 10</i> as in force prior to 21 March 2016 will cease to apply from the date of the election.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>
39	<u>TP 39</u>	<u>G</u>	<u>TP 38 allows a <i>firm</i> to apply the <i>MCD</i> requirements relating to pre-contractual information early.</u>		
40	<u><i>MCOB 5A, MCOB 6A, 7B and MCOB 10A</i></u>	<u>R</u>	<u>A <i>firm</i> to which these provisions will apply from 21 March 2016 may elect to comply with them all, in full, and any related provisions, from 21 December 2015; and accordingly the <i>rules</i> and other provisions in <i>MCOB 5, MCOB 6, MCOB 7.6.7R to MCOB 7.6.17R and MCOB 10</i> as in force prior to 21 March 2016 will cease to apply from the date of the election.</u>	<u>21 December 2015 to 20 March 2016</u>	<u>21 March 2016</u>
41	<u>TP 40</u>	<u>G</u>	<u>TP 40 allows a <i>firm</i> to apply the <i>MCD</i> requirements relating to further advances early</u>		

**Part 2: Comes into force on 21 March 2016**

1.2.3C G In the case of a *high net worth mortgage customer* under a *MCD regulated mortgage contract*, compliance in full with *MCOB* does not require compliance with provisions in *MCOB* expressed not to apply to such contracts.

...

1.2.9 G The disclosure *rules* in *MCOB* place particular emphasis on the description of borrowing. Where the *regulated mortgage contract* is for a business purpose or with a *high net worth mortgage customer who is not a consumer* under a *MCD regulated mortgage contract* a firm should reflect this emphasis in any disclosure by first describing any borrowing before addressing the other facilities provided under the *regulated mortgage contract*.

...

1.2.10 R ... except for:

(1) ~~MCOB 2.2 (Communications)~~ MCOB 3A (Financial promotions and communications with customers).

(2) ~~MCOB 3 (Financial promotion)~~.

....

1.2.11 G (2) ~~MCOB 3.1.9 R~~ MCOB 3A.1.3R ... under ~~MCOB 3.2.5R(3)~~ MCOB 3A.1.9R(2) (Exemptions).

....

**MCD Application**

1.2.14 G (1) The provisions in the table in (2) apply only in relation to a *MCD regulated mortgage contract*.

(2) This table belongs to (1).

<u>Chapter</u>	<u>Provisions</u>
<u>MCOB 2A</u>	<u>Whole chapter</u>
<u>MCOB 3A</u>	<u>MCOB 3A.2.4 R(2) and MCOB 3A.5</u>
<u>MCOB 3B</u>	<u>Whole chapter</u>
<u>MCOB 4</u>	<u>MCOB 4.4A.4R(1)(a), MCOB 4.4A.4R(1)(c), MCOB 4.4A.8R(1)(d) and MCOB 4.4A.8R(2)(e)</u>

<u>MCOB 4A</u>	<u>Whole chapter</u>
<u>MCOB 7A</u>	<u>Whole chapter</u>
<u>MCOB 10A</u>	<u>Whole chapter</u>
<u>MCOB 11</u>	<u>MCOB 11.6.21A R and MCOB 11.6.21B</u>
<u>MCOB 11A</u>	<u>Whole chapter</u>

1.2.15     G     (1)     In the table in (2), the provisions in column (1) apply in relation to a MCD regulated mortgage contract instead of the provisions in column (2).

(2)     This table belongs to (1).

<u>(1) MCD requirement</u>	<u>(2) Non MCD requirement</u>
<u>MCOB 5A</u>	<u>MCOB 5</u>
<u>MCOB 6A</u>	<u>MCOB 6</u>
<u>MCOB 7B</u>	<u>MCOB 7.6.7R to 7.6.17R</u>

1.2.16     R     A firm may elect to treat any regulated mortgage contract which is not a MCD regulated mortgage contract as if it were a MCD regulated mortgage contract and comply:

(1)     in relation to a lifetime mortgage, with the whole of MCOB as if the lifetime mortgage were a MCD regulated mortgage contract, save that the firm must continue to provide an illustration in accordance with the relevant requirements in MCOB rather than an ESIS; or

(2)     in any other case, with the whole of MCOB as if the regulated mortgage contract were a MCD regulated mortgage contract.

1.2.17     G     The purpose of MCOB 1.2.16R is to allow a firm to comply with provisions of MCOB which implement the MCD for a MCD regulated mortgage contract, save in respect of lifetime mortgages where the firm must continue to provide an illustration in accordance with the relevant requirements in MCOB rather than an ESIS.

1.2.18     R     A firm that makes the election in MCOB 1.2.16R to treat a MCD exempt bridging loan as if it were a MCD regulated mortgage contract must calculate the APRC for the MCD exempt bridging loan applying the following additional assumptions:

(1)     the total amount of credit must be deemed to be drawn down in full and for the duration of the MCD exempt bridging loan; and

(2)     if the duration of the MCD exempt bridging loan is not known, the

APRC must be calculated on the assumption that the duration of the credit is 12 months.

....

- 1.3.2 R The territorial scope of MCOB 3A (Financial promotions and communications with customers) is set out in ~~MCOB 3.3~~ MCOB 3A.1.13R to MCOB 3A.1.16R (Territorial scope, Exceptions to territorial scope; Meaning of communicated to a person inside or outside the UK Application: where?) rather than in this section.

....

- 2.1.2 R **This table belongs to MCOB 2.1.1 R**

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i>	whole chapter except <del>MCOB 2.2.6A R, MCOB 2.2.8A R, MCOB 2.2.8B G, MCOB 2.6A.1 R to MCOB 2.6A.18 G and MCOB 2.8.6 G</del>
<i>mortgage administrator</i> <i>mortgage adviser</i> <i>mortgage arranger</i>	As for a <i>mortgage lender</i> , except that MCOB 2.6A.-1 R does not apply.
<i>home purchase provider</i>	<del>MCOB 2.1, MCOB 2.2.1 G, MCOB 2.2.6 R to MCOB 2.2.9 G, MCOB 2.5 to MCOB 2.6, MCOB 2.6A.1 R to MCOB 2.6A.4 G, MCOB 2.6A.7 G to MCOB 2.6A.10 G, MCOB 2.7.4 R to MCOB 2.7.6 R, MCOB 2.7A and MCOB 2.8.6 G</del>
<i>home purchase administrator</i>	As for a <i>home purchase provider</i> but MCOB 2.6A.1 R to MCOB 2.6A.4 G and MCOB 2.6A.7 G do not apply
<i>home purchase adviser</i> <i>home purchase arranger</i>	As for a <i>home purchase provider</i> but MCOB 2.6A does not apply
<i>reversion provider</i>	whole chapter except <del>MCOB 2.2.6A R, MCOB 2.2.8A R and MCOB 2.2.8B G, MCOB 2.6A.7 G, MCOB 2.7.4 R to MCOB 2.7.6 R and MCOB 2.8.6 G</del>
<i>reversion administrator</i> <i>reversion arranger</i>	As for a <i>reversion provider</i> but the relevant provisions of MCOB 2.6A apply only when <i>arranging for a home reversion plan to be entered into by a reversion occupier with, or administering a home reversion plan provided by, an unauthorised reversion provider.</i>
<i>reversion adviser</i>	As for a <i>reversion provider</i> but MCOB 2.6A does not apply
<i>SRB administrator</i>	<del>MCOB 2.1, MCOB 2.2.1 G, MCOB 2.2.2 G, MCOB 2.2.3 R, MCOB 2.2.6 R, MCOB 2.2.7 G, MCOB 2.2.8 G, MCOB 2.5 to MCOB 2.6, MCOB 2.6A.5BR (5), MCOB 2.6A.8 R to MCOB 2.6A.11 G, MCOB 2.6A.17A R, MCOB 2.6A.18 G, MCOB 2.7.1 G to MCOB 2.7.5 R, MCOB 2.7A, MCOB 2.8.1</del>

	G to MCOB 2.8.5 G.
<i>SRB adviser</i>	Whole chapter except <del>MCOB 2.2.5 G, MCOB 2.2.6A R, MCOB 2.2.8A R, MCOB 2.2.8B G</del> , MCOB 2.6A.5 R, MCOB 2.6A.7 G, MCOB 2.6A.17 R and MCOB 2.8.6 G.
<i>SRB agreement provider</i>	Whole chapter except <del>MCOB 2.2.5 G, MCOB 2.2.6A R, MCOB 2.2.8A R, MCOB 2.2.8B G</del> , MCOB 2.6A.5 R, MCOB 2.6A.7 G, MCOB 2.6A.17 R, MCOB 2.6A.17A R, MCOB 2.6A.18 G and MCOB 2.8.6 G.
<i>SRB arranger</i>	Whole chapter except <del>MCOB 2.2.5 G, MCOB 2.2.6A R, MCOB 2.2.8A R, MCOB 2.2.8B G</del> , MCOB 2.6A.5 R, MCOB 2.6A.7 G, MCOB 2.6A.17 R and MCOB 2.8.6 G.
<i>a firm that communicates or approves a financial promotion of qualifying credit or of a home reversion plan</i>	MCOB 2.5, MCOB 2.6, MCOB 2.7 (except, when the <i>financial promotion</i> relates to a <i>home reversion plan</i> , MCOB 2.7.4 R to MCOB 2.7.6 R), MCOB 2.7A and MCOB 2.8 (except MCOB 2.8.6 G)
<i>a firm that communicates or approves a financial promotion of a home purchase plan</i>	<del>MCOB 2.2.6 R to MCOB 2.2.9 G</del> , MCOB 2.5, MCOB 2.6, MCOB 2.7, MCOB 2.7A and MCOB 2.8.6 G

**MCOB 2.2 is deleted in its entirety. The deleted text is not shown.**

## **2.5A The customer’s best interests**

2.5A.1 R ...

[Note: article 7(1) of the MCD]

....

## **2.8 Record keeping**

...

2.8.5 G Except for MCOB 11.6.21A R, each ~~Each~~ ....

## **2A Mortgage Credit Directive**

### **2A.1 Remuneration: MCD regulated mortgage contracts**

2A.1.1 R (1) A MCD mortgage lender must not remunerate its members of staff or MCD credit intermediaries in a way that impedes compliance with

the MCD mortgage lender acting in accordance with the rules.

- (2) A MCD mortgage credit intermediary must not remunerate its members of staff or appointed representatives in a way that impedes compliance with the MCD credit intermediary acting in accordance with the rules.

**[Note: article 7(2) of the MCD]**

2A.1.2     R     A MCD mortgage lender, when establishing and applying remuneration policies for members of staff who are responsible for the assessment of affordability for consumers, must comply with the following principles:

- (1) the remuneration policy must be consistent with and promote sound and effective risk management;
- (2) the remuneration policy must not encourage risk-taking that exceeds the level of tolerated risk of the MCD mortgage lender;
- (3) the remuneration policy must be in line with the business strategy, objectives, values and long-term interests of the MCD mortgage lender; and
- (4) the remuneration policy must incorporate measures to avoid conflicts of interest, in particular by providing that remuneration is not contingent on the number or proportion of applications accepted.

**[Note: article 7(3) of the MCD]**

2A.1.3     R     A MCD mortgage lender must comply with MCOB 2A.1.2R in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities:

**[Note: article 7(3) of the MCD]**

2A.1.4     R     Where a MCD mortgage adviser acts as such, the remuneration structure of the members of staff involved must:

- (1) not prejudice the ability of the members of staff or the firm to act in the consumer's best interest; and
- (2) not be contingent on sales targets.

**[Note: article 7(4) of the MCD]**

2A.1.5     G     MCD mortgage lenders and MCD credit intermediaries should not design their remuneration policies in a way that would incentivise their members of staff to conclude a given number or type of MCD regulated mortgage contracts.

## **2A.2**      **Tying practices**

**2A.2.1**      **R**      Except in the circumstances specified in *MCOB 2A.2.2R*, *2A.2.3R* and *2A.2.4R*, neither a *MCD mortgage lender* nor a *MCD credit intermediary* may engage in any *tying practice*.

[Note: article 12(1) of the *MCD*]

**2A.2.2**      **R**      A *MCD mortgage lender* may request the *consumer* or family member or close relation of the *consumer* to:

- (1) open or maintain a payment or a savings account, where the only purpose of such an account is to accumulate capital to repay the *credit*, to service the *credit*, to pool resources to obtain the *credit*, or to provide additional security for the *MCD mortgage lender* in the event of default;
- (2) purchase or keep an investment product or a private pension product, where such product which primarily offers the investor an income in retirement serves also to provide additional security for the *MCD mortgage lender* in the event of default or to accumulate capital to repay the *credit*, to service the *credit* or to pool resources to obtain the *credit*; or
- (3) conclude a separate *MCD regulated mortgage contract* in conjunction with a *shared equity credit agreement* to obtain the *credit*.

[Note: article 12(2) of the *MCD*]

**2A.2.3**      **R**      A *MCD mortgage lender* may engage in *tying practices* where it can demonstrate to the *FCA* that the tied products or categories of product offered, on terms and conditions similar to each other, which are not made available separately, result in a clear benefit to the *consumer* taking due account of the availability and the prices of the relevant products offered on the market. This *rule* only applies to products which are marketed after 20 March 2014.

[Note: article 12(3) of the *MCD*]

**2A.2.4**      **R**      A *MCD mortgage lender* may require the *consumer* to hold a relevant insurance policy related to the *MCD regulated mortgage contract* but, where it does so, the *MCD mortgage lender* must accept an insurance policy from a supplier different to his preferred supplier where such policy has a level of guarantee equivalent to the one the *MCD mortgage lender* has proposed.

[Note: article 12(4) of the *MCD*]

## **2A.3** **Foreign currency loans**

2A.3.1 R Where a MCD regulated mortgage contract relates to a foreign currency loan, at the time the MCD regulated mortgage contract is entered into the MCD mortgage lender must ensure:

- (1) the consumer has a right to convert the MCD regulated mortgage contract into an alternative currency under specified conditions; or
- (2) there are other arrangements in place to limit the exchange rate risk to which the consumer is exposed under the MCD regulated mortgage contract.

**[Note: article 23(1) of the MCD]**

2A.3.2 R The alternative currency referred to in MCOB 2A.3.1R(1) must be either:

- (1) the currency in which the consumer primarily receives income or holds assets from which the credit is to be repaid, as indicated at the time that the most recent affordability assessment in relation to the regulated mortgage contract was made; or
- (2) the currency of the EEA State in which the consumer either was resident at the time that the MCD regulated mortgage contract was entered into or is currently resident.

**[Note: article 23(2) of the MCD]**

2A.3.3 R Where a consumer has a right to convert the MCD regulated mortgage contract into an alternative currency in accordance with MCOB 2A.3.1R(1), the exchange rate at which the conversion is carried out must be the market exchange rate applicable on the day of application for conversion unless otherwise specified in the MCD regulated mortgage contract.

**[Note: article 23(3) of the MCD]**

2A.3.4 R A firm must disclose to the consumer its arrangements for complying with the obligations set out in MCOB 2A.3.1R in the MCD regulated mortgage contract.

**[Note: article 23(6) of the MCD]**

## **2A.4** **Early repayment**

- 2A.4.1 R
- (1) A MCD mortgage lender must give a consumer who enters into a MCD regulated mortgage contract the right to discharge fully or partially his obligations under that MCD regulated mortgage contract prior to its expiry.
  - (2) If the consumer exercises the right in (1), the MCD mortgage lender must reduce the total cost of the credit to the consumer by an amount

equal to the interest and costs for the remaining duration of the *MCD regulated mortgage contract*.

[**Note:** article 25(1) of the *MCD*]

2A.4.2 R *MCOB 2A.4.1R(2)* does not prevent a *MCD mortgage lender* from imposing an *early repayment charge* in accordance with *MCOB 12.3.1R*.

## **2A.5** **Variable rate credits**

2A.5.1 R Where the *borrowing rate* under a *MCD regulated mortgage contract* is variable, the *MCD mortgage lender* must:

- (1) ensure that any index or reference rate used to calculate that rate is clear, accessible, objective and verifiable by the parties to the *MCD regulated mortgage contract* and the *FCA*; and
- (2) keep a record of the index or reference rate used to calculate that rate for as long as the *MCD regulated mortgage contract* remains outstanding.

[**Note:** article 24 of the *MCD*]

## **2A.6** **Information free of charge**

2A.6.1 R When a *MCD mortgage lender* or a *MCD credit intermediary*, provides information in compliance with the requirements in *MCOB* relating to a *MCD regulated mortgage contract*, it must provide that information free of charge.

[**Note:** article 8 of the *MCD*]

**MCOB 3 is deleted in its entirety and replaced with MCOB 3A. The deleted text is not shown**

## **3A** **Financial promotions and communications with customers**

### **3A.1** **Application**

#### **Application: who?**

3A.1.1 R This chapter applies to a *firm*:

- (1) communicating information to a *customer* in relation to a *home*

finance transaction; or

- (2) communicating or approving a financial promotion of qualifying credit, a home reversion plan, a home purchase plan or a regulated sale and rent back agreement.

3A.1.2    G    As a result of this chapter and CONC 3:

- (1) a financial promotion is not subject to CONC 3 to the extent that it relates to qualifying credit; and
- (2) where a firm makes a communication, which consists of a financial promotion of qualifying credit and a financial promotion of a different form of lending that is not qualifying credit (for example an unsecured personal loan), the content of the latter will need to comply with CONC 3.

**Authorised professional firms**

3A.1.3    R    (1) Except for MCOB 3A.5, MCOB 3A does not apply to an authorised professional firm in relation to the communication of a financial promotion if the following conditions are satisfied:

- (a) the firm's main business must be the practice of its profession (see IPRU(INV) 2.1.2R(3));
- (b) the financial promotion must be made for the purposes of and incidental to the promotion or provision by the firm of:
- (i) its professional services; or
- (ii) its non-mainstream regulated activities (see PROF 5.2 (Nature of non-mainstream activities)); and
- (c) the financial promotion must not be communicated on behalf of another person who would not be able lawfully to communicate the financial promotion if he were acting in the course of business.

(2) in (1)(b)(i), 'professional services' means services:

- (a) which do not constitute a regulated activity; and
- (b) the provision of which is supervised and regulated by a designated professional body.

**Application for a financial promotion of qualifying credit**

3A.1.4    R    This chapter applies to the communication or approval of a financial promotion of qualifying credit as follows:

<u>Application and purpose</u>	<u>MCOB 3A.1</u>
--------------------------------	------------------

<u>The fair, clear and not misleading rules</u>	<u>MCOB 3A.2 except MCOB 3A.2.5R</u>
<u>Other general requirements for financial promotions</u>	<u>MCOB 3A.3</u>
<u>Qualifying credit financial promotions</u>	<u>MCOB 3A.4</u>
<u>MCD financial promotions</u>	<u>MCOB 3A.5</u>
<u>Systems and controls</u>	<u>MCOB 3A.9</u>

**Application for a financial promotion of a home reversion plan**

3A.1.5 R This chapter applies to the *communication or approval of a financial promotion of a home reversion plan* as follows:

<u>Application and purpose</u>	<u>MCOB 3A.1</u>
<u>The fair, clear and not misleading rules</u>	<u>MCOB 3A.2 except MCOB 3A.2.5R</u>
<u>Other general requirements for financial promotions</u>	<u>MCOB 3A.3</u>
<u>Home reversion plan financial promotions</u>	<u>MCOB 3A.7</u>
<u>Systems and controls</u>	<u>MCOB 3A.9</u>

**Application for a financial promotion of a regulated sale and rent back agreement**

3A.1.6 R This chapter applies to the *communication or approval of a financial promotion of a regulated sale and rent back agreement* as follows:

<u>Application and purpose</u>	<u>MCOB 3A.1</u>
<u>The fair, clear and not misleading rules</u>	<u>MCOB 3A.2 except MCOB 3A.2.5R</u>
<u>Other general requirements for financial promotions</u>	<u>MCOB 3A.3</u>
<u>Sale and rent back financial promotions</u>	<u>MCOB 3A.8</u>
<u>Systems and controls</u>	<u>MCOB 3A.9</u>

**Application for a financial promotion of a home purchase plan**

3A.1.7 R This chapter applies to the *communication* or *approval* of a *financial promotion* of a *home purchase plan* as follows:

<u>Application and purpose</u>	<u>MCOB 3A.1</u>
<u>Fair, clear and not misleading rule for approval of home purchase plan financial promotions</u>	<u>MCOB 3A.2.5R</u>
<u>Home purchase plan financial promotions</u>	<u>MCOB 3A.6</u>

**Exemptions**

3A.1.8 R Except for *MCOB 3A.2.4R(2)* and *MCOB 3A.5*, this chapter does not apply to a *firm* in relation to a *financial promotion* of *qualifying credit* that is of a kind listed in *MCOB 3A.1.9 R*, except that if the *firm approves* the *financial promotion*, the following apply:

- (1) *MCOB 3A.1* (Application and Purpose);
- (2) *MCOB 3A.2.4R* (Fair, clear and not misleading financial promotions);
- (3) *MCOB 3A.4.4G* to *MCOB 3A.4.7G* (Approval of qualifying credit promotions; No approval of real time qualifying credit promotions; Approval of qualifying credit promotions when not all the rules apply); and
- (4) if the *firm approves* a *non-real time financial promotion* of *qualifying credit* by an *overseas person MCOB 3A.4.8R* (Non-real time qualifying credit promotions for overseas persons) applies.

3A.1.9 R This table belongs to *MCOB 3A.1.8R*.

<b><u>Exemptions</u></b>	
<u>This chapter does not apply to the following:</u>	
<u>(1)</u>	<u>a <i>financial promotion</i> which contains only one or more of the following</u>
<u>(a)</u>	<u>the name of the <i>firm</i> (or its <i>appointed representative</i>);</u>
<u>(b)</u>	<u>a logo;</u>
<u>(c)</u>	<u>a contact point (address (including an e-mail address), telephone or facsimile number);</u>
<u>(d)</u>	<u>a brief, factual statement of the <i>firm's</i> (or its <i>appointed representative's</i>) main occupation;</u>

(2)	<u>a financial promotion which can lawfully be communicated by an unauthorised person without approval;</u>
(3)	<u>a financial promotion communicated from outside the United Kingdom which would be exempt under articles 30, 31, 32 or 33 of the Financial Promotion Order (Overseas communicators) if the office from which the financial promotion is communicated were a separate unauthorised person (but see GEN 4.4.1R (Business for private customers from non-UK offices)).</u>

### **Combination of exemptions**

3A.1.10 R A firm may rely on more than one exemption in relation to the same financial promotion.

### **Other relevant handbook rules**

3A.1.11 G Firms are reminded that financial promotions (including those which are exempt) may be subject to more general rules, including Principle 7 (Communications with clients), SYSC 3 to SYSC 10 (Systems and controls) and MCOB 3A.2.4R (Fair, clear and not misleading communications).

### **Territorial scope**

3A.1.12 G The territorial scope for rules relating to communicating information to a customer is set out in MCOB 1.3.1R.

3A.1.13 R This chapter applies to a firm in relation to:

- (1) the communication of a financial promotion to a person in the United Kingdom;
- (2) the communication of a cold call of qualifying credit, a home reversion plan or a regulated sale and rent back agreement, unless it is made from a place, and for the purposes of a business which is only carried on, outside the United Kingdom;
- (3) the approval of a non-real time financial promotion of qualifying credit, a home reversion plan or a regulated sale and rent back agreement for communication to a person in the United Kingdom;
- (4) the communication or approval for communication of a financial promotion that is an electronic commerce communication to a person in an EEA State other than in the United Kingdom; and
- (5) the communication or approval for communication of a financial promotion in relation to a MCD credit agreement to a person in an EEA State other than in the United Kingdom.

3A.1.14 G The application under MCOB 3A.1.13 R is relevant both when a firm

communicates a financial promotion itself and when a firm approves a non-real time financial promotion for communication by others. However, see also MCOB 3A.1.15R (Exceptions to territorial scope: rules without territorial limitation for approval of financial promotions).

**Exceptions to territorial scope: rules without territorial limitation for approval of financial promotions**

3A.1.15 R Subject to MCOB 3A.1.16 R the following parts of this chapter apply without any territorial limitation if a firm approves a financial promotion of qualifying credit, a home reversion plan or a regulated sale and rent back agreement:

- (1) MCOB 3A.1 (Application and Purpose);
- (2) rules requiring a financial promotion to be fair, clear and not misleading (see MCOB 3A.2.4R); and
- (3) the provisions regarding approval of financial promotions (except those relating to approval of financial promotions of qualifying credit provided by an overseas person) (see MCOB 3A.4.4G to MCOB 3A.4.7G, MCOB 3A.7.1R and MCOB 3A.8.5R ).

**Exceptions to territorial scope: financial promotions of qualifying credit relating to distance contracts**

3A.1.16 R (1) Notwithstanding MCOB 3A.1.13 R and MCOB 3A.1.15 R, where a firm which satisfies the conditions in (2) communicates a financial promotion of qualifying credit, the rules in (3) do not apply.

- (2) The conditions are that:
  - (a) the firm communicates the financial promotion of qualifying credit from an establishment maintained by the firm in an EEA State other than the United Kingdom, and not from an establishment maintained by the firm in the United Kingdom or outside the EEA;
  - (b) either that EEA State:
    - (i) has implemented the Distance Marketing Directive; or
    - (ii) has obligations in its domestic law corresponding to those provided for by the Distance Marketing Directive;
  - (c) the financial promotion of qualifying credit relates, exclusively, to a distance contract, for the conclusion of which the obligations provided for by the the Distance Marketing Directive (or corresponding obligations) are applied by that State; and

(d) the firm is a national of an EEA State or a company or firm mentioned in article 54 of the Treaty.

(3) The rules which do not apply are:

(a) MCOB 3A.3.2R (Name and contact point); and

(b) MCOB 3A.4.1R(1) and (2) (Real time qualifying credit promotions).

### **Principles 6 and 7**

3A.1.17 G This chapter amplifies, for activities within its scope, Principle 6 (Customers' interests) and Principle 7 (Communications with clients).

## **3A.2 The fair, clear and not misleading rules**

### **Fair, clear and not misleading communications**

3A.2.1 R (1) When a firm communicates information to a customer, it must take reasonable steps to do so in a way that is fair, clear and not misleading.

(2) A firm must be able to show that it has taken reasonable steps to ensure that any illustration or ESIS is fair, clear and not misleading.

3A.2.2 G The purpose of MCOB 3A.2.1R is to restate, in slightly amended form, and as a separate rule, the part of Principle 7 (Communications with clients) that relates to communication of information.

3A.2.3 G In many circumstances there will be two or more customers under any home finance transaction, or two or more prospective customers looking to enter into the same home finance transaction. In such circumstances, where a rule in MCOB requires the provision of information to such customers and the customers have different addresses, a firm sending out this information should send it to each address. If the customers share the same address it will be sufficient to send a single copy of the information addressed to each of the customers.

### **Fair, clear and not misleading financial promotions**

3A.2.4 R (1) A firm communicating or approving a non-real time financial promotion of qualifying credit other than in (2), a home reversion plan or a regulated sale and rent back agreement must be able to show that it has taken reasonable steps to ensure that the non-real time financial promotion is fair, clear and not misleading.

(2) A firm communicating a financial promotion, or approving a non-real time financial promotion, in relation to a MCD regulated

mortgage contract must ensure that it:

- (a) is fair, clear and not misleading; and
- (b) in particular does not contain wording that may create false expectations for a consumer regarding the availability or the cost of a credit.

[**Note:** article 10 of the *MCD*]

**Fair, clear and not misleading rule for approval of home purchase plan financial promotions**

3A.2.5 R A firm which approves a financial promotion of a home purchase plan must take reasonable steps to ensure that the financial promotion is fair, clear and not misleading.

**Restrictions on use of terms**

- 3A.2.6 R Any communication, including a non-real time financial promotion, must describe:
- (1) any early repayment charge as an 'early repayment charge' and not use any other expression to describe such charges;
  - (2) any higher lending charge as a 'higher lending charge' and not use any other expression to describe such charges;
  - (3) any lifetime mortgage as a 'lifetime mortgage' and not use any other expression to describe such a mortgage;
  - (4) any home reversion plan as a 'home reversion plan' and not use any other expression to describe it;
  - (5) any regulated sale and rent back agreement as a "sale and rent back agreement" and not use any other expression such as "equity release" to describe it.

**3A.3 Other general requirements for financial promotions**

**Financial promotions to be balanced and with appropriate warnings**

3A.3.1 R A firm communicating or approving a financial promotion within MCOB 3A.2.4R must in addition ensure that the financial promotion:

- (1) is accurate;
- (2) is balanced and in particular does not emphasise any potential benefits of the MCD credit agreement, other qualifying credit, home reversion plan or regulated sale and rent back agreement (as the case

may be) without also giving a fair and prominent indication of any relevant risks;

- (3) is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received;
- (4) makes it clear where applicable that the credit is secured on the customer's home;
- (5) does not disguise, omit, diminish or obscure important items, statements or warnings; and
- (6) where it contains a comparison or contrast, presents the comparison or contrast in a fair and balanced way and ensures that is meaningful.

#### **Name and contact point**

3A.3.2 R A non-real time financial promotion must contain the name of the firm or its appointed representative and either an address or a contact point from which an address is available.

#### **Solicited financial promotions**

3A.3.3 R A financial promotion is not a solicited financial promotion unless a firm ensures that:

- (1) it is clear from all the circumstances when the call, visit or dialogue is initiated or requested that during the course of the visit, call or dialogue a financial promotion would be made; and
- (2) a person is not to be treated as expressly requesting a call, visit or dialogue:
  - (a) because he omits to indicate that he does not wish to receive any or any further visits or calls or to engage in any or any further dialogue;
  - (b) because he agrees to standard terms that state that such visits, calls or dialogues will take place unless he has signified clearly that, in addition to agreeing to the terms, he is willing for them to take place.

3A.3.4 R If a financial promotion is solicited by a person ('R'), it is treated as also having been solicited by any other person to whom it is made at the same time as R if that other person is a close relative of R or is expected to enter into a home reversion plan, a regulated sale and rent back agreement or any contract for qualifying credit jointly with R.

#### **Prohibition on cold calls to customers**

3A.3.5 R A firm must not make a cold call of qualifying credit, a home reversion plan

or a regulated sale and rent back agreement unless the customer has an established existing customer relationship with the firm and the relationship is such that the customer envisages receiving such financial promotions.

### **3A.4** **Qualifying credit financial promotions**

#### **Real time qualifying credit promotions**

3A.4.1 **R** A firm must ensure that an individual who makes a real time financial promotion of qualifying credit on the firm's behalf:

- (1) makes clear the purpose (or purposes) of the financial promotion at the initial point of communication, and identifies himself and the firm which he represents;
- (2) if the time and method of communication were not previously agreed by the recipient:
  - (a) checks that the recipient wishes him to proceed;
  - (b) terminates the communication if the recipient does not wish him to proceed (but may ask for another appointment);
  - (c) recognises and respects, promptly, the right of the recipient to:
    - (i) end the communication at any time;
    - (ii) refuse any request for another appointment;
- (3) gives any person with whom he arranges an appointment a contact point;
- (4) does not communicate with a person:
  - (a) at an unsocial hour, unless the person has previously agreed to such a communication;
  - (b) on an unlisted telephone number, unless the person has previously agreed to such calls on that number.

3A.4.2 **G** In MCOB 3A.4.1R (4)(a) an unsocial hour usually means on a Sunday or before 9am or after 9pm on any other day. It could also mean other days of the week or other times if the firm knows that a particular customer would not wish to be called on that day or at that time for reasons of, for example, religious faith or night shift working.

3A.4.3 **G** The requirements of MCOB 3A.4.1R and MCOB 3A.4.2G do not prevent, for example, a telephone call centre which has received a call from a customer at an hour generally regarded as unsocial, either responding to that call or asking during the call if the customer would like details of other qualifying

credit.

### **Approval of qualifying credit promotions**

- 3A.4.4    G    Most of the rules in this chapter apply when a firm approves a financial promotion of qualifying credit in the same way as when a firm communicates a financial promotion of qualifying credit itself. A firm therefore has a similar responsibility for a financial promotion of qualifying credit that it approves as for one that it communicates.

### **No approval of real time qualifying credit promotions**

- 3A.4.5    R    A firm must not approve a financial promotion of qualifying credit made in the course of a personal visit, telephone conversation or other interactive dialogue.

### **Approval of qualifying credit promotions when not all the rules apply**

- 3A.4.6    R    If a firm approves a financial promotion of qualifying credit in circumstances in which one or more of the rules in this chapter are expressly disapplied, the approval must be given on terms that it is limited to those circumstances.

- 3A.4.7    G    If an approval is limited in accordance with MCOB 3A.4.6R, and an unauthorised person communicates the financial promotion to persons not covered by the approval, the unauthorised person may commit an offence under section 21(1) of the Act (Restrictions on financial promotion). A firm giving a limited approval may wish to advise the unauthorised person accordingly.

### **Financial promotions for the business of overseas persons**

- 3A.4.8    R    A firm must not communicate or approve a financial promotion which relates to qualifying credit provided by an overseas person, unless:
- (1)    the financial promotion of qualifying credit makes clear which firm has approved or communicated it and, where relevant, explains:
    - (a)    that the rules made under the Act for the protection of customers do not apply;
    - (b)    the extent and level to which the compensation scheme will be available, or if the scheme will not be available, a statement to that effect; and
    - (c)    if the communicator wishes, the protection or compensation available under another system of regulation; and
  - (2)    the firm has taken reasonable steps to satisfy itself that the overseas person will deal with customers in the United Kingdom in an honest and reliable way.

### **3A.5**      **MCD financial promotions**

**3A.5.1**    **R**    **(1)**    When communicating or approving a financial promotion concerning a MCD credit agreement which indicates an interest rate or any figures relating to the cost of the credit to the consumer, a firm must ensure that the financial promotion includes standard information which specifies in a clear, concise and prominent way:

**[Note: article 11(1) of the MCD.]**

**(a)**      the identity of the MCD creditor or, where applicable, the credit intermediary or appointed representative;

**[Note: article 11(2)(a) of the MCD.]**

**(b)**      where applicable, that the MCD credit agreement will be secured by a mortgage or another comparable security or by a right related to residential immovable property;

**[Note: article 11(2)(b) of the MCD.]**

**(c)**      the borrowing rate, indicating whether this is fixed or variable or a combination of both, together with particulars of any charges included in the total cost of the credit to the consumer;

**[Note: article 11(2)(c) of the MCD.]**

**(d)**      the total amount of the credit;

**[Note: article 11(2)(d) of the MCD.]**

**(e)**      the APRC which must be included at least as prominently as any interest rate;

**[Note: article 11(2)(e) of the MCD.]**

**(f)**      where applicable, the duration of the MCD credit agreement;

**[Note: article 11(2)(f) of the MCD.]**

**(g)**      where applicable, the amount of the instalments;

**[Note: article 11(2)(g) of the MCD.]**

**(h)**      where applicable, the total amount payable by the consumer;

**[Note: article 11(2)(h) of the MCD.]**

(i) where applicable, the number of instalments; and,

[**Note:** article 11(2)(i) of the *MCD*.]

(j) where applicable, a warning regarding the fact that possible fluctuations of the exchange rate could affect the amount payable by the consumer.

[**Note:** article 11(2)(j) of the *MCD*.]

(2) The information listed in (1), other than that listed in points (a), (b) or (j) thereof, must be specified by means of a representative example.

[**Note:** article 11(3) of the *MCD*.]

(3) For the purposes of (2), an example is not representative unless it is at or below the *APRC* at which at least 50% of consumers:

(a) responding to the *financial promotion*; and

(b) who enter into a *MCD credit agreement* which is the subject of the *financial promotion*;

would be charged.

[**Note:** article 11(3) of the *MCD*.]

(4) Where the conclusion of a contract regarding an ancillary service, in particular insurance, is compulsory in order to obtain the *MCD credit agreement* or to obtain it on the terms and conditions marketed, and the cost of that service cannot be determined in advance, the obligation to enter into that contract must be stated in a clear, concise and prominent way, together with the *APRC*.

[**Note:** article 11(4) of the *MCD*.]

(4) The information referred to in (1) and (4) must be easily legible or clearly audible as appropriate, depending on the medium used for advertising.

[**Note:** article 11(5) of the *MCD*.]

### **3A.6 Home purchase plan financial promotions**

#### **APR equivalent for home purchase plan financial promotions**

**3A.6.1** **R** If a firm uses a figure equivalent to an *APR* in a communication of a *financial promotion* of a home purchase plan, when calculating that figure it must use an approach equivalent to the *APR rules*.

### **3A.7 Home reversion plan financial promotions**

#### **No approval of real time home reversion plan promotions**

- 3A.7.1 R A firm must not approve a financial promotion of a home reversion plan made in the course of a personal visit, telephone conversation or other interactive dialogue.

### **3A.8 Sale and rent back financial promotions**

#### **Guidance on fair, clear and not misleading sale and rent back financial promotions**

- 3A.8.1 G The effect of giving no less prominence to the possible disadvantages than to the benefits associated with a feature will depend on the context of the promotion. The costs, restrictions or conditions relating to a feature such as any option available should be detailed for the following non-exhaustive examples:

- (1) where any part of the discount on the market value of the property is to be repaid to the consumer after a qualifying period; and
- (2) where a consumer is to benefit from shared appreciation in the value of the property.

#### **Ban on SRB leaflet dropping**

- 3A.8.2 R A regulated sale and rent back firm must not communicate an unsolicited financial promotion that relates to a regulated sale and rent back agreement to a potential SRB agreement seller in the form of a leaflet or brochure or similar.

#### **Non-real time financial promotions to customers and advertisements**

- 3A.8.3 R A non-real time financial promotion relating to a regulated sale and rent back agreement and any other advertisement which is issued by a regulated sale and rent back firm that could lead to the conclusion of a regulated sale and rent back agreement, must (unless it is of a kind listed in MCOB 3A.1.9 R(1)) contain a risk warning that uses the following wording:

"If you enter into a sale and rent back agreement you are unlikely to get the market value of your home and, as a tenant, may only be able to remain there for a limited period. There may be other options available. Please ask for a key terms statement."

#### **Exploitation of customer**

3A.8.4 R A firm must not in any financial promotion of a regulated sale and rent back agreement exploit the vulnerable nature or circumstances of any customer who may be in financial difficulties and at risk of losing his or her home and must accordingly avoid using in the promotion phrases or terms such as "fast sales", "rescue" or "cash quickly" or any other similar expression.

**No approval of real time financial promotions of a regulated sale and rent back agreement**

3A.8.5 R A firm must not approve a financial promotion of a regulated sale and rent back agreement made in the course of a personal visit, telephone conversation or other interactive dialogue.

**3A.9 Systems and controls**

**Record keeping**

3A.9.1 R A firm must make an adequate record of each non-real time financial promotion of qualifying credit, a home reversion plan or a regulated sale and rent back agreement which it has confirmed as complying with the rules in this chapter. The record must be retained for a year from the date at which the financial promotion was last communicated.

3A.9.2 G MCOB 2.8 (Record keeping) applies to the form in which records required in accordance with this chapter must be kept.

**3B MCD general information**

**3B.1 Provision of general information**

3B.1.1 R This chapter applies to a firm that is a MCD mortgage lender or a tied MCD credit intermediary.

3B.1.2 R A firm must make available clear and comprehensible information about MCD regulated mortgage contracts at all times on paper or on another durable medium or in electronic form that includes:

- (1) the identity and the geographical address of the firm;
- (2) the purposes for which the credit may be used;
- (3) the forms of security, including, where applicable, the possibility for it to be located in a different EEA State;
- (4) the possible duration of the MCD regulated mortgage contracts;

- (5) the types of available *borrowing rate*, indicating whether fixed or variable or both, with a short description of the characteristics of a fixed and variable rate, including related implications for the *consumer*;
- (6) where *foreign currency loans* are available, an indication of the foreign currency or currencies, including an explanation of the implications for the *consumer* where the *credit* is denominated in a foreign currency;
- (7) a representative example of the *total amount of credit*, the *total cost of the credit to the consumer*, the *total amount payable by the consumer* and the *APRC*;
- (8) an indication of possible further costs, not included in *the total cost of the credit to the consumer*, to be paid in connection with a *MCD regulated mortgage contract*;
- (9) the different options available for repaying the *credit* to the *MCD mortgage lender*, including the number, frequency and amount of the regular repayment instalments;
- (10) where applicable, a clear and concise statement that compliance with the terms and conditions of the *MCD regulated mortgage contract* does not ensure repayment of the *total amount of credit*;
- (11) whether a valuation of the property is necessary and, where applicable, who is responsible for ensuring that the valuation is carried out, and whether any related costs arise for the *consumer*;
- (12) an indication of ancillary services the *consumer* is obliged to acquire in order to obtain the *credit* or to obtain it on the terms and conditions marketed and, where applicable, a clarification that the ancillary services may be purchased from a provider that is not the *MCD mortgage lender*; and
- (13) a general warning concerning possible consequences of non-compliance with the commitments linked to the *MCD regulated mortgage contract*.

[**Note:** article 13 of the *MCD*.]

- 3B.1.3     G     (1) A *firm* may make available the information referred to in *MCOB 3B.1.2R* by publishing it on a website.
- (2) The *MCD regulated mortgage contracts* referred to in *MCOB 3B.1.2R* above are those offered or entered into by the *firm*.

....

#### 4.4A     **Initial disclosure requirements**

Description of a firm's services in all cases

- 4.4A.1 R Using the methods and at the times specified in this section, a *firm* must provide the *customer* with the following information
- (1) whether there are any limitations in the range of products that it will offer to the *customer*, and if so what those are; ~~and~~
  - (2) the basis on which the *firm* will be remunerated; and,
  - (3) the availability of alternative finance options.
- ...
- 4.4A.4 R (1) If a *firm* is not offering to the *customer* products from an unlimited range from across the relevant market, in its disclosure on product range in *MCOB* 4.4A.1R the firm must ~~either~~:
- (a) where it is a *MCD mortgage lender* or a *MCD credit intermediary*, list the names of all the mortgage lenders whose products it is offering; or
- [Note: article 15(1)(c) of the *MCD*]**
- (b) where it is not a *MCD mortgage lender* or a *MCD credit intermediary*, either
    - (i) comply with (a); or
    - (ii) inform the *customer* of the number of *mortgage lenders* whose products it is offering and that he has the right to request a list of those *mortgage lenders*.
  - (c) where it is a *MCD credit intermediary* only disclose that it is independent where its consideration of *MCD regulated mortgage contracts* across the market is unlimited.
- [Note: articles 15(1)(c) and 22(4) of the *MCD*]**
- (2) If a *customer* requests the list in (1)(b)(ii) the *firm* must provide it in a *durable medium* as soon as possible following the request and in any event within five *business days*. The list must also indicate whether the *firm* offers all of the products generally available from each *mortgage lender* on the list.
- ...
- 4.4A.8 R (1) The information about the basis of remuneration required by *MCOB* 4.4A.1R(2) must include all relevant information,

including the following details:

- (a) any fees which the *firm* will charge to the *customer*;
- (b) when any such fees will be payable and, if applicable, reimbursable;
- (c) whether the *firm* will receive commissions from the mortgage lender or a another third party and, if applicable, any arrangements for offsetting this whether any commission will be offset against any fees charged and the arrangements for doing so; and

[**Note:** article 15(3) of the MCD]

- (d) in the case of a MCD regulated mortgage contract, the amount of commissions or other inducements, or where the amount is not known at the time of disclosure, notification that the actual amount will be disclosed at a later stage in the ESIS.

[**Note:** article 15(1)(g) of the MCD]

(2) ...

- (e) in the case of a MCD regulated mortgage contract, if the firm will charge a fee calculated other than in 2(a)-(d), the firm must provide details of the method for calculating the fee.

[**Note:** article 15(1)(e) of the MCD]

### **Alternative finance options**

4.4A.8A **R** Where a customer is looking to increase the borrowing secured on a property which is the subject of an existing regulated mortgage contract the firm must first inform the customer, either orally or in writing, that the following alternative finance options may be available, and more appropriate for the customer:

- (1) a further advance from the existing lender, unless the firm knows that the existing lender will not make a further advance to the customer;
- (2) (a) a second charge regulated mortgage contract, where the firm would offer services in relation to a new first charge regulated mortgage contract;

(b) a new first charge regulated mortgage contract, where the firm would offer services in relation to a second charge regulated mortgage contract; or

(3) unsecured lending.

4.4A.8B G Firms are not obliged to explore whether a further advance with the existing lender, a new first charge regulated mortgage contract with another lender, a second charge regulated mortgage contract or unsecured lending is more appropriate for the customer where that is not the service offered to the customer.

Method of providing initial disclosure in all cases

4.4A.9 R The information required by *MCOB 4.4A.1R, MCOB 4.4A.2R, MCOB 4.4A.4R(1), and MCOB 4.4A.8R and MCOB 4.4A.8AR* must be communicated clearly and prominently, and in doing so: ...

...

...

4.4A.12 R The information required by *MCOB 4.4A.R, MCOB 4.4A.2R, MCOB 4.4A.4R (1), and MCOB 4.4A.8R and MCOB 4.4A.8A R* must be provided during the course of the *initial contact*.

...

Additional disclosure where the services are to be provided to a consumer under a distance contract

4.4A.18 R Where a *firm* provides services to a *consumer* by way of a *distance contract*, the *firm* must provide the *consumer* with the following information in a *durable medium* in good time before the *distance contract* has been agreed:

(1) the information which is required by *MCOB 4.4A.1 R to MCOB 4.4A.8A R* and *MCOB 4.4A.8A R*;

...

4.4A.21 R (1) If at the point that initial disclosure must be made in accordance with *MCOB 4.4A.1R, MCOB 4.4A.2R, MCOB 4.4A.4R, and MCOB 4.4A.8R and MCOB 4.4A.8AR* a *firm* is uncertain whether the contract will be a *regulated mortgage contract*, the *firm* must:

...

...

4.7A Advised sales

...

Shared equity

4.7A.14 R When a firm assesses whether a shared equity credit agreement is appropriate to the needs and circumstances of the customer for the purposes of MCOB 4.7A.5R(1), in addition to the factors listed at MCOB 4.7A.6R, it must consider whether it is appropriate for the customer to:

A

- (1) take out the shared equity credit agreement for a particular term taking into account the customer's intentions with respect to the repayment of that shared equity credit agreement and the term of the customer's associated first charge regulated mortgage contract;
- (2) have flexibility in respect of payment of interest;
- (3) have flexibility in respect of repayment of capital; and
- (4) purchase a property by using his own resources, rather than by borrowing under the shared equity credit agreement.

...

4.7A.17 R ~~Where the customer is looking to increase the borrowing secured on the property which is the subject of an existing regulated mortgage contract, unless the firm knows that the existing lender will not make a further advance to the customer, the firm must inform the customer, either orally or in writing, that it may be possible, and more appropriate, to do so rather than to enter into a regulated mortgage contract with another lender.~~[deleted]

4.7A.18 G ~~Firms are not under any obligation to explore whether a further advance with the existing lender is, in fact, more appropriate for the customer.~~

[deleted]

...

Other considerations when advising

...

4.7A.21 G In complying with MCOB 4.7A.5R(1) a firm is not required to consider whether it would be preferable for the customer to:

- (1) purchase a property by using his own resources, rather than by borrowing under a regulated mortgage contract (save for where

the customer is seeking to enter into a shared equity credit agreement (see MCOB 4.7A.14AR(4)); or

...

...

#### **4.8A Execution-only sales**

...

Cases where execution-only sales are not permitted

4.8A.7 R A *firm* must not enter into or *arrange* an *execution-only sale* for a *regulated mortgage contract* if:

...

- (3) there is spoken or other interactive dialogue between the *firm* and the *customer* at any point during the sale; or
- (4) the regulated mortgage contract is a shared equity credit agreement.

....

#### **4A Additional MCD advising and selling standards**

##### **4A.1 Additional disclosure by MCD credit intermediaries**

4A.1.1 R (1) A MCD credit intermediary must in good time before carrying out any MCD credit intermediation activity, provide the consumer with at least the following information in a durable medium:

[Note: article 15(1) of the MCD]

(a) the identity and the geographical address of the MCD credit intermediary;

[Note: article 15(1)(a) of the MCD]

(b) the Financial Services Register or other registers in which the MCD credit intermediary has been included, the registration numbers, where applicable, and the means for verifying such registrations;

[Note: article 15(1)(b) of the MCD]

(c) whether the MCD credit intermediary is a MCD mortgage adviser; and

[Note: article 15(1)(d) of the MCD]

- (d) the procedures allowing consumers or other interested parties to complain to the MCD credit intermediary, whether complaints may subsequently be referred to the Financial Ombudsman Service and, if so, the methods of having access to it.

[Note: article 15(1)(f) of the MCD]

4A.1.2 G In MCOB 4A.1.1 R(1)(d):

- (1) other interested parties includes all parties to the relevant MCD regulated mortgage contract and parties that have an interest in the MCD regulated mortgage contract, such as a guarantor of the obligations under the MCD regulated mortgage contract;
- (2) where the MCD credit intermediary provides the information in the general terms and conditions of the sales or service contracts, before carrying out any MCD credit intermediation activity it need not provide it again.

4A.1.3 G The information listed in MCOB 4A.1R(1) need not all be given at the same time or in the same disclosure.

4A.1.4 G In general, where other requirements for disclosure in a durable medium also apply, the MCD credit intermediary may, if it would also satisfy those requirements, combine those other disclosures with the information required by MCOB 4A.1.1 R, so long as the combined disclosure is provided to the consumer in good time before the MCD credit intermediary carries out any MCD credit intermediation.

4A.1.5 R A MCD credit intermediary who is not a tied MCD credit intermediary but who receives commission from one or more MCD mortgage lenders must, at the consumer's request, provide information on the variation in levels of commission payable by the MCD mortgage lenders providing the MCD regulated mortgage contract being offered to the consumer. The consumer must be informed that he has the right to request such information.

[Note: article 15(2) of the MCD]

4A.1.6 R A MCD credit intermediary must inform the MCD mortgage lender of any fee payable by the consumer to the MCD credit intermediary for its services, for the purpose of calculating the APRC.

[Note: article 15(4) of the MCD]

4A.1.7 R A MCD credit intermediary must require their appointed representatives to disclose to the consumer the capacity in which the appointed representative is acting, and the MCD credit intermediary that the appointed

representative is representing when contacting or before dealing with any consumer.

[**Note:** article 15(5) of the *MCD*]

## **4A.2 Adequate Explanations**

4A.2.1 R (1) A MCD mortgage lender or MCD credit intermediary must provide, orally or in a durable medium, adequate explanations to the consumer of the proposed MCD regulated mortgage contract and any ancillary services, before any binding offer is issued to that consumer, to enable the consumer to assess whether the proposed MCD regulated mortgage contract and ancillary services meet his needs and financial situation.

[**Note:** article 16(1) of the *MCD*]

(2) The explanations must, where applicable, include:

(a) the pre-contractual information to be provided in accordance with:

(i) the ESIS or illustration; and

(ii) in the case of a MCD credit intermediary, MCOB 4A.1.1R to MCOB 4A.1.7R

[**Note:** article 16(1)(a) of the *MCD*]

(b) the essential characteristics of the products proposed;

[**Note:** article 16(1)(b) of the *MCD*]

(c) the specific effects the products proposed may have on the consumer, including the consequences of default in payment by the consumer; and

[**Note:** article 16(1)(c) of the *MCD*]

(d) where ancillary services are bundled with a MCD regulated mortgage contract, whether each component of the bundle can be terminated separately and the implications for the consumer of doing so.

[**Note:** article 16(1)(d) of the *MCD*]

4A.2.2 R In complying with MCOB 4A.2.1R a firm may adapt the manner and extent of giving the explanations, as well as the person giving them,

according to:

- (1) the circumstances of the situation in which the *MCD regulated mortgage contract* is offered;
- (2) the *consumer* to whom it is offered; and
- (3) the nature of the *MCD regulated mortgage contract* offered.

[Note: article 16(2) of the *MCD*]

4A.2.3    G    The explanations given to a *consumer* for the purposes of complying with *MCOB* 4A.2.1R do not amount to advice to that *consumer*. *Firms* may wish to refer to *PERG* (particularly *PERG* 4.6) for guidance on the regulatory perimeter in relation to *advising on a home finance transaction*.

### **4A.3**    **Record of recommendation**

4A.3.1    R    Where a *MCD mortgage advisor* advises on a *MCD regulated mortgage contract*, it must give the *consumer* a record on paper or in another *durable medium* of the recommendation provided.

[Note: article 22(3)(e) of the *MCD*]

4A.3.2    G    The record in *MCOB* 4A.3.1R may consist of the completed *ESIS* or *illustration*.

...

5.1.1    R    Subject to *MCOB* 5.1.2A R, this chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB* 5.1.2 R in accordance with column (2) of that table.

...

5.1.2A    R    This chapter does not apply to a *firm* that is a *MCD mortgage lender* or *MCD credit intermediary*.

...

~~Clear, fair and not misleading~~

5.4.1    R    [deleted]

...

5.4.16    G

## Accuracy

- 5.4.2 R ~~[deleted]~~
- 5.4.3 R A *mortgage intermediary* must take reasonable steps to ensure that an *illustration* which it issues, or which is issued on its behalf, other than that provided by a *mortgage lender*:
- (1) ~~is accurate within the following tolerances:~~
- (a) ~~no more than one percent or £1, whichever is the greater, below the actual figures charged by the *mortgage lender* for the following:~~
- (i) ~~the *total amount payable* in Section 5 of the *illustration*;~~
- (ii) ~~the amount payable for every £1 borrowed in Section 5 of the *illustration*;~~
- (iii) ~~the amounts that the *customer* must pay by regular instalment in Section 6 of the *illustration* (or in Section 7 of the *illustration* for an interest rate with a floor or a ceiling); and~~
- (iv) ~~the amount by which the regular instalment (or the *total amount payable* for loans without a term or a regular repayment plan) would increase following a one percentage point increase in interest rates in Section 7;~~
- (b) ~~the *APR* in Section 5 of the *illustration* cannot be understated by more than 0.1%; and~~
- (2) ~~except in the case of conveyancing fees and insurance premiums (where estimates may be used), is accurate in respect of other figures quoted in the *illustration* including fees payable to the *mortgage lender* or *mortgage intermediary* in Section 8 of the *illustration* and cash examples of *early repayment charges*, calculated in accordance with the rules in *MCOB 5.6.84 R* to *MCOB 5.6.88 R*, in Section 10.~~
- 5.4.4 G ~~[deleted]~~
- 5.4.5 G ~~[deleted]~~
- 5.4.6 G It is the responsibility of a *mortgage intermediary* to ensure compliance with *MCOB 5.4.3 R*. However, where a *firm* can show that it was reasonable for it to rely on information provided to it by another *person*, other than the *mortgage lender*, that an *illustration* was ~~within the tolerances described in *MCOB 5.4.3 R*~~ accurate, ~~he~~ it may be able to rely on *MCOB 2.5.2 R*, if this turns out not to be the case.
- 5.4.7 G ~~[deleted]~~

...

5.4.13A G When providing information on *regulated mortgage contracts*, firms should bear in mind that the information must be ~~clear, fair and not misleading in accordance with Principle 7 and MCOB 2.2.6 R; and must be given in~~ accordance with *MCOB 2.5A.1 R* (The customer's best interests).

...

5.5.16 G *MCOB 5* places no restrictions on the provision of information that is not specific to the amount the *customer* wants to borrow, for example, marketing literature including generic mortgage repayment tables or graphs illustrating the benefits of making a regular overpayment on a flexible mortgage. Such literature may, however, constitute a *financial promotion* and be subject to the provisions of ~~*MCOB 3 (Financial promotion)*~~ *3A (Financial promotions and communications with customers)*.

...

5.5.1C R If, notwithstanding *MCOB 5.5.1AR (1)*, a firm chooses to give an *illustration* in relation to a *direct deal*, it ~~need not comply with *MCOB 5.4.2 R* or *MCOB 5.4.3 R (Accuracy)*~~ remains subject to *MCOB 3A.2.1R(2)* (fair, clear and not misleading communications).

5.5.1D G [deleted]

...

#### ~~Shared appreciation mortgages~~

5.6.129 R [deleted]

5.6.130 G [deleted]

...

5 Annex R ...

1

### **1. About this illustration**

We are required by the Financial Conduct Authority (FCA) – the independent watchdog that regulates financial services – to provide you with this illustration.

All firms selling mortgages are required to give you illustrations like this one, that contain similar information ~~presented in the same way~~.

Ensure that you obtain other illustrations if you want to compare this mortgage with

mortgages from other lenders.

...

**Insert MCOB 5A after MCOB 5. The text in MCOB 5A is new and is not underlined.**

## **5A MCD Pre-application disclosure**

### **5A.1 Application and purpose**

- 5A.1.1 R This chapter applies to a *firm* that is a *MCD mortgage lender* or *MCD credit intermediary*.
- 5A.1.2 G (1) *MCOB 5A* amplifies *Principle 6* and *Principle 7*.
- (2) The purpose of *MCOB 5A* is to ensure that, before a *consumer* submits an application for a particular *MCD regulated mortgage transaction*, he is supplied with information that makes clear:
- (a) (in relation to a *MCD regulated mortgage contract*) its features, any *linked deposits*, any *linked borrowing* and any *tied products*; and
- (b) the price that the *consumer* will be required to pay under that *MCD regulated mortgage contract*, to enable the *consumer* to make a well-informed purchasing decision.
- (3) *MCOB 5A* requires information to be disclosed in a consistent way to facilitate comparison between products of different providers.

### **5A.2 Applying for a MCD regulated mortgage contract**

- 5A.2.1 R A *MCD mortgage lender* must not enter into a *MCD regulated mortgage contract*, or agree to do so, with a *consumer* unless the *consumer* has submitted an application for that particular *MCD regulated mortgage contract*.
- G (1) The purpose of *MCOB 5A.2.1R*, taken in conjunction with other rules in this chapter, is to ensure that the *consumer* has received details of the particular *MCD regulated mortgage contract* for which he has applied, and has had the opportunity to satisfy himself that it is appropriate for him.
- (2) The application should identify the type of interest rate, rate of interest, and the *MCD mortgage lender* at the point it is submitted by the *consumer*.

## 5A.3 Information on MCD regulated mortgage contracts: general

### Accuracy

- 5A.3.1 R A *firm* that is a *MCD credit intermediary* must take reasonable steps to ensure that an *ESIS* which it issues, or which is issued on its behalf, other than that provided by a *mortgage lender* is accurate.
- 5A.3.2 R It is the responsibility of the *firm* to ensure compliance with *MCOB* 5A.3.1 R. However, where a *firm* can show that it was reasonable for it to rely on information provided to it by another *person*, other than the *MCD mortgage lender*, that an *ESIS* was accurate, it may be able to rely on *MCOB* 2.5.2 R, if this turns out not to be the case.

### ESISs where consumer is ineligible

- 5A.3.3 R A *firm* must not issue an *ESIS* to a *consumer* for a *MCD regulated mortgage contract* for which the *consumer* is clearly ineligible on the basis of the information that the *firm* has obtained from the *consumer* or the *MCD mortgage lender's* lending criteria.
- 5A.3.4 G The purpose of *MCOB* 5A.3.3 R is not to require a *firm* to ascertain whether a *consumer* is eligible for a particular *MCD regulated mortgage contract* before providing an *ESIS*. Instead, the purpose is to ensure that the *firm* takes into account the information it has obtained from the *consumer* before providing an *ESIS* to the *consumer*.

### Explaining the importance of an ESIS

- 5A.3.5 R In providing an *ESIS* to a *consumer*, a *firm* must explain to the *consumer* the importance of reading the *ESIS* and understanding it.
- 5A.3.6 G A *firm* may satisfy *MCOB* 5A.3.5 R by drawing the *consumer's* attention orally to the importance of reading and understanding the *ESIS*, for example in a face-to-face meeting, or by referring to its importance in a covering letter or electronic communication or other written information that accompanies the *ESIS*.

### Form of an ESIS

- 5A.3.7 R Any *ESIS* provided to a *consumer* by a *firm* must be in a *durable medium*.
- [Note: article 14(2) of the *MCD*]

### Provision of information

- 5A.3.8 G When providing information on *MCD regulated mortgage contracts*, *firms* should bear in mind that the information must be given in accordance with *MCOB* 2.5A.1 R (The customer's best interests).
- 5A.3.9 G *MCOB* 5A places no restrictions on the provision of information that is not specific to the amount the *consumer* wants to borrow, for example,

marketing literature including generic mortgage repayment tables or graphs illustrating the benefits of making a regular overpayment on a flexible mortgage. Such literature may, however, constitute a *financial promotion* and be subject to the provisions of *MCOB* 3A (Financial promotions and communications with customers).

### **Messages to be given when providing information on MCD regulated mortgage contracts**

- 5A.3.10 R (1) Whenever a *firm* provides a *consumer* with information specific to the amount that the *consumer* wants to borrow on a particular *MCD regulated mortgage contract* following an assessment of the *consumer's* needs and circumstances in order to comply with *MCOB* 4.7A.2 R, it must give, clearly and prominently, the following information:
- (a) the same information on the *firm's* product range as is required by *MCOB* 4.4A.1 R(1), *MCOB* 4.4A.2 R and *MCOB* 4.4A.4 R(1) ; and
  - (b) that the *consumer* has the right to request an *ESIS* for any *MCD regulated mortgage contract* which the *firm* is able to offer the *consumer*.
- (2) A *firm* need not give the information in (1) if it has previously given that information in compliance with this *rule* within the last ten *business days*.
- 5A.3.11 G In order to demonstrate compliance with *MCOB* 5A.3.10 R(1), a *firm* may wish to consider, for example, doing one or more of the following: give the messages to the *consumer* in a *durable medium*; build the requirements into the *firm's* training of staff, as evidenced by its training and compliance manuals; insert appropriate prompts into paper-based or automated sales systems; have procedures in place to monitor compliance by its staff with that *rule*. What is required in each case will depend on all the circumstances.

### **Messages to be given when consumer requests an execution-only sale**

- 5A.3.12 R (1) Whenever, as part of an *execution-only sale* (or potential *execution-only sale*), a *consumer* provides a *firm* with the information in *MCOB* 4.8A.14 R(1), (2) or (3) the *firm* must inform the *consumer*, clearly and prominently, that the *consumer* has the right to request an *ESIS* for any *MCD regulated mortgage contract* which the *firm* is able to offer the *consumer*.
- (2) A *firm* need not give the information in (1) if it has previously given that information in compliance with this *rule* within the last ten *business days*.

### **Record keeping**

- 5A.3.13 R A *firm* must make an adequate record of each *ESIS* that it issues to a *consumer* in accordance with *MCOB* 5A.4.1 R where the *consumer* applies for that particular *MCD regulated mortgage contract*.
- 5A.3.14 R The record required by *MCOB* 5A.3.13 must be retained for a year from the date of the application made by the *consumer*.
- 5A.3.15 R *MCOB* 5A.3.13 R does not require a *firm* to keep records of *ESISs* that are issued to a *consumer* where the *consumer* does not apply to enter into that particular *MCD regulated mortgage contract*.
- 5A.3.16 G The record maintained in accordance with *MCOB* 5A.3.13 R should contain or refer to matters such as:
- (1) the date on which the *ESIS* was provided to the *consumer*;
  - (2) the date of the application made by the *consumer*; and
  - (3) details of the medium through which the *ESIS* was provided.

#### 5A.4 **Provision of ESISs**

##### **Timing**

- 5A.4.1 R (1) A *firm* must provide the *consumer* with an *ESIS* for a *MCD regulated mortgage contract* before the *consumer* submits an application for that particular *MCD regulated mortgage contract* to a *MCD mortgage lender*, unless an *ESIS* for that particular *MCD regulated mortgage contract* has already been provided.
- (2) Except in the circumstances in *MCOB* 5A.4.2R, a *firm* must provide the *consumer* with an *ESIS* for a *MCD regulated mortgage contract* when any of the following occurs, unless an *ESIS* for that *MCD regulated mortgage contract* has already been provided:
- (a) the *firm* advises the particular *consumer* to enter into that *MCD regulated mortgage contract*, in which case an *ESIS* must be provided at the point the advice is given, unless the advice is given by telephone, in which case the *firm* must provide an *ESIS* within 5 *business days*; or
  - (b) the *consumer* requests an *ESIS* for that *MCD regulated mortgage contract*, unless the *firm* is aware that it is unable to offer that *regulated mortgage contract* to him; or
  - (c) as part of an *execution-only sale* (or potential *execution-only sale*) the *consumer* has provided the *firm* with the information in *MCOB* 4.8A.14 R (1) to *MCOB* 4.8A.14 R (3) to indicate which *MCD regulated mortgage contract* he wishes to enter

into.

(3) Except in the circumstances in *MCOB 5A.4.2R* and unless an *ESIS* for that *MCD regulated mortgage contract* has already been provided, a *firm* must provide the *consumer* with an *ESIS* for a *MCD regulated mortgage contract*:

(a) without undue delay after the *consumer* has given the necessary information on his needs, financial situation and preferences in accordance with *MCOB 11.6.5R(2)*, *MCOB 11.6.35R(2)*, *MCOB 11A1.1R* and *MCOB 11A1.1R* ; and

[**Note:** article 14(1)(a) of the *MCD*]

(b) in good time before the *consumer* is bound by any *MCD regulated mortgage contract* or offer.

[**Note:** article 14(1)(b) of the *MCD*]

5A.4.2 R A *firm* need not provide an *ESIS*:

(1) in relation to a *direct deal*;

(2) if the *consumer* refuses to disclose key information (for example, in a telephone conversation, his name or a communication address) or where the *consumer* is not interested in pursuing the enquiry; or

(3) if the *firm* does not wish to do business with the *consumer*.

5A.4.3 R If the *firm* chooses not to give an *ESIS* in the circumstances set out in *MCOB 5A.4.2 R (1)*, where it has given advice on a *direct deal*, the *firm* must give the *consumer* a written record of the advice.

5A.4.4 G In the circumstances in *MCOB 5A.4.2 R(2)*, the *rule* in *MCOB 5A.4.1 R (1)* will mean that the *consumer* may not make an application for a *MCD regulated mortgage contract* as an *ESIS* has not been provided.

5A.4.5 G The effect of the requirements at *MCOB 5A.2.1 R* and *MCOB 5A.4.1 R (1)* is that if a *consumer's* application to enter into a *MCD regulated mortgage contract* with a *MCD mortgage lender*, made via a *MCD credit intermediary*, is subsequently passed by that *firm* to another *MCD mortgage lender*, then the *firm* must ensure that the application is amended and the *consumer* is provided with an *ESIS* for the other *MCD mortgage lender's MCD regulated mortgage contract* before the application is passed to the other *MCD mortgage lender*.

5A.4.6 G If a *firm* chooses to issue an *offer document* in addition to an *ESIS* it will need to comply with *MCOB 6A.3.1* (*MCD Mortgages: content of the offer document*).

- 5A.4.7 R A *firm* must not undertake any action that commits the *consumer* to an application (including accepting product-related fees in relation to the *MCD regulated mortgage contract* concerned) until the *consumer* has had the opportunity to consider an *ESIS*.
- 5A.4.8 G The effect of the requirements at *MCOB* 5A.4.1 R(1) and *MCOB* 5A.4.7 R is that a *consumer* will be deemed to be committed to an application if, for example, he pays a product related fee (including a valuation fee) or provides electronic or verbal authority to process an application. It is not necessary for a *consumer* to provide a *MCD mortgage lender* with a completed application form to submit an application for a *MCD regulated mortgage contract*.
- 5A.4.9 R The *firm* dealing directly with the *consumer* is responsible for ensuring compliance with the content and timing requirements, that is, a *MCD mortgage lender* is not responsible for ensuring that a *consumer* has received an *ESIS* before accepting an application from a *MCD credit intermediary*.
- 5A.4.10 R Where a *firm* has already provided an *ESIS* in accordance with *MCOB* 5A.4.1 R and the terms for the proposed *regulated mortgage contract* are subsequently materially altered or different, the *firm* must ensure that the *consumer* is provided with a revised *ESIS*, before acting on the amendment, when the change occurs at the point at which a *consumer* submits an application for the *MCD regulated mortgage contract*.
- 5A.4.11 G What constitutes “materially altered” or “different” requires consideration of the facts of each individual case. For example, a change of product such that the underlying terms and conditions of the *MCD regulated mortgage contract* have changed should normally be regarded as material or different, as would an additional charge, such as a *higher lending charge*, applying to the *MCD regulated mortgage contract* when it did not previously.

#### Uncertainty whether a mortgage is regulated

- 5A.4.12 R (1) If, at the point an *ESIS* must be provided in accordance with *MCOB* 5A.4.1 R., a *firm* is uncertain whether the contract will be a *MCD regulated mortgage contract*, the *firm* must:
- (a) provide an *ESIS*; or
  - (b) seek to obtain from the *consumer* information that will enable the *firm* to ascertain whether the contract will be a *MCD regulated mortgage contract*.
- (2) Where (1)(b) applies, an *ESIS* must be provided, unless, on the basis of the information the *consumer* provides, the *firm* has reasonable evidence that the contract is not a *MCD regulated mortgage contract*.

#### **Providing an *ESIS* without delay in response to a customer request**

5A.4.13 G Where the *consumer* requests an *ESIS* for a particular *MCD regulated mortgage contract* (see *MCOB* 5A.4.1 R(2)(b)) the purpose of *MCOB* 5A.4.14 R, *MCOB* 5A.4.15 R and *MCOB* 5A.4.16 G is to ensure that the *consumer* receives an *ESIS* without unnecessary delay. These requirements do not restrict the information that the *firm* may obtain from the *consumer* after it has provided the *consumer* with an *ESIS*.

5A.4.14 R In meeting a request for an *ESIS* in accordance with *MCOB* 5A.4.1 R(2)(b), the *firm* must not delay the provision of the *ESIS* by requesting information other than:

- (1) the information necessary to complete the *ESIS* in accordance with *MCOB* 5A.5.2 R and *MCOB* 5A.5.3 R, if the *firm* does not already know it;
- (2) where the *firm* acts in accordance with *MCOB* 5A.4.12 R(2), such information as is necessary to ascertain whether or not the contract will be a *MCD regulated mortgage contract*;
- (3) where the interest rates, payments or any other terms and conditions to be included in the *ESIS* are dependent on the *consumer's* credit record, such information as is necessary to produce an *ESIS*;
- (4) where the *firm* includes a quotation for any *tied products* or compulsory insurance in the *ESIS*, such information as is necessary to produce those quotations;
- (5) any of the following information where it affects the availability of the *MCD regulated mortgage contract* that the *consumer* has requested information on or affects the information to be included in the *ESIS*:
  - (a) whether the *consumer* is a first-time buyer, a subsequent buyer moving home or entering into a *MCD regulated mortgage contract* without moving home;
  - (b) whether the *MCD regulated mortgage contract* is required for a right-to-buy purchase or for a shared ownership purchase;
  - (c) the location of the property to be purchased, where known; and
  - (d) whether the terms are dependent on a third party guarantee.

5A.4.15 R Where *MCOB* 5A.5.14 R(3) applies:

- (1) a *firm* must ask the *consumer* relevant questions about his credit history or obtain information on his credit record from a credit reference agency;
- (2) a credit reference agency must not be used unless:

- (a) it would be quicker than asking the *consumer* the relevant questions about his credit history; or
- (b) the *consumer* is not able to provide sufficient information on his credit history.

5A.4.16 G A *firm* may use information that it already holds on the *consumer* for the purpose of producing the *ESIS* (for example, if it already holds the *consumer's* credit record), providing the use of this information does not delay the *consumer* receiving the *ESIS* and the *consumer's* consent is obtained where appropriate.

5A.4.17 R If, on the basis of the information obtained from the *consumer* or on the basis of information that the *firm* already holds on the *consumer*, the *firm* would do business with the *consumer*, but not on the terms requested, the *firm* may provide the *consumer* with an *ESIS* in respect of a different *MCD regulated mortgage contract* if it chooses to do so.

## 5A.5 Content of ESISs

### Content, order, format etc

5A.5.1 G *MCOB* 5A.5 sets out the required content of an *ESIS* provided to a *consumer* by a *firm*.

5A.5.2 R An *ESIS* provided to a *consumer* must follow the form and contain the material set out in *MCOB* 5A Annex 1 R.

5A.5.3 R A *firm* must:

- (1) reproduce the text in *MCOB* 5A Annex 1 R as such in the *ESIS*;
- (2) replace the indications between square brackets with the corresponding information;
- (3) complete the *ESIS* in accordance with *MCOB* 5A Annex 2 R;
- (4) wherever the words “where applicable” are indicated:
  - (a) provide the information required if it is relevant to the *MCD regulated mortgage contract*; or
  - (b) Where the information is not relevant to the *MCD regulated mortgage contract*, delete the information in question or the entire section (for example, in cases where the section is not applicable);
- (5) if it deletes an entire section, adjust the numbering of the *ESIS* sections accordingly;

- (6) provide the *ESIS* in a single document;
- (7) ensure that the font used is clearly readable;
- (8) use bold font, shading or larger font sizes for the information elements to be highlighted; and
- (9) highlight all applicable risk warnings.

[**Note:** article 14(2) and Annexe II, Part A, preamble of the *MCD*]

- 5A.5.4 G (1) The *ESIS* can contain the *mortgage lender's* or *MCD credit intermediary's* logo and other 'brand' information, so long as the requirements of *MCOB 5A.5* are satisfied.
- (2) The *ESIS* can contain page numbers and other references that aid understanding, record keeping and identification of a particular *ESIS*, such as the date and time an *ESIS* is produced or a unique reference number, provided these do not detract from the content of the *ESIS*.
- (3) *Firms* are reminded of their general obligation for communications to *consumers* to be clear, fair and not misleading. Sections of the *ESIS* may be split across pages where it is impractical to do otherwise. When splitting sections, *firms* should split the section at an appropriate place, for example at the end of a sub-section, and not split tables or risk warnings.

**Content: required information**

- 5A.5.5 R The *ESIS* provided to *consumers* must:
- (1) contain only the material prescribed in *MCOB 5A.5* and no other material; and
  - (2) be in a document separate from any other material that is provided to the *consumer*.
- 5A.5.6 G A *firm* should not illustrate more than one *MCD regulated mortgage contract* in the same *ESIS*, for example by using one *ESIS* to compare alternative products, repayment methods or repayment terms.
- 5A.5.7 G *Firms* are reminded that they must comply with *MCOB 7.6.5 R* in respect of the release of loan instalments after the start of the *MCD regulated mortgage contract*.

**Other information**

- 5A.6.1 R (1) A *firm* may provide information to the *consumer* in addition to the information in the *ESIS*.

(2) A *firm* must provide the additional information in (1) in a separate document.

(3) A *firm* may annexe the separate document in (2) to the *ESIS*.

[**Note:** article 14(8) of the *MCD*]

5A R **European Standardised Information Sheet (ESIS)**  
Annex 1

[**Note:** Annex II Part A of the *MCD*]

**MCOB 5A Annex 1 R**

1. This annex belongs to *MCOB 5A.5.2 R*.

(Introductory text)
<p>This document was produced for [name of consumer] on [current date].</p> <p>This document was produced on the basis of the information that you have provided so far and on the current financial market conditions.</p> <p>The information below remains valid until [validity date], (where applicable) apart from the interest rate and other costs. After that date, it may change in line with market conditions.</p> <p>(Where applicable) This document does not constitute an obligation for [name of creditor] to grant you a loan.</p>
1. Lender
<p>[Name]</p> <p>[Telephone number]</p> <p>[Geographical address]</p> <p>(Optional) [E-mail address]</p> <p>(Optional) [Fax number]</p>

(Optional) [Web address]

(Optional) [Contact person/point]

(Where applicable information as to whether advisory services are being provided:) [(We recommend, having assessed your needs and circumstances, that you take out this mortgage. We are not recommending a particular mortgage for you. However, based on your answers to some questions, we are giving you information about this mortgage so that you can make your own choice.)]

## 2. (Where applicable) Credit intermediary

[Name]

[Telephone number]

[Geographical address]

(Optional) [E-mail address]

(Optional) [Fax number]

(Optional) [Web address]

(Optional) [Contact person/point]

(Where applicable [information as to whether advisory services are being provided]) [(We recommend, having assessed your needs and circumstances, that you take out this mortgage./We are not recommending a particular mortgage for you. However, based on your answers to some questions, we are giving you information about this mortgage so that you can make your own choice.)]

[Remuneration]

## 3. Main features of the loan

Amount and currency of the loan to be granted: [value][currency]

(Where applicable) This loan is not in [national currency of the borrower].

(Where applicable) The value of your loan in [national currency of the borrower] could change.

(Where applicable) For example, if the value of [national currency of the borrower] fell by 20 % relative to [credit currency], the value of your loan would increase to [insert amount in national currency of the borrower]. However, it could be more than this if the value of [national currency of the borrower] falls by more than 20 %.

(Where applicable) The maximum value of your loan will be [insert amount in national currency of the borrower]. (Where applicable) You will receive a warning if the credit amount reaches [insert amount in national currency of the borrower]. (Where applicable) You will have the opportunity to [insert right to renegotiate foreign currency loan or right to convert loan into [relevant currency] and conditions].

Duration of the loan: [duration]

[Type of loan]

[Type of applicable interest rate]

Total amount to be reimbursed:

This means that you will pay back [amount] for every [unit of the currency] borrowed.

(Where applicable) [This/Part of this] is an interest-only loan. You will still owe [insert amount of loan on an interest- only basis] at the end of the mortgage term.

(Where applicable) Value of the property assumed to prepare this information sheet: [insert amount]

(Where applicable) Maximum available loan amount relative to the value of the property [insert ratio] or Minimum value of the property required to borrow the illustrated amount [insert amount]

(Where applicable) [Security]

#### 4. Interest rate and other costs

The annual percentage rate of charge (APRC) is the total cost of the loan expressed as an annual percentage. The APRC is provided to help you to compare different offers.

The APRC applicable to your loan is [APRC].

It comprises:

Interest rate [value in percentage or, where applicable, indication of a reference rate and percentage value of creditor's spread]

[Other components of the APRC]

Costs to be paid on a one-off basis

(Where applicable) You will need to pay a fee to register the mortgage. [Insert amount of fee where known or basis for calculation.]

Costs to be paid regularly

(Where applicable) This APRC is calculated using assumptions regarding the interest rate.

(Where applicable) Because [part of] your loan is a variable interest rate loan, the actual APRC could be different from this APRC if the interest rate for your loan changes. For example, if the interest rate rose to [scenario as described in Part B], the APRC could increase to [insert illustrative APRC corresponding to the scenario].

(Where applicable) Please note that this APRC is calculated on the basis that the interest rate remains at the level fixed for the initial period throughout the duration of the contract.

(Where applicable) The following costs are not known to the lender and are therefore not included in the APRC: [Costs]

(Where applicable) You will need to pay a fee to register the mortgage.

Please make sure that you are aware of all other taxes and costs associated with your loan.

#### 5. Frequency and number of payments

Repayment frequency: [frequency]

Number of payments: [number]

#### 6. Amount of each instalment

[Amount] [currency]

Your income may change. Please consider whether you will still be able to afford your [frequency] repayment instalments if your income falls.

(Where applicable) Because [this/part of this] is an interest-only loan you will need to make separate arrangements to repay the [insert amount of loan on an interest-only basis] you will owe at the end of the mortgage term. Remember to add any extra payments you will need to make to the instalment amount shown here.

(Where applicable) The interest rate on [part of] this loan can change. This means the amount of your instalments could increase or decrease. For example, if the interest rate rose to [scenario as described in Part B] your payments could increase to [insert instalment amount corresponding to the scenario].

(Where applicable) The value of the amount you have to pay in [national currency of the borrower] each [frequency of instalment] could change. (Where applicable) Your payments could increase to [insert maximum amount in national currency of the borrower] each [insert period]. (Where applicable) For example, if the value of [national currency of the borrower] fell by 20 % relative to [credit currency] you would have to pay an extra [insert amount in national currency of the borrower] each [insert period]. Your payments could increase by more than this.

(Where applicable) The exchange rate used for converting your repayment in [credit currency] to [national currency of the borrower] will be the rate published by [name of institution publishing exchange rate] on [date] or will be calculated on [date] using [insert name of benchmark or method of calculation].

(Where applicable) [Details on tied savings products, deferred-interest loans]

#### 7. (Where applicable) Illustrative repayment table

This table shows the amount to be paid every [frequency].

The instalments (column [relevant no.]) are the sum of interest to be paid (column [relevant no.]), where applicable, capital paid (column [relevant no.]) and, where applicable, other costs (column [relevant no.]). (Where applicable) The costs in the other costs column relate to [list of costs]. Outstanding capital (column [relevant no.]) is the amount of the loan that remains to be reimbursed after each instalment.

[Table]

#### 8. Additional obligations

The borrower must comply with the following obligations in order to benefit from the lending

conditions described in this document.

[Obligations]

(Where applicable) Please note that the lending conditions described in this document (including the interest rate) may change if these obligations are not complied with.

(Where applicable) Please note the possible consequences of terminating at a later stage any of the ancillary services relating to the loan:

[Consequences]

#### 9. Early repayment

You have the possibility to repay this loan early, either fully or partially.

(Where applicable) [Conditions]

(Where applicable) Exit charge: [insert amount or, where not possible, the method of calculation]

(Where applicable) Should you decide to repay this loan early, please contact us to ascertain the exact level of the exit charge at that moment.

#### 10. Flexible features

(Where applicable) [Information on portability/subrogation] You have the possibility to transfer this loan to another [lender][or] [property]. [Insert conditions]

(Where applicable) You do not have the possibility to transfer this loan to another [lender] [or] [property].

(Where applicable) Additional features: [insert explanation of additional features listed in Part B and, optionally, any other features offered by the lender as part of the credit agreement not referred to in previous sections].

#### 11. Other rights of the borrower

You have [length of reflection period] after [point in time when the reflection period begins] to reflect before committing yourself to taking out this loan.

12. Complaints

If you have a complaint please contact [insert internal contact point and source of information on procedure].

(Where applicable) Maximum time for handling the complaint [period of time]

(Where applicable) [If we do not resolve the complaint to your satisfaction internally,] you can also contact: [insert name of external body for out-of-court complaints and redress]

(Where applicable) or you can contact FIN-NET for details of the equivalent body in your own country.

13. Non-compliance with the commitments linked to the loan: consequences for the borrower

[Types of non-compliance]

[Financial and/or legal consequences]

Should you encounter difficulties in making your [frequency] payments, please contact us straight away to explore possible solutions.

(Where applicable) As a last resort, your home may be repossessed if you do not keep up with payments.

(Where applicable) 14. Additional information

(Where applicable) [Indication of the law applicable to the credit contract].

(Where the lender intends to use a language different from the language of the ESIS) Information and contractual terms will be supplied in [language]. With your consent, we intend to communicate in [language/s] during the duration of the credit agreement.

[Insert statement on right to be provided with or offered, as applicable, a draft credit agreement]

15. Supervisor

This lender is supervised by [Name(s), and web address(es) of supervisory authority/ies]

(Where applicable) This credit intermediary is supervised by [Name and web address of supervisory authority].

5A R **Instructions to complete the ESIS**

Annex 2

[**Note:** Annex II Part B of the *MCD*]

**MCOB 5A Annex 2 R**

Instructions to complete the ESIS

1. This Annex belongs to *MCOB 5A.5.3 R(3)*.
2. Unless italicised the definitions used in the *MCD* apply.
3. Where the number of an instruction listed below is followed by a G that instruction is *guidance* rather than a *rule*.
4. Where the *MCD regulated mortgage contract* is divided into more than one part the required ESIS content must be set out in respect of each part.

Section 'Introductory text'

- (1) The validity date shall be properly highlighted. For the purpose of this section, the 'validity date' means the length of time the information, e.g. the borrowing rate, contained in the ESIS will remain unchanged and will apply should the creditor decide to grant the credit within this period of time. Where the determination of the applicable borrowing rate and other costs depends on the results of the selling of underlying bonds, the eventual borrowing rate and other costs may be different from those stated. In those circumstances only, it shall be stipulated that the validity date does not apply to the borrowing rate and other costs by adding the words: 'apart from the interest rate and other costs'.

Section '1. Lender'

- (1) Name, telephone number, and geographical address of the creditor shall refer to the contact information that the consumer may use for future correspondence.
- (2) Information on the e-mail address, fax number, web address and contact person/point is optional.
- (3) In line with Article 3 of Directive 2002/65/EC, where the transaction is being offered at a distance, the creditor shall indicate, where applicable, the name and geographical address of its representative in the Member State of residence of the consumer. Indication of the telephone number, e-mail address and web address of the representative of the credit provider is optional.

- (4) Where Section 2 is not applicable, the creditor shall inform the consumer whether advisory services are being provided and on what basis using the wording in *MCOB 5A Annex 1 R*.

(Where applicable) Section '2. Credit intermediary'

Where the product information is being provided to the consumer by a credit intermediary, that intermediary shall include the following information:

- (1) Name, telephone number and geographical address of the credit intermediary shall refer to the contact information that the consumer may use for future correspondence.
- (2) Information on the e-mail address, fax number, web address and contact person/point is optional.
- (3) The credit intermediary shall inform the consumer whether advisory services are being provided and on what basis using the wording in *MCOB 5A Annex 1 R*.

(3A) G In the event that the creditor provides the consumer with a binding offer and the characteristics of the offer are different from the information in the ESIS previously provided by the credit intermediary, if the credit intermediary confirms to the creditor that the revised transaction can proceed, the creditor may complete section 2 and update the wording referred to at (3) to say "[Name of credit intermediary] recommends ... / [Name of credit intermediary] is not recommending..." instead of "We recommend .../We are not recommending".

(4) An explanation of how the credit intermediary is being remunerated. Where it is receiving commission from a creditor, the amount and, where different from the name in Section 1, the name of the creditor shall be provided.

(5) The explanation of how the credit intermediary is being remunerated shall not include remuneration paid to a third party.

(6) The explanation of how the credit intermediary is being remunerated shall include a range or representative examples where the amount is unknown at the time of providing the ESIS.

Section '3. Main features of the loan'

- (1) This section shall clearly explain the main characteristics of the credit, including the value and currency and the potential risks associated with the borrowing rate, including the ones referred to in point (8), and amortisation structure.
- (2) Where the credit currency is different from the national currency of the consumer, the creditor shall indicate that the consumer will receive a regular warning at least when the exchange rate fluctuates by more than 20 %, where applicable the right to convert the currency of the credit agreement or to the possibility to renegotiate the conditions and any other arrangements available to the consumer to limit their exposure to exchange rate risk. Where there is a provision in the credit agreement to limit the exchange rate risk, the creditor shall indicate the maximum amount the consumer could have to pay back. Where there is no provision in the credit agreement to limit the exchange rate risk to which the consumer is exposed to a fluctuation in the exchange rate of less than 20 %, the creditor shall indicate an illustration of the effect of a 20 % fall in the value of consumer's national currency relative to the credit currency on the value of the credit.

- (3) The duration of the credit shall be expressed in years or months (or a combination of the two), whichever is the most relevant. Where the duration of the credit can vary during the lifetime of the contract, the creditor shall explain when and under which conditions this can occur. Where the credit is open-ended, for example, for a secured credit card, the creditor shall clearly state that fact.
- (4) The type of credit shall be clearly indicated (e.g. mortgage credit, home loan, secured credit card). The description of the type of credit shall clearly indicate how the capital and the interest shall be reimbursed during the life of the credit (i.e. the amortisation structure), specifying clearly whether the credit agreement is on capital repayment or interest-only basis, or a mixture of the two.
- (5) Where all or part of the credit is an interest-only credit, a statement clearly indicating that fact shall be inserted prominently at the end of this section using the wording in *MCOB 5A Annex 1 R*.
- (6) This section shall explain whether the borrowing rate is fixed or variable and, where applicable, the periods during which it will remain fixed; the frequency of subsequent revisions and the existence of limits to the borrowing rate variability, such as caps or floors.

The formula used to revise the borrowing rate and its different components (e.g. reference rate, interest rate spread) shall be explained. The creditor shall indicate, e.g. by means of a web address, where further information on the indices or rates used in the formula can be found, e.g. Euribor or central bank reference rate.

- (7) If different borrowing rates apply in different circumstances, the information shall be provided on all applicable rates.
- (8) The 'total amount to be reimbursed' corresponds to the total amount payable by the consumer. It shall be shown as the sum of the credit amount and the total cost of the credit to the consumer. Where the borrowing rate is not fixed for the duration of the contract, it shall be highlighted that this amount is illustrative and may vary in particular in relation with the variation in the borrowing rate.
- (9) Where the credit will be secured by a mortgage on the immovable property or another comparable security or by a right related to immovable property, the creditor shall draw the consumer's attention to this. Where applicable the creditor shall indicate the assumed value of the immovable property or other security used for the purpose of preparing this information sheet.

(9A) G In order for the *firm* to comply with the principle of 'fair, clear and not misleading' in *MCOB 3A.2.1R(1)* an estimated valuation, where the estimated valuation is not that provided by the *consumer*, must be a reasonable assessment based on all the facts available at the time. For example, an overstated valuation could enable a more attractive *MCD regulated mortgage contract* to be illustrated on the basis of a lower ratio of the loan amount to the property value - for example, one with a lower rate of interest, or without a *higher lending charge*.

- (10) The creditor shall indicate, where applicable, either:

- a) ‘maximum available loan amount relative to the value of the property’, indicating the loan-to-value ratio. This ratio is to be accompanied by an example in absolute terms of the maximum amount that can be borrowed for a given property value; or
- b) the ‘minimum value of the property required by the creditor to lend the illustrated amount’.

(11) Where credits are multi-part credits (e.g. concurrently part fixed rate, part variable rate), this shall be reflected in the indication of the type of credit and the required information shall be given for each part of the credit.

(12) The amount of the loan to be granted is:

a) in cases where on the basis of the information obtained from the consumer before providing the ESIS it is clear that the consumer would not be eligible to borrow the amount he requested, an estimate of the amount that the consumer could borrow based on the information obtained from the consumer, this does not require information to be obtained from the consumer before providing an ESIS in order to ascertain the amount the customer is eligible to borrow, instead, this means that a firm does not have to provide a consumer with an ESIS for an amount it knows the customer would not be eligible for, based on whatever information it has obtained from the customer before providing the ESIS; or

b) where the *MCD regulated mortgage contract* is a revolving credit agreement such as a secured overdraft or *mortgage credit card*, the total borrowing that the *firm* is willing to provide under the *MCD regulated mortgage contract*; or

c) where it is known that the loan will be released in instalments, for example in the case of a self-build mortgage:

i) where the lender has made a binding offer for the full amount , the total amount of the loan required and not the amount of the initial instalment;

ii) where the lender has made a binding offer for an initial amount, the initial amount; and

iii) where the lender’s binding offer for an initial amount has been replaced by a binding offer for a larger amount , the larger amount.

#### Section ‘4. Interest rate’ and other costs

(1) The reference to ‘interest rate’ corresponds to the borrowing rate or rates.

(2) The borrowing rate shall be mentioned as a percentage value. Where the borrowing rate is variable and based on a reference rate the creditor may indicate the borrowing rate by stating a reference rate and a percentage value of creditor’s spread. The creditor shall however indicate the value of the reference rate valid on the day of issuing the ESIS.

Where the borrowing rate is variable the information shall include: (a) the assumptions used to calculate the APRC; (b) where relevant, the applicable caps and floors and (c) a warning that the variability could affect the actual level of the APRC. In order to attract the consumer’s attention the font size used for the warning shall be bigger and shall figure prominently in the main body of the ESIS. The warning shall be accompanied by an illustrative example on the APRC. Where there is a cap on the borrowing rate, the example

shall assume that the borrowing rate rises at the earliest possible opportunity to the highest level foreseen in the credit agreement. Where there is no cap the example shall illustrate the APRC at the highest borrowing rate in at least the last 20 years, or where the underlying data for the calculation of the borrowing rate is available for a period of less than 20 years the longest period for which such data is available, based on the highest value of any external reference rate used in calculating the borrowing rate where applicable or the highest value of a benchmark rate specified by the *FCA* or another competent authority or *EBA* where the creditor does not use an external reference rate. Such requirement shall not apply to credit agreements where the borrowing rate is fixed for a material initial period of several years and may then be fixed for a further period following negotiation between the creditor and the consumer. For credit agreements where the borrowing rate is fixed for a material initial period of several years and may then be fixed for a further period following negotiation between the creditor and the consumer, the information shall include a warning that the APRC is calculated on the basis of the borrowing rate for the initial period. The warning shall be accompanied by an additional, illustrative APRC calculated in accordance with *MCOB* 10A.1.4 R. Where credits are multi-part credits (e.g. concurrently part fixed rate, part variable rate), the information shall be given for each part of the credit. However, the additional illustrative APRC shall be calculated and stated once in respect of the entire credit agreement.

(2A) The *FCA*'s benchmark rate is the difference between the Bank of England's base rate on the date the *ESIS* is issued and the highest value of the Bank of England's base rate over at least the last 20 years, added to the borrowing rate shown in the *ESIS*.

(2B) When more than one interest rate applies during the term of the loan, for example, because there is an initial fixed or discounted interest rate period, the *FCA*'s benchmark rate shall be calculated by reference to the reversionary borrowing rate shown in the *ESIS*.

(2C) G When calculating the *FCA*'s benchmark rate:

(a) the last 20 years may be calculated from up to three *months* prior to the date the *ESIS* is issued; and

(b) the period for calculating the *FCA*'s benchmark rate may be extended beyond the last 20 years to any period longer than 20 years.

(2D) In the event of a scenario in column (1) in the table below, the illustrative example of the APRC (the additional APRC) shall be calculated in accordance with column (2) of that table.

Scenario	Calculation of additional APRC  <b>N.B. A creditor's standard variable rate is not to be used as an external reference rate (ERR)</b>
1. Mortgage with an interest rate cap	Calculate the APRC based on the borrowing rate rising at the earliest possible opportunity to the level of the cap.
2. Where the product is not linked to an ERR	Use the <i>FCA</i> 's benchmark rate.

3. Creditor uses an ERR and has 20 years of data relating to the margin applied by the creditor	Use the highest ERR in the previous 20 years, and apply the highest margin over that or lowest margin under it, to produce the highest additional APRC.
4. Creditor uses an ERR and has less than 20 years of data relating to the margin applied by the creditor	Use the highest ERR in the previous 20 years, and apply the highest margin over that or lowest margin under it, used in the period of data available, to produce the highest additional APRC.
5. Creditor comprises a group which contains separate legal entities or comprises distinct product brands and has 20 years of data relating to the margin applied by that legal entity or product brand. It may have similar products across entities or brands within the same group or company with different margins above or below the ERR.	Use the highest ERR in the previous 20 years with respect to the pricing approach for the specific legal entity or product brand and apply the highest margin over that or lowest margin under it to produce the highest additional APRC
6. Creditor comprises a group which contains separate legal entities or comprises distinct product brands and has less than 20 years of data relating to the margin applied by that legal entity or product brand. It may have similar	Use the highest ERR in the previous 20 years with respect to the pricing approach for the specific legal entity or product brand and apply the highest margin over that or lowest margin under it used in the period of data available to produce the highest additional APRC.

products across entities or brands within the same group or company with different margins above or below the ERR.	
7. Creditor has previously purchased a brand that uses an ERR and has 20 years of data relating to the margin applied by the creditor for same product	Where the purchaser is carrying on new lending under the purchased brand - same as above, using previous firm's data where relevant and where it may be reasonably obtained.
8. Creditor has previously purchased a brand that uses an ERR and has less than 20 years of data relating to the margin applied by the creditor for same product	Where the purchaser is carrying on new lending under the purchased brand - same as above, using previous firm's data where relevant and where it may be reasonably obtained. Otherwise use the FCA's benchmark rate.
9. Creditor has different ERR calculation methods that apply over time (e.g. 0.5% over Bank of England rate for the first two years and then 2% over Bank of England rate for the rest of the mortgage lifetime)	Calculate using the method which produces the highest additional APRC
10. Creditor has different methods that apply to different proportions of the principal (e.g. ERR + x% applies to 50% principal and SVR applies to the other 50%)	Calculate using the ERR where applicable and the FCA's benchmark rate where applicable, and use both to calculate the illustrative APRC.
11. Creditor uses an ERR where its basis has changed in the past 20 years	Consider whether there was an equivalent predecessor ERR, and use the ERR (and its equivalent predecessor(s) if any) provided that it (or they) have existed at least 20 years, otherwise use the FCA's benchmark rate.

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- (3) In the section on ‘other components of the APRC’ all the other costs contained in the APRC shall be listed, including one-off costs such as administration fees, and regular costs, such as annual administration fees. The creditor shall list each of the costs by category (costs to be paid on a one-off basis, costs to be paid regularly and included in the instalments, costs to be paid regularly but not included in the instalments), indicating their amount, to whom they are to be paid and when. This does not have to include costs incurred for breaches of contractual obligations. Where the amount is not known, the creditor shall provide an indication of the amount if possible, or if not possible, how the amount will be calculated and specify that the amount provided is indicative only. Where certain costs are not included in the APRC because they are unknown to the creditor, this shall be highlighted.

Where the consumer has informed the creditor of one or more components of his preferred credit, such as the duration of the credit agreement and the total amount of credit, the creditor shall, where possible, use those components; if a credit agreement provides different ways of drawdown with different charges or borrowing rates and the creditor uses the assumptions set out in *MCOB* 10.3.1 R, it shall indicate that other drawdown mechanisms for this type of credit agreement may result in a higher APRC. Where the conditions for drawdown are used for calculating the APRC, the creditor shall highlight the charges associated with other drawdown mechanisms that are not necessarily the ones used in calculating the APRC.

- (4) Where a fee is payable for registration of the mortgage or comparable security that shall be disclosed in this section with the amount, where known, or where this is not possible the basis for determining the amount. Where the fees are known and included in the APRC the existence and amount of the fee shall be listed under ‘Costs to be paid on a one-off basis’. Where the fees are not known to the creditor and therefore not included in the APRC the existence of the fee shall be clearly mentioned in the list of costs which are not known to the creditor. In either case the standardised wording in *MCOB* 5A Annex 1 R shall be used under the appropriate heading.

#### Section ‘5. Frequency and number of payments’

- (1) Where payments are to be made on a regular basis, the frequency of payments shall be indicated (e.g. monthly). Where the frequency of payments will be irregular, this shall be clearly explained to the consumer.
- (2) The number of payments indicated shall cover the whole duration of the credit.

#### Section ‘6. Amount of each instalment’

- (1) The credit currency and currency of the instalments shall be clearly indicated.
- (2) Where the amount of the instalments may change during the life of the credit, the creditor shall specify the period during which that initial instalment amount will remain unchanged and when and how frequently afterwards it will change.

- (3) Where all or part of the credit is an interest-only credit, a statement clearly indicating that fact, shall be inserted prominently at the end of this section using the wording in *MCOB 5A Annex 1 R*.

If there is a requirement for the consumer to take out a tied savings product as a condition for being granted an interest-only credit secured by a mortgage or another comparable security, the amount and frequency of any payments for this product shall be provided.

- (4) Where the borrowing rate is variable the information shall include a statement indicating that fact, using the wording in *MCOB 5A Annex 1 R* and an illustration of a maximum instalment amount. Where there is a cap, the illustration shall show the amount of the instalments if the borrowing rate rises to the level of the cap. Where there is no cap, the worst case scenario shall illustrate the level of instalments at the highest borrowing rate in the last 20 years, or where the underlying data for the calculation of the borrowing rate is available for a period of less than 20 years the longest period for which such data is available, based on the highest value of any external reference rate used in calculating the borrowing rate where applicable, or the highest value of a benchmark rate specified by a competent authority or EBA where the creditor does not use an external reference rate. The requirement to provide an illustrative example shall not apply to credit agreements where the borrowing rate is fixed for a material initial period of several years and may then be fixed for a further period following negotiation between the creditor and the consumer. Where credits are multi-part credits (e.g. concurrently part fixed rate, part variable rate), the information shall be given for each part of the credit, and in total.
- (5) (Where applicable) Where the credit currency is different from the consumer's national currency or where the credit is indexed to a currency which is different from the consumer's national currency, the creditor shall include a numerical example clearly showing how changes to the relevant exchange rate may affect the amount of the instalments using the wording in *MCOB 5A Annex 1 R*. That example shall be based on a 20 % reduction in the value of the consumer's national currency together with a prominent statement that the instalments could increase by more than the amount assumed in that example. Where there is a cap which limits that increase to less than 20 %, the maximum value of the payments in the consumer's currency shall be given instead and the statement on the possibility of further increases omitted.
- (6) Where the credit is fully or partly a variable rate credit and point 3 applies, the illustration in point 5 shall be given on the basis of the instalment amount referred to in point 1.
- (7) Where the currency used for the payment of instalments is different from the credit currency or where the amount of each instalment expressed in the consumer's national currency depends on the corresponding amount in a different currency, this section shall indicate the date at which the applicable exchange rate is calculated and either the exchange rate or the basis on which it will be calculated and the frequency of their adjustment. Where applicable such indication shall include the name of institution publishing the exchange rate.
- (8) Where the credit is a deferred-interest credit under which interest due is not fully repaid by the instalments and is added to the total amount of credit outstanding, there shall be an explanation of: how and when deferred interest is added to the credit as a cash amount; and what the implications are for the consumer in terms of their remaining debt.

Section '7. Illustrative repayment table'

- (1) This section shall be included where the credit is a deferred interest credit under which interest due is not fully repaid by the instalments and is added to the total amount of credit outstanding or where the borrowing rate is fixed for the duration of the credit agreement. Where the consumer has the right to receive a revised amortisation table, this shall be indicated along with the conditions under which the consumer has that right.
- (2) The table to be included in this section shall contain the following columns: ‘repayment schedule’ (e.g. month 1, month 2, month 3), ‘amount of the instalment’, ‘interest to be paid per instalment’, ‘other costs included in the instalment’ (where relevant), ‘capital repaid per instalment’ and ‘outstanding capital after each instalment’.
- (3) For the first repayment year the information shall be given for each instalment and a subtotal shall be indicated for each of the columns at the end of that first year. For the following years, the detail can be provided on an annual basis. An overall total row shall be added at the end of the table and shall provide the total amounts for each column. The total cost of the credit paid by the consumer (i.e. the overall sum of the ‘amount of the instalment’ column) shall be clearly highlighted and presented as such.
- (4) Where the borrowing rate is subject to revision and the amount of the instalment after each revision is unknown, the creditor may indicate in the amortisation table the same instalment amount for the whole credit duration. In such a case, the creditor shall draw that fact to the attention of the consumer by visually differentiating the amounts which are known from the hypothetical ones (e.g. using a different font, borders or shading). In addition, a clearly legible text shall explain for which periods the amounts represented in the table may vary and why.

#### Section ‘8. Additional obligations’

- (1) The creditor shall refer in this section to obligations such as the obligation to insure the immovable property, to purchase life insurance, to have a salary paid into an account with the creditor or to buy any other product or service. For each obligation, the creditor shall specify towards whom and by when the obligation needs to be fulfilled.
- (2) The creditor shall specify the duration of the obligation, e.g. until the end of the credit agreement. The creditor shall specify for each obligation any costs to be paid by the consumer, which are not included in the APRC.
- (3) The creditor shall state whether it is compulsory for the consumer to hold any ancillary services to obtain the credit on the stated terms, and if so whether the consumer is obliged to purchase them from the creditor’s preferred supplier or whether they may be purchased from a provider of consumer’s choice. Where such possibility is conditional on the ancillary services meeting certain minimum characteristics, such characteristics shall be described in this section.

Where the credit agreement is bundled with other products the creditor shall state the key features of those other products and clearly state whether the consumer has a right to terminate the credit agreement or the bundled products separately, the conditions for and implications of doing so, and, where applicable, of the possible consequences of terminating the ancillary services required in connection with the credit agreement.

#### Section ‘9. Early repayment’

- (1) The creditor shall indicate under what conditions the consumer can repay the credit early, either fully or partially.
- (2) In the section on exit charges the creditor shall draw the consumer's attention to any exit charge or other costs payable on early repayment in order to compensate the creditor and where possible indicate their amount. In cases where the amount of compensation would depend on different factors, such as the amount repaid or the prevailing interest rate at the moment of the early repayment, the creditor shall indicate how the compensation will be calculated and provide the maximum amount that the charge might be, or where this is not possible, an illustrative example in order to demonstrate to the consumer the level of compensation under different possible scenarios.

#### Section '10. Flexible features'

- (1) Where applicable, the creditor shall explain the possibility to and conditions for transferring the credit to another creditor or immovable property.
- (2) (Where appropriate) Additional features: Where the product contains any of the features listed in point 5, this section must list these features and provide a brief explanation of: the circumstances in which the consumer can use the feature; any conditions attached to the feature; if the feature being part of the credit secured by a mortgage or comparable security means that the consumer loses any statutory or other protections usually associated with the feature; and the firm providing the feature (if not the creditor).
- (3) If the feature contains any additional credit, then this section must explain to the consumer: the total amount of credit (including the credit secured by the mortgage or comparable security); whether the additional credit is secured or not; the relevant borrowing rates; and whether it is regulated or not. Such additional credit amount shall either be included in the original creditworthiness assessment or, if it is not, this section shall make clear that the availability of the additional amount is dependent on a further assessment of the consumer's ability to repay.
- (4) If the feature involves a savings vehicle, the relevant interest rate must be explained.
- (5) The possible additional features are: 'Overpayments/Underpayments' [paying more or less than the instalment ordinarily required by the amortisation structure]; 'Payment holidays' [periods where the consumer is not required to make payments]; 'Borrow back' [ability for the consumer to borrow again funds already drawn down and repaid]; 'Additional borrowing available without further approval'; 'Additional secured or unsecured borrowing' [in accordance with point 3 above]; 'Credit card'; 'Linked current account'; and 'Linked savings account'.
- (6) The creditor may include any other features offered by the creditor as part of the credit agreement not mentioned in previous sections.

#### Section '11. Other rights of the borrower'

- (1) The creditor shall clarify the right of withdrawal and where applicable other rights such as, portability (including subrogation) that exist, specify the conditions to which this/these right(s) is subject, the procedure that the consumer will need to follow in order to exercise this/these right(s), inter alia, the address to which the notification of withdrawal shall be sent, and the corresponding fees (where applicable).
- (2) Where a reflection period for the consumer applies this shall be clearly mentioned.
- (3) In line with Article 3 of Directive 2002/65/EC, where the transaction is being offered at a distance, the consumer shall be informed of the absence of a right of withdrawal.

#### Section ‘12. Complaints’

- (1) This Section shall indicate the internal contact point [name of the relevant department] and a means of contacting them to complain [Geographical address] or [Telephone number] or [Contact person:] [contact details] and a link to the complaints procedure on the relevant page of a website or similar information source.
  - (1A) The information required by (1) is in respect of the firm providing the ESIS.
  - (2) It shall indicate the name of the relevant external body for out-of-court complaints and redress and where using the internal complaint procedure is a precondition for access to that body, indicate that fact using the wording in *MCOB 5A Annex 1 R*.
  - (3) In the case of credit agreements with a consumer who is resident in another Member State, the creditor shall refer to the existence of FIN-NET ([http://ec.europa.eu/internal\\_market/fin-net/](http://ec.europa.eu/internal_market/fin-net/)).

#### Section ‘13. Non-compliance with the commitments linked to the credit: consequences for the borrower’

- (1) Where non-observance of any of the consumer’s obligations linked to the credit may have financial or legal consequences for the consumer, the creditor shall describe in this section the different main cases (e.g. late payments/ default, failure to respect the obligations set out in Section 8 ‘Additional obligations’) and indicate where further information could be obtained.
  - (1A) The disclosure required by (1) relates to “main cases” rather than every case.
  - (2) (For each of those cases, the creditor shall specify, in clear, easy comprehensible terms, the sanctions or consequences to which they may give rise. Reference to serious consequences shall be highlighted.
    - (2A) The description required by (2) must be a summary which can be read and understood on its own. The detail can be provided separately in the terms and conditions.
- (3) Where the immovable property used to secure the credit may be returned or transferred to the creditor, if the consumer does not comply with the obligations, this section shall include a statement indicating that fact, using the wording in *MCOB 5A Annex 1 R*.

#### Section '14. Additional information'

- (1) In the case of distance marketing, this section will include any clause stipulating the law applicable to the credit agreement or the competent court.
- (2) Where the creditor intends to communicate with the consumer during the life of the contract in a language different from the language of the ESIS that fact shall be included and the language of communication named. This is without prejudice to point (g) of point 3 of paragraph 1 of Article 3 of Directive 2002/65/EC.
- (3) The creditor or credit intermediary shall state the consumer's right to be provided with or offered, as applicable, a copy of the draft credit agreement at least once an offer binding on the creditor has been made.

#### Section '15. Supervisor'

- (1) The relevant authority or authorities for the supervision of the pre-contractual stage of lending shall be indicated.

...

- 6.1.1 R Subject to MCOB 6.1.2A R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 6.1.2 R* in accordance with column (2) of that table.

...

- 6.1.2A R This chapter does not apply to a *firm* that is a *MCD lender*.

...

- 6.3.1 G [deleted]

...

**Insert MCOB 6A after MCOB 6. The text in MCOB 6A is new and is not underlined.**

**6A MCD Disclosure at the offer stage**

**6A.1 Application and purpose**

6A.1.1 R This chapter applies to a *firm* that is a *MCD mortgage lender*.

6A.1.2 R This chapter applies with respect to an offer made by a *firm* to a *consumer* with a view to the *firm*:

- (1) entering into a *MCD mortgage contract*;

- (2) varying the terms of a *MCD mortgage contract* entered into by the *consumer* in any of the following ways:
  - (a) adding or removing a party;
  - (b) making a further advance; or
  - (c) switching all or part of the *MCD regulated mortgage contract* from one interest rate to another;

(whether or not the *consumer* agrees to enter into the *MCD regulated mortgage contract* or variation).

- 6A.1.3 R In *MCOB 6A*, a reference to an offer to enter into a *MCD regulated mortgage contract* is to be read as including a reference to an offer to vary an existing *MCD regulated mortgage* in a manner specified in this section if the context so requires.
- 6A.1.4 G *MCOB 6A* amplifies *Principle 6* and *Principle 7*. The purpose of *MCOB 6A* is to ensure that a *customer* receives a clear *offer document* to enable him to check the features and price of the *MCD regulated mortgage contract* before he enters into it

## 6A.2 **General**

- 6A.2.1 R Any *communication* required by *MCOB 6A* to be given to a *consumer* by a *firm* must be in a *durable medium*.

[**Note:** article 14(3) of the *MCD*]

## 6A.3 **MCD Mortgages: binding offer, content of the offer document and reflection period**

- 6A.3.1 R
  - (1) If a *firm* offers to enter into a *MCD regulated mortgage contract* with a *consumer*, it must provide the *customer* with a binding offer set out in an *offer document*.
  - (2) The *firm* may also provide an *ESIS*.
  - (3) The *firm's* offer in the *offer document* must be on the basis of the information set out in the *ESIS* relevant to that offer.
- 6A.3.2 R When a *MCD mortgage lender* provides the *consumer* with a binding offer, that offer must be accompanied by an *ESIS* where the characteristics of the offer are different from the information contained in the *ESIS* previously provided.

[**Note:** articles 14(3)(b) and 14(4) of the *MCD*]

- 6A.3.3 G (1) Where a *MCD mortgage lender* makes an offer that is subject to conditions (for example in respect of valuation or legal searches), when those conditions have been satisfied the *MCD mortgage lender* may satisfy the requirement at *MCOB* 6A.3.1 R by either:
- (a) confirming that it is now willing to be bound by the previously conditional offer; or
  - (b) making a new binding offer.

### **Reflection period**

- 6A.3.4 R (1) Where a *MCD mortgage lender* provides the *consumer* with a binding offer, it must give the *consumer* a reflection period of at least seven *days*.
- (2) The *MCD mortgage lender* must ensure that during the reflection period:
- (a) the offer remains binding on the *MCD mortgage lender*;
  - (b) the *consumer* may accept the offer at any time.

[**Note:** article 14(6) of the *MCD*]

- 6A.3.5 G The purpose of the reflection period is to provide the *consumer* with sufficient time to compare offers, assess their implications and make an informed decision.

- 6A.3.6 R A *firm* must provide the *consumer* with a copy of the draft *MCD regulated mortgage contract* at the beginning of the reflection period.

[**Note:** article 14(11) of the *MCD*]

### Self-build mortgages and other tranching forms of lending

- 6A.3.7 G Where it is known that a loan will be released in instalments, for example in the case of a self-build mortgage, the loan can involve either:
- (1) a binding offer, *ESIS* and reflection period for the full amount; or
  - (2) a binding offer, *ESIS* and reflection period for an initial amount, which would be replaced by a binding offer, *ESIS* and reflection period for a larger amount and so on.

### **Records**

- 6A.3.8 R (1) A *firm* must make an adequate record of each *offer document* which it issues to a *consumer* in accordance with *MCOB* 6A.

- (2) The record required by (1) must be retained for a year from the date that the *offer document* is issued to the *consumer*.
- (3) If, in accordance with *MCOB* 6A.4 (Information to be provided in the offer document or separately), information is included in a separate document that is sent with the *offer document*, that information must also be retained as part of the record required by (1).

**Information contained in the offer**

- 6A.3.9 R A *firm* must ensure that the *offer document* contains a prominent statement:
- (1) of the period for which the offer is valid;
  - (2) explaining, where the *MCD regulated mortgage contract* contains features, such as additional unsecured borrowing facilities, which could result in the *consumer* borrowing more money, that where such features are used, the amount of the *consumer's* debt will increase;
  - (3) explaining when any interest rate change on the *MCD regulated mortgage contract* takes effect. This statement must be used, for example, to explain cases where an annual review system is used;
  - (4) explaining the consequences that might arise from the *consumer* not entering into the *MCD regulated mortgage contract*, including any fees that the *consumer* has paid which will not be reimbursed;
  - (5) explaining that once the *MCD regulated mortgage contract* is concluded there will be no right of withdrawal; and
  - (6) explaining that although no right of withdrawal exists the *consumer* will have a right to repay the *MCD regulated mortgage contract* in accordance with the terms of the *MCD regulated mortgage contract*.
- 6A.3.10 G When setting the period for which the offer is valid referred to at *MCOB* 6A.3.9 R(1), a *firm* should bear in mind the requirement under *MCOB* 6A.3.4 R for a reflection period.
- 6A.3.11 R The *offer document* must state the *repayment strategy* the *consumer* intends to use.
- 6A.3.12 R The *offer document* may contain information about any retentions or reinspections that will be required by the *firm*
- 6A.3.14 R A *firm* must ensure that the *offer document* includes information on how to complain to the *firm* about the services provided by the *firm* in relation to the *MCD regulated mortgage contract* and whether or not complaints may subsequently be referred to the *Financial Ombudsman Service*.
- 6A.3.15 G *DISP* 1 requires a *firm* to deal promptly and fairly with *complaints*, including referring to another *firm's* *complaints* about that other *firm's* services.

- 6A.3.16 G In addition to the information required by *MCOB* 6A.3.9 R, a *firm* may include information about how to complain to any other *firm* about the services that firm provided to the *consumer* in relation to the *MCD regulated mortgage contract*. For example, where the *consumer* received advice from another *firm*, a *MCD mortgage lender* may include contact details for the *firm* that provided the advice.
- 6A.3.17 R If the *firm* knows at the point that the offer is made to the *consumer* that its interest in the *MCD regulated mortgage contract* will be assigned (by sale or transfer) and the *firm* will no longer be responsible for setting interest rates and charges, the *offer document* must:
- (1) state this; and
  - (2) state, where known, who will be responsible for setting interest rates and charges after the sale or transfer.
- 6A.3.18 R Where *MCOB* 6A.3.17 R applies, if the name of the party who will be responsible for setting interest rates and charges after the sale or transfer is not known at the point the offer is made, the *firm* must notify the *consumer* of this as soon as it becomes known.
- 6A.3.19 G *MCOB* 6A.3.17 R and *MCOB* 6A.3.18 R could apply where the ownership of a *MCD regulated mortgage contract* is transferred to a third party through *securitisation*.

6A.4 **MCD Mortgages: information to be provided in the offer document or separately**

**Tariff of charges**

- 6A.4.1 R If a *firm* makes an offer to a *consumer* with a view to entering into a *MCD regulated mortgage contract*, it must provide the *consumer*, along with the *offer document*, with a *tariff of charges* that could be incurred on the *regulated mortgage contract*.
- 6A.4.2 R If the *MCD regulated mortgage contract* has any *linked borrowing* or *linked deposits*, details of the charges on these linked facilities, for example charges payable on a linked current account, must be included in the *firm's tariff of charges*.
- 6A.4.3 G A *firm* may include the *tariff of charges* as an integral part of the *offer document*, or provide it separately along with the *offer document*.

**Mortgage credit cards**

- 6A.4.4 R If a *firm* makes an offer to a *consumer* with a view to entering into a *MCD regulated mortgage contract* that includes a *mortgage credit card*, it must provide the *customer* with information explaining that the card will not give

the *customer* the statutory rights associated with traditional credit cards.

6A.4.5 G A *firm* may include the information described in *MCOB 6A.4.4 R* as an integral part of the *offer document*, or provide it separately along with the *offer document*.

## 6A.5 MCD distance contracts with retail customers

6A.5.1 R If a *firm* makes an offer to a *consumer* with a view to entering into a *MCD regulated mortgage contract* which is a *distance contract*, it must provide the *consumer* with the following information with the *offer document*:

- (1) the *EEA State* or States whose laws are taken by the *firm* as a basis for the establishment of relations with the *consumer* prior to the conclusion of the *MCD regulated mortgage contract*;
- (2) any contractual clause on law applicable to the *MCD regulated mortgage contract* or on competent court, or both;
- (3) the language in which the contract is supplied and in which the *firm* will communicate during the course of the *MCD regulated mortgage contract*; and
- (4) if not provided previously:
  - (a) all of the contractual terms and conditions of the *MCD regulated mortgage contract* to which the *offer document* relates; and
  - (b)
    - (i) an appropriate status disclosure statement (compliant with *GEN 4*) for the *MCD mortgage lender*;
    - (ii) the *MCD mortgage lender's* Firm Reference Number; and
    - (iii) confirmation that the *customer* can check the *Financial Services Register* on the *FCA's* website [www.fca.org.uk/firms/systems-reporting/register](http://www.fca.org.uk/firms/systems-reporting/register) or by contacting the *FCA* on 0800 111 6768.

...

7.1.1 R Subject to *MCOB 7.1.2A R*, this chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 7.1.2 R* in accordance with column (2) of that table.

...

7.1.2A R *MCOB 7.6.7 R* to *MCOB 7.6.17 R* do not apply to a *firm* that is a *MCD*

mortgage lender or MCD credit intermediary.

7.1.2B G MCOB 7B applies to a firm that is a MCD mortgage lender or MCD credit intermediary instead of MCOB 7.6.7 R to MCOB 7.6.17 R

...

#### Rate switches

7.6.18 R Before a *customer* submits an application to a *firm* to change all or part of a *regulated mortgage contract* from one interest rate to another (for example, a transfer from a variable rate *regulated mortgage contract* to a fixed rate *regulated mortgage contract*, or from one fixed rate *regulated mortgage contract* to another fixed rate *regulated mortgage contract*), the *firm* must provide the *customer* with either:

(1) an *illustration* for the whole loan that complies with the requirements of *MCOB 5* (Pre-application disclosure); or

(2) an *ESIS* for the whole loan that complies with the requirements of *MCOB 5A* (MCD Pre-application disclosure),

unless such an *illustration* or *ESIS* has already been provided.

7.6.19 G If a number of different *firms* are involved in relation to the transaction referred to in *MCOB 7.6.18 R*, having regard to *MCOB 2.5.4 R(2)*, those *firms* should take reasonable steps to establish which one of them is responsible for providing the *customer* with the *illustration* or *ESIS* required by *MCOB 7.6.18 R*.

7.6.20 R (1) The *illustration* provided in accordance with *MCOB 7.6.18 R(1)* may diverge from the requirements of *MCOB 5* where it is necessary to do so in order to reflect the fact that the *illustration* is being provided for a rate switch.

(2) The *ESIS* provided in accordance with *MCOB 7.6.18 R(2)* may diverge from the requirements of *MCOB 5A* where it is necessary to do so in order to reflect the fact that the *ESIS* is being provided for a rate switch.

7.6.21 G *MCOB 7.6.20 R(1)* and *MCOB 7.6.20 R(2)* allows a *firm* to make changes to wording and to add, remove or alter information that would otherwise be misleading to the *customer*. For example, a *firm* could replace the statement in Section 3 of the *illustration*, explaining that if information provided by the *customer* changes, the *illustration* may be affected, with a statement explaining that the *illustration* is based on information gathered in the past, which may no longer be accurate.

#### Addition or removal of a party to the contract

7.6.22 R Before a *customer* submits an application to add or remove a party to a *regulated mortgage contract*, a *firm* must provide any *customer* who

will remain or become a party to the contract with either:

- (1) an *illustration* for the whole loan that complies with the requirements of *MCOB 5* (Pre-application disclosure); or
- (2) an *ESIS* for the whole loan which complies with the requirements of *MCOB 5A* (MCD Pre-application disclosure).

...

7.6.24 G If a number of different *firms* are involved in relation to the transaction referred to in *MCOB 7.6.22 R*, having regard to *MCOB 2.5.4 R(2)*, those *firms* should take reasonable steps to establish which one of them is responsible for providing the *customer* with the *illustration* or *ESIS* required by *MCOB 7.6.22 R*.

7.6.25 R (1) The *illustration* provided in accordance with *MCOB 7.6.22 R* (1) may diverge from the requirements of *MCOB 5* (Pre-application disclosure) where it is necessary to do so in order to reflect the fact that the *illustration* is being provided in respect of the addition or removal of a party to the contract.

(2) The *ESIS* provided in accordance with *MCOB 7.6.22 R(2)* may diverge from the requirements of *MCOB 5A* (MCD Pre-application disclosure) where it is necessary to do so in order to reflect the fact that the *ESIS* is being provided in respect of the addition or removal of a party to the contract.

7.6.26 G *MCOB 7.6.25 R(1)* and *MCOB 7.6.25 R(2)* allows the *firm* to make changes to wording and to add, remove or alter information that would otherwise be misleading to the *customer*. For example, a *firm* may choose not to include a property valuation in the 'What you have told us' section of the *illustration* if the property value does not have a bearing on the terms of the *regulated mortgage contract*.

...

Use of illustrations or *ESISs* in place of information under *MCOB 7.6.28R*

7.6.31 R Where *MCOB 7.6.28 R* applies, a *firm* may issue either:

- (1) an *illustration* in accordance with *MCOB 5* (Pre-application disclosure); or
- (2) an *ESIS* in accordance with *MCOB 5A* (MCD Pre-application disclosure).

in place of the information set out in *MCOB 7.6.28 R*.

7.6.31A R (1) The *illustration* provided in accordance with *MCOB 7.6.31 R(1)* may diverge from the requirements of *MCOB 5* (Pre-application disclosure) where it is necessary to do so in order

to reflect the circumstances in which it is being provided.

- (2) The *ESIS* provided in accordance with *MCOB 7.6.31 R(2)* may diverge from the requirements of *MCOB 5A (MCD Pre-application disclosure)* where it is necessary to do so in order to reflect the circumstances in which it is being provided.

7.6.31B G *MCOB 7.6.31A R(1)* and *MCOB 7.6.31A R(2)* allow the *firm* to make changes to wording and to add, remove or alter information that would otherwise be misleading to the *customer*.

7.6.32 R Where *MCOB 7.6.28 R* applies and the *customer* simultaneously requests a rate switch or the addition or removal of a party to the contract, a *firm* will not be required to provide the information in accordance with *MCOB 7.6.28 R* where it is provided as part of:

- (1) an *illustration* issued in accordance with *MCOB 7.6.18 R(1)* or *MCOB 7.6.22 R(1)*; or
- (2) an *ESIS* issued in accordance with *MCOB 7.6.18 R(2)* or *MCOB 7.6.22 R(2)*.

Simultaneous request for a rate switch and addition or removal of a party to a contract

- 7.6.33 G (1) Where a *customer* simultaneously requests a rate switch and the addition or removal of a party to the loan, a *firm* will not be required to provide the *customer* with a separate *illustration* for each in accordance with *MCOB 7.6.18 R(1)* and *MCOB 7.6.22 R(1)*. The *firm* may provide the *customer* with a single *illustration* that complies with the requirements of *MCOB 5 (Pre-application disclosure)* for both.
- (2) Where a *customer* simultaneously requests a rate switch and the addition or removal of a party to the loan, a *firm* will not be required to provide the *customer* with a separate *ESIS* for each in accordance with *MCOB 7.6.18 R(2)* and *MCOB 7.6.22 R(2)*. The *firm* may provide the *customer* with a single *ESIS* that complies with the requirements of *MCOB 5A (MCD Pre-application disclosure)* for both.

ESIS additional APRC

7.6.34 R Where a *firm* is required to provide a *customer* with an *ESIS* under *MCOB 7.6.18 R(2)* or *MCOB 7.6.22 R(2)* or a *firm* chooses to provide a *customer* with an *ESIS* under *MCOB 7.6.31(2)*, the *firm* need not include the additional *APRC* required under *MCOB 10A.1.6 R, Section 4 of MCOB 5A Annex 1 R* and Sections 4(2) and (2A) of *MCOB 5A Annex 2 R*.

7.6.35 R Where a *firm* provides a *customer* with an *ESIS* under *MCOB 7.6.18*

R(2) or MCOB 7.6.22 R(2) or MCOB 7.6.31(2), that includes an additional APRC, the firm must either:

- (1) base that additional APRC on the APRC previously provided to the customer in accordance with MCOB 5A (MCD Pre-application disclosure); or
- (2) calculate that additional APRC in accordance with MCOB 10A.1.6 R, Section 4 of MCOB 5A Annex 1 R and Sections 4(2), 4(2A), 4(2B), 4(2C) and 4(2D) of MCOB 5A Annex 2 R.

7.6.36      G      When considering whether to apply MCOB 7.6.35 R(1) or MCOB 7.6.35 R(2) a firm should consider its obligations under MCOB 3A.2.1R(2) to communicate in a way that is fair, clear and not misleading.

...

7.7.1      R      (1) Where, in relation to a regulated mortgage contract for a business purpose or a high net worth mortgage customer who is not a consumer under a MCD regulated mortgage contract, a customer either.

...

7.7.3      R      Where a customer applies for a further advance that is a regulated mortgage contract for a business purpose or a high net worth mortgage customer who is not a consumer under a MCD regulated mortgage contract and MCOB 7.7.1R does not apply:

....

**Insert MCOB 7A after MCOB 7**

7A      **Additional MCD disclosure at start of contract and after sale**

7A.1      **Application and general**

7A.1.1      R      This chapter applies to a firm that is a MCD mortgage lender or a MCD mortgage administrator.

7A.1.2      R      A firm must provide the information required by this chapter in a durable medium.

7A.2      **Notification of interest rate changes**

7A2.1      R      When giving notice to a consumer of any changes that the consumer is required to make resulting from interest rate changes in relation to an MCD regulated mortgage contract, a firm must:

- (1) give notice of the amount of the payments to be made after the new

interest rate change takes effect; and

- (2) in cases where the number or frequency of the payments will change, give particulars of these changes.

[**Note:** article 27(1) of the *MCD*]

### **7A.3 Early repayment disclosure**

7A.3.1 R (1) Where a consumer notifies a firm that he wishes to discharge his obligations under a MCD regulated mortgage contract prior to its expiry, the firm must provide the consumer without delay with the information necessary to allow him to consider that option.

(2) The information under (1) must:

(a) quantify the implications for the consumer of discharging his obligations prior to the expiry of the MCD regulated mortgage contract; and

(b) clearly set out any assumptions that have been used.

(3) The assumptions under (2)(b) must be reasonable and justifiable.

[**Note:** article 25(4) of the *MCD*]

### **7A.4 Foreign currency loans and significant exchange rate movement disclosure**

7A.4.1 R (1) A firm must warn the consumer with a foreign currency loan on a regular basis where the value of either:

(a) the total amount payable by the consumer which remains outstanding; or

(b) the regular instalments;

varies by more than 20% from what it would be if the exchange rate between the currency of the MCD regulated mortgage contract and the currency of the EEA State applicable at the time of the conclusion of the MCD regulated mortgage contract were applied.

(2) The warning referred to at (1) must inform the consumer of a rise in the total amount payable by the consumer, setting out where applicable the right to convert to an alternative currency and the conditions for doing so, and explain any other applicable mechanisms for limiting the exchange rate risk to which the consumer is exposed.

[**Note:** article 23(4) of the *MCD*]

7A.4.2 R A firm must disclose to the consumer its arrangements for complying with the obligations set out in MCOB 7A.4.1R in the MCD regulated mortgage contract.

[**Note:** article 23(6) of the *MCD*]

## **7A.5 Notification of changes resulting from auctions on the capital market**

7A.5.1 R In relation to a MCD regulated mortgage contract, where there is an auction on the capital markets which will or might reasonably be expected to result in an interest rate change, the firm must give the consumer, in good time before the auction, notice in a durable medium of:

- (1) the upcoming procedure for the auction; and
- (2) an indication of how the interest rates could be affected.

[**Note:** article 27(4) of the *MCD*]

**Insert MCOB 7B after MCOB 7A.**

### **7B MCD Further advances**

7B.1.1 R This chapter applies to a firm that is a MCD mortgage lender or MCD credit intermediary.

7B.1.2 R Before a consumer submits an application to a firm for a further advance on an existing MCD regulated mortgage contract or for a further advance that is a new MCD regulated mortgage contract, if the further advance requires the approval of the MCD mortgage lender, the firm must provide the consumer with an ESIS that complies with the requirements of MCOB 5A (MCD pre-application disclosure) and MCOB 7B.1.4 R for the further advance, unless an ESIS has already been provided.

7B.1.3 G If a number of different firms are involved in relation to the transaction referred to in MCOB 7B.1.2 R, having regard to MCOB 2.5.4 R(2), those firms should take reasonable steps to establish which one of them is responsible for providing the consumer with the ESIS required by MCOB 7B.1.2 R.

7B.1.4 R The ESIS provided in accordance with MCOB 7B.1.2 R must be based on the amount of the further advance only.

7B.1.5 G In order to comply with MCOB 7B.1.4R a firm should calculate the APRC on the basis of the further advance amount only.

.....

## **10A**      **MCD Annual Percentage Rate of Charge**

### **10A.1**      **Calculation of the APRC**

**10A.1.1**    **R**      The APRC must be calculated for a MCD regulated mortgage contract in accordance with the mathematical formula set out in MCOB 10A.2 R.

[Note: article 17(1) of the MCD]

**10A.1.2**    **R**      The total cost of credit to the consumer must include the following costs:

- (1)      opening and maintaining a specific account;
  - (2)      using a means of payment for both transactions and drawdowns on that account;
  - (3)      other costs relating to payment transactions;
- whenever the opening or maintaining of an account is obligatory in order to obtain the credit or to obtain it on the terms and conditions marketed.

[Note: article 17(2) of the MCD]

**10A.1.3**    **R**      The calculation of the APRC must be based on the assumption that the MCD regulated mortgage contract is to remain valid for the period agreed and that the MCD mortgage lender and the consumer will fulfil their obligations under the terms and by the dates specified in the MCD regulated mortgage contract.

[Note: article 17(3) of the MCD]

**10A.1.4**    **R**      If a MCD regulated mortgage contract allows:

- (1)      variations in the borrowing rate; or
  - (2)      variations in the charges contained in the APRC;
- and they are unquantifiable at the time of that the APRC is calculated, the APRC must be calculated on the assumption that the borrowing rate and other charges will remain fixed in relation to the level set when the contract is entered into.

[Note: article 17(4) of the MCD]

**10A.1.5**    **R**      If a MCD regulated mortgage contract contains a fixed borrowing rate in relation to the initial period of at least five years, at the end of which a negotiation on the borrowing rate must take place to agree on a new fixed rate for a further material period, the calculation of the additional, illustrative APRC disclosed in the ESIS must:

- (1)      cover only the initial fixed rate period; and

- (2) be based on the assumption that, at the end of the fixed *borrowing rate* period, the capital outstanding is repaid.

[**Note:** article 17(5) of the *MCD*]

10A.1.6 R If a *MCD regulated mortgage contract*:

- (1) allows for variations in the *borrowing rate*; and  
(2) it does not fall within *MCOB 10A.1.5R*,

the *ESIS* must contain an additional *APRC* which illustrates the possible risks linked to a significant increase in the *borrowing rate*. Where the *borrowing rate* is not capped, this information must be accompanied by a warning highlighting that the *total cost of the credit to the consumer*, shown by the *APRC*, may change.

[**Note:** article 17(6) of the *MCD*]

10A.1.7 R The assumptions in *MCOB 10A.2 R* and, where applicable, the additional assumptions set out in *MCOB 10A.3 R* must be used and applied in calculating the *APRC*.

[**Note:** article 17(7) of the *MCD*]

## 10A.2 **Mathematical formula and assumptions for calculating the *APRC***

10A.2.1 G The mathematical formula for calculating the *APRC* in *MCOB 10A.2.2R* is a basic equation for establishing the *APRC* which equates, on an annual basis, the total present value of drawdowns on the one hand and the total present value of repayments and payments of charges on the other.

[**Note:** Annex I, Part I of the *MCD*]

10A.2.2 R The equation referred to in *MCOB 10A.2.1 R* is:

$$\sum_{k=1}^m C_k (1+X)^{-t_k} = \sum_{l=1}^{m'} D_l (1+X)^{-S_l}$$

where:

- *X* is the *APRC*
- *m* is the number of the last drawdown
- *k* is the number of a drawdown, thus  $1 \leq k \leq m$
- *C<sub>k</sub>* is the amount of drawdown *k*
- *t<sub>k</sub>* is the interval, expressed in years and fractions of a year, between

the date of the first drawdown and the date of each subsequent drawdown, thus  $t_1 = 0$

- $m'$  is the number of the last repayment or payment of charges
- $l$  is the number of a repayment or payment of charges
- $D_j$  is the amount of a repayment or payment of charges
- $s_j$  is the interval, expressed in years and fractions of a year, between the date of the first drawdown and the date of each repayment or payment of charges.

**[Note: Annex I, Part I of the MCD]**

10A.2.3 R The following matters must be applied when calculating the APRC:

- (1) The amounts paid by both parties at different times must not necessarily be equal and must not necessarily be paid at equal intervals.

**[Note: Annex I, Part I, paragraph (a) of the MCD]**

- (2) The starting date must be that of the first drawdown.

**[Note: Annex I, Part I, paragraph (b) of the MCD]**

- (3) (a) Intervals between dates used in the calculations must be expressed in years or in fractions of a year. A year is presumed to have 365 days (or 366 days for leap years), 52 weeks or 12 equal months. An equal month is presumed to have 30.41666 days (i.e. 365/12) regardless of whether or not it is a leap year.

(b) Where intervals between dates used in the calculations cannot be expressed as a whole number of weeks, months or years, the intervals must be expressed as a whole number of one of those periods in combination with a number of days. Where using days:

- (i) every day must be counted, including weekends and holidays;
- (ii) equal periods and then days must be counted backwards to the date of the initial drawdown;
- (iii) the length of the period of days must be obtained excluding the first day and including the last day and must be expressed in years by dividing this period by the number of days (365 or 366 days) of the complete year counted backwards from the last day to the same day of the previous year.

[**Note:** Annex I, Part I, paragraph (c) of the *MCD*]

- (4) The result of the calculation must be expressed with an accuracy of at least one decimal place. If the figure at the following decimal place is greater than or equal to 5, the figure at the preceding decimal place must be increased by one.

[**Note:** Annex I, Part I, paragraph (d) of the *MCD*]

- (5) The equation can be rewritten using a single sum and the concept of flows ( $A_k$ ), which will be positive or negative, in other words either paid or received during periods 1 to n, expressed in years, using the following formula:

$$s = \sum_{k=1}^n A_k (1 + X)^{-t_k}$$

where  $s$  is the present balance of flows. If the aim is to maintain the equivalence of flows, the value of  $s$  will be zero.

[**Note:** Annex I, Part I, paragraph (e) of the *MCD*]

### 10A.3 **Additional assumptions for calculating the APRC**

- 10A.3.1 R (1) If a *MCD regulated mortgage contract* gives the consumer freedom of drawdown, the *total amount of credit* must be deemed to be drawn down immediately and in full.

[**Note:** Annex I, Part II, paragraph (a) of the *MCD*]

- (2) If a *MCD regulated mortgage contract* provides different ways of drawdown with different charges or *borrowing rates*, the *total amount of credit* must be deemed to be drawn down at the highest charge and *borrowing rate* applied to the most common drawdown mechanism for that type of *MCD regulated mortgage contract*.

[**Note:** Annex I, Part II, paragraph (b) of the *MCD*]

- (3) If a *MCD regulated mortgage contract* gives the consumer freedom of drawdown in general but imposes, amongst the different ways of drawdown, a limitation with regard to the amount of *credit* and period of time, the amount of *credit* must be deemed to be drawn down on the earliest date provided for in the *MCD regulated mortgage contract* and in accordance with those drawdown limits.

[**Note:** Annex I, Part II, paragraph (c) of the *MCD*]

- (4) If different *borrowing rates* and charges are offered for a limited period or amount, the highest *borrowing rate* and charges must be

deemed to be the *borrowing rate* and charges for the whole duration of the *MCD regulated mortgage contract*.

[Note: Annex I, Part II, paragraph (d) of the *MCD*]

- (5) For a *MCD regulated mortgage contract* for which a fixed *borrowing rate* is agreed in relation to the initial period, at the end of which a new *borrowing rate* is determined and subsequently periodically adjusted according to an agreed indicator or internal reference rate the calculation of the *APRC* must be based on the assumption that, at the end of the fixed *borrowing rate* period, the *borrowing rate* is the same as at the time of calculation of the *APRC*, based on the value of the agreed indicator or internal reference rate at that time, but is not less than the fixed *borrowing rate*.

[Note: Annex I, Part II, paragraph (e) of the *MCD*]

- (6) If the ceiling applicable to the *credit* has not yet been agreed, that ceiling must be assumed to be EUR 170,000. In the case of a *MCD regulated mortgage contract* (other than a *MCD contingent liability or guarantee*) the purpose of which is not to acquire or retain a right in immovable property or land, an *overdraft facility*, a deferred debit card or a credit card, this ceiling must be assumed to be EUR 1,500.

[Note: Annex I, Part II, paragraph (f) of the *MCD*]

- (7) In the case of a *MCD regulated mortgage contract* that does not fall within *MCOB* 10A.3.1 R(9), (10), (11), (12) or (13):
- (a) if the date or amount of a repayment of capital to be made by the *customer* cannot be ascertained, it must be assumed that the repayment is made at the earliest date provided for in the credit agreement and is for the lowest amount for which the *MCD regulated mortgage contract* provides;
- (b) if the interval between the date of initial drawdown and the date of the first payment to be made by the *customer* cannot be ascertained, it must be assumed to be the shortest interval.

[Note: Annex I, Part II, paragraph (g) of the *MCD*]

- (8) Where the date or amount of a payment to be made by the *consumer* cannot be ascertained on the basis of the *MCD regulated mortgage contract* or the assumptions set out at *MCOB* 10A.3.1 R(7), (9), (10), (11), (12) or (13), it must be assumed that the payment is made in accordance with the dates and conditions required by the *MCD mortgage lender* and, when these are unknown:
- (a) interest charges are paid together with the repayments of the capital;

- (b) non-interest charges expressed as a single sum are paid as at the date of entering into the *MCD regulated mortgage contract*;
- (c) non-interest charges expressed as several payments are paid at regular intervals, commencing with the date of the first repayment of capital, and if the amount of such payment is not known they must be assumed to be equal amounts;
- (d) the final payment clears the balance of capital, interest and other charges, if any.

**[Note: Annex I, Part II, paragraph (h) of the *MCD*]**

- (9) In the case of a *MCD regulated mortgage contract* that is an *overdraft facility*, the *total amount of credit* must be deemed to be drawn down in full and for the whole duration of the *MCD regulated mortgage contract*. If the duration of the *overdraft facility* is not known, the *APRC* must be calculated on the assumption that the duration of the *credit* is three months.

**[Note: Annex I, Part II, paragraph (i) of the *MCD*]**

- (10) In the case of a *MCD exempt bridging loan*, the *total amount of credit* must be deemed to be drawn down in full and for the whole duration of the *MCD regulated mortgage contract*. If the duration of the *MCD regulated mortgage contract* is not known, the *APRC* must be calculated on the assumption that the duration of the *credit* is 12 months.

**[Note: Annex I, Part II, paragraph (j) of the *MCD*]**

- (11) In the case of an open ended *MCD regulated mortgage contract*, other than an *overdraft facility* and a *MCD exempt bridging loan*, it must be assumed that:

- (a) the *credit* is provided for a period of time starting from the date of the initial drawdown, and the final payment made by the *consumer* clears the balance of capital, interest and other charges, if any, where that period of time is:
  - (i) 20 years for a *MCD regulated mortgage contract*, the purpose of which is to acquire or retain rights in immovable property;
  - (ii) 1 year in the case of a *MCD regulated mortgage contract* the purpose of which is not to acquire or retain rights in immovable property or which is drawn down by a deferred debit card or a credit card.
- (b) the capital is repaid by the *consumer* in equal monthly

payments, commencing one month after the date of the initial drawdown. However, in cases where the capital must be repaid only in full, in a single payment, within each payment period, successive drawdowns and repayments of the entire capital by the consumer must be assumed to occur over the period of one year. Interest and other charges must be applied in accordance with those drawdowns and repayments of capital and as provided for in the MCD regulated mortgage contract.

- (c) For the purposes of this rule an open-ended MCD regulated mortgage contract is a MCD regulated mortgage contract without fixed duration and includes credits which must be repaid in full within or after a period but, once repaid, become available to be drawn down again.

[**Note:** Annex I, Part II, paragraph (k) of the MCD]

(12) In the case of a MCD contingent liability or guarantee, the total amount of credit must be deemed to be drawn down in full as a single amount at the earlier of:

- (a) the latest draw down date permitted under the MCD regulated mortgage contract being the potential source of the MCD contingent liability or guarantee; or
- (b) in the case of a rolling MCD regulated mortgage contract, at the end of the initial period prior to the rollover of the agreement.

[**Note:** Annex I, Part II, paragraph (l) of the MCD]

(13) In the case of a shared equity credit agreement:

- (a) the payments by a consumer must be deemed to occur at the latest date or dates permitted under the shared equity credit agreement;
- (b) percentage increases in value of the immovable property which secures the shared equity credit agreement, and the rate of any inflation index referred to in the agreement, must be assumed to be:
- (i) a percentage equal to the higher of:
- (aa) the current central bank target inflation rate;  
or
- (bb) the level of inflation in the EEA State where the immovable property is located at the time of that the MCD regulated mortgage

contract is entered into; or

(ii) 0 % if those percentages are negative.

**[Note: Annex I, Part II, paragraph (m) of the MCD]**

10A.3.2    **G**    (1)    Articles 17(1) to (5), (7) and (8) and Annex I of the MCD, which MCOB 10A transpose, are subject to maximum harmonisation.

**[Note: article 2(2) of the MCD.]**

(2)    The UK has decided to exercise the discretion afforded by article 3(3)(d) of the MCD not to apply the MCD to MCD exempt bridging loans. Accordingly, MCOB 10A.3.1R(10) has no application.

...

## **11.6        Responsible lending and financing**

...

11.6.2        **R**        (1)        ...

(a)        ...

**[Note: article 18(1) of the MCD]**

(b)        ...

**[Note: article 18(5)(a) of the MCD]**

...

...

11.6.3        **R**        ...

(2)        ...

(a)        ...

**[Note: article 18(6) of the MCD]**

...

11.6.5        **R**        (1)        ...

**[Note: article 18(3) of the MCD]**

(2)        ...

**[Note: article 20(1) of the MCD]**

...

(4) ...

**[Note: article 18(1) of the MCD]**

...

11.6.11 G (1) Examples of committed expenditure are: credit commitments such as secured and unsecured loans and credit cards; ...

...

...

11.6.18A R (1) Under MCOB 11.6.5R(4), in taking account of likely future interest rate increases for the purposes of its assessment of whether the customer will be able to pay the sums due, a second charge lender must also consider the likely future interest rates of any regulated mortgage contract in existence at the time of the assessment and remaining in existence after the relevant second charge regulated mortgage contract has been entered into.

(2) The second charge lender must at a minimum base its assessment under (1) on the balance outstanding and the current interest rate of any regulated mortgage contract relevant under (1).

...

11.6.20 R ...

**[Note: article 18(2) of the MCD]**

...

11.6.21A R A MCD mortgage lender must keep a record of the valuation and types of immovable property accepted as a security as well as the related mortgage underwriting policies used.

**[Note: article 19(2) and second sentence of article 26(1) of the MCD]**

11.6.21B G When considering the period for which the records kept under MCOB 11.6.21AR are to be retained, MCD mortgage lenders are reminded of the high level record-keeping provisions in the Senior Management Arrangements, Systems and Controls sourcebook.

...

11.6.34 R ...

(1) ...

[**Note:** article 18(3) of the *MCD*]

(2) ...

[**Note:** article 20(1) of the *MCD*]

...

11.6.40A    G    *A shared equity credit agreement may be an interest-only mortgage.*

...

11.6.58    R    *A mortgage lender may not enter into an interest roll-up mortgage, or vary an existing regulated mortgage contract so that it becomes an interest roll-up mortgage, unless it is:*

...

(4)    a loan solely for business purposes; or

(5)    *a shared equity credit agreement.*

...

11.6.59A    G    *A shared equity credit agreement may be an interest roll-up mortgage.*

...

11.6.60    R    ...

[**Note:** article 18(2) of the *MCD*]

...

**Insert MCOB 11A after MCOB 11.**

## **11A            Additional MCD responsible lending requirements**

### **11A.1            MCD credit intermediary submission of information to MCD mortgage lender**

11A.1.1    R    *A MCD credit intermediary must accurately submit any relevant information obtained from the consumer to the MCD mortgage lender to enable an assessment of affordability to be carried out.*

[**Note:** article 20(2) of the *MCD*]

### **11A.2            Prohibition on cancellation or variation of MCD regulated mortgage**

### **contract on grounds of creditworthiness**

- 11A.2.1 R A MCD mortgage lender must not cancel, or vary the terms of, a MCD mortgage contract to the detriment of the consumer on the grounds that the assessment of affordability was incorrectly conducted or the information provided by the consumer prior to the agreement of the MCD regulated mortgage contract was incomplete, save where the MCD mortgage lender can demonstrate that the consumer knowingly withheld or falsified information relevant to the assessment of affordability of the MCD regulated mortgage contract.

[**Note:** articles 18(4) and 20(3) of the MCD]

### **11A.3 Obtaining information for and assessment of affordability from the consumer and rejecting an application**

- 11A.3.1 R (1) A MCD mortgage lender must specify in a fair, clear and not misleading way, in good time before assessing affordability of a MCD regulated mortgage contract, to a consumer:
- (a) all the necessary information and independently verifiable evidence that the consumer needs to provide; and
  - (b) the timeframe within which the consumer needs to provide the information or evidence.
- (2) A request for information or evidence under (1) must be proportionate and limited to what is necessary to conduct a proper affordability assessment.
- (3) A request for information or evidence under (1) may be made directly or through a MCD credit intermediary. The MCD mortgage lender, or the MCD credit intermediary if requesting on behalf of the MCD mortgage lender, must:
- (a) ensure the consumer is aware of the need to provide correct information in response to the request and that such information is as complete as necessary to conduct a proper assessment of affordability; and
  - (b) warn the consumer that, where the MCD mortgage lender is unable to carry out an assessment of affordability because the consumer chooses not to provide the information or evidence necessary for an assessment of affordability, the credit cannot be granted.
- (4) The MCD mortgage lender may seek clarification, directly or via a MCD credit intermediary, of the information or evidence received in response to a request under (1) where necessary to enable the

assessment of affordability of a *MCD regulated mortgage contract*.

[**Note:** article 20(3) and 20(4) of the *MCD*]

11A.3.2     **G**     In accordance with the *Data Protection Act*, a *MCD mortgage lender* must inform a *consumer* in advance if a database is to be consulted in conducting any assessment of affordability for a *MCD regulated mortgage contract*.

[**Note:** article 18(5)(b) of the *MCD*]

11A.3.3     **R**     (1)    Where a *MCD mortgage lender* rejects a *consumer's* application for a *MCD regulated mortgage contract*, the *MCD mortgage lender* must inform the *consumer* without delay:

(a)    of the rejection and, where applicable, that the decision is based on automated processing of data; and

(b)    where the rejection is based on the result of the database consultation, of the result of such consultation and of the particulars of the database consulted.

[**Note:** article 18(5)(c) of the *MCD*]

(2)    No obligation under (1) shall be interpreted in a manner which contravenes the *Data Protection Act*.

....

#### Charges under second charge regulated mortgage contracts

12.1.5A     **R**     The *rules* in *MCOB 12.4* (Payment shortfall charges: regulated mortgage contracts) and *MCOB 12.5* (Excessive charges: regulated mortgage contracts, home reversion plans and regulated sale and rent back agreements) apply to *second charge regulated mortgage contracts* entered into before 21 March 2016 in relation to charges imposed on a *customer* in respect of events occurring from that date onwards.

...

#### **12.3     Early repayment charges: regulated mortgage contracts**

...

##### Early settlement charges on second charge regulated mortgage contracts

12.3.5     **G**     The Consumer Credit (Early Settlement) Regulations 2004 continue to apply with respect to a *second charge regulated mortgage contract* entered into before 21 March 2016.

...

**12.5 Excessive charges: regulated mortgage contracts, home reversion plans and regulated sale and rent back agreements**

...

12.5.5 **R** *A second charge lender may only charge interest on charges applied to a customer for breach of a second charge regulated mortgage contract if the interest is simple interest.*

...

12.6.1 **G** *Firms are reminded that, in relation to a regulated mortgage contract which is solely for a business purpose or is with a high net worth mortgage customer who is not a consumer under a MCD regulated mortgage contract in circumstances where MCOB 7.7.1R applies, if there is a new early repayment charge or a change to the existing early repayment charge, MCOB 7.7.1R(2) requires a firm to notify the customer within five business days of the maximum amount payable as an early repayment charge.*

...

**13.3 Dealing fairly with customers with a payment shortfall: policy and procedures**

...

Vulnerable customers

13.3.1C **R** *A firm must establish and implement clear, effective and appropriate policies and procedures for the fair and appropriate treatment of customers whom the firm understands or reasonably suspects to be particularly vulnerable.*

13.3.1D **G** (1) *Customers who have mental health difficulties or mental capacity limitations may fall into the category of particularly vulnerable customers.*

(2) *In developing procedures and policies for dealing with customers who may not have the mental capacity to make financial decisions, a firm may wish to have regard to the principles outlined in the Money Advice Liaison Group (MALG) Guidelines "Good Practice Awareness Guidelines for Consumers with Mental Health Problems and Debt".*

...

**After MCOB 13.4 insert the following new section.**

**13.4A Data sharing with other charge holders**

- 13.4A.1    R    (1)    Where a *firm* commences legal proceedings against a *customer* in respect of a *regulated mortgage contract* or a *home purchase plan*, it must give to all *persons* specified in *MCOB 13.4A.2R*:
- (a)    notice of the commencement of the legal proceedings at the time of their commencement or as soon as reasonably practicable afterwards;
  - (b)    notice of the date of any Court hearing within five days from the date on which the *firm* was notified of the hearing;
  - (c)    details of the outcome of any Court hearing within ten working days from the date of that hearing, including the nature of any order granted or whether the hearing was adjourned; and
  - (d)    notice of the date on which the *customer's* property will be *repossessed* within ten working days from the date on which the *firm* ascertains the date of the *repossession*.
- (2)    Where a *customer* voluntarily surrenders possession of their property to a *firm*, the *firm* must give all *persons* specified in *MCOB 13.4A.2R* notice of the surrender at the time it happens or as soon as reasonably practicable afterwards.
- (3)    Where a sale is proposed of a *customer's* property subject to a *regulated mortgage contract* or a *home purchase plan* with a *firm* that has taken possession, that *firm* must give all *persons* specified in *MCOB 13.4A.2R*:
- (a)    notice of the proposed sale and details of the proposed sale price and method of sale at least ten working days before the date on which the property is proposed to be offered for sale; and
  - (b)    details of the sale price within no more than ten working days from the acceptance of an offer to purchase the property.
- (4)    Where a *customer* is placed in an *assisted voluntary sale process*, a *firm* must give all *persons* specified in *MCOB 13.4A.2R*:
- (a)    notice that the *customer* has entered an *assisted voluntary sale process* within ten working days from the date the customer entered the *assisted voluntary sale process*;
  - (b)    notice of the proposed sale and details of the proposed sale price and method of sale at least ten working days before the date on which the property is proposed to be offered for sale; and
  - (c)    details of the sale price within no more than ten working days from the acceptance of an offer to purchase the property.

## Relevant other charge holders

- 13.4A.2 R Notices and other details under *MCOB* 13.4A.R are to be given to each *person* having a *legal or equitable mortgage* in the relevant property over which the *firm* has security under a *regulated mortgage contract* or a *home purchase plan*.

...

## Insert MCOB 14 after MCOB 13

### **14** **MCD article 3(1)(b) credit agreements**

- 14.1.1 G The purpose of *MCOB* 14 is to apply *rules* in *MCOB* to *MCD* article 3(1)(b) *creditors* and *MCD* article 3(1)(b) *credit intermediaries*; and to identify *rules* and *guidance* in *CONC* that apply or which may (subject to the election in *MCOB* 14.1.6R) apply to them. They include *rules* in *MCOB* that transpose or implement the *MCD*.

- 14.1.2 R Except in *MCOB* 3A and subject to *MCOB* 14.1.6R:

(1) Any *rule* in *MCOB* that applies to a *MCD mortgage lender* or to a *MCD mortgage administrator* in respect of a *MCD regulated mortgage contract* shall be deemed to apply to a *MCD* article 3(1)(b) *creditor* in respect of a *MCD* article 3(1)(b) *credit agreement*; and all such *rules* shall be construed and applied accordingly.

(2) Any *rule* in *MCOB* that applies to a *MCD credit intermediary* in respect of a *MCD regulated mortgage contract* shall be deemed to apply to a *MCD* article 3(1)(b) *credit intermediary* in respect of a *MCD* article 3(1)(b) *credit agreement*; and all such *rules* shall be construed and applied accordingly.

- 14.1.3 R Any *rule* that is deemed to apply to a *MCD* article 3(1)(b) *creditor* or *MCD* article 3(1)(b) *credit intermediary*, as the case may be, as a result of *MCOB* 14.1.2R, shall for the purposes of that *rule* in addition be construed as follows:

(1) any reference to “land” shall be deemed to include a reference to property rights in an existing or projected building;

(2) any reference to *regulated mortgage contract* or *MCD regulated mortgage contract* shall be deemed to include reference to a *MCD* article 3(1)(b) *credit agreement*.

- 14.1.4 R In *MCOB* 3A and subject to *MCOB* 14.1.6R:

(1) any reference to *qualifying credit* shall be deemed to include a *MCD* article 3(1)(b) *credit agreement*;

(2) any reference to a MCD regulated mortgage contract shall be deemed to include reference to a MCD article 3(1)(b) credit agreement; and

(3) any reference to a firm shall be deemed to include a MCD article 3(1)(b) creditor or a MCD article 3(1)(b) credit intermediary;

and the rules in MCOB 3A shall be construed and applied accordingly.

14.1.5 G The effect of MCOB 14.1.4R is that, for example, MCOB 3A.1.16R (Exceptions to territorial scope: financial promotions of qualifying credit relating to distance contracts) and MCOB 3A.4.5R (No approval of real time qualifying credit promotions) apply to a financial promotion in respect of a MCD article 3(1)(b) credit agreement.

14.1.6 R A MCD article 3(1)(b) creditor or MCD article 3(1)(b) credit intermediary may elect to comply with either:

(1) all the provisions in MCOB that are listed in column A of the table in MCOB 14.1.7R where applicable; or

(2) all the provisions in CONC that are listed in column B of that table where applicable.

14.1.7 R This table belongs to MCOB 14.1.6R.

<u>Column A: MCOB</u>	<u>Column B: CONC</u>
<u>1</u>	<u>1.2</u>
<u>2.7</u>	<u>2.7, 2.8</u>
<u>3A</u>	<u>3.3, 3.5, 3.8, 3.10</u>
<u>2.5A(1), 4.7A, 5.5</u>	<u>4.2</u>
<u>4.4A(8)</u>	<u>4.5</u>
<u>2.5A</u>	<u>4.8</u>
<u>11.6</u>	<u>5.2, 5.3, 6.2</u>
<u>7.6.2</u>	<u>6.5</u>
<u>2.5A</u>	<u>6.7</u>
<u>13</u>	<u>7.2, 7.3, 7.4, 7.7, 7.12, 7.14</u>
<u>4.6</u>	<u>11</u>
<u>1.5</u>	<u>14</u>

- 14.1.8 G The purpose of MCOB 14.1.6R is to enable a MCD article 3(1)(b) creditor or MCD article 3(1)(b) credit intermediary to choose whether to comply with certain rules in MCOB or, instead, certain rules in CONC which are comparable. A MCD article 3(1)(b) creditor or MCD article 3(1)(b) credit intermediary must comply with other rules in MCOB in accordance with MCOB 14.1.2R to 14.1.4R.
- 14.1.9 G A MCD article 3(1)(b) creditor or MCD article 3(1)(b) credit intermediary is also subject to the following provisions in CONC: CONC 1.3, CONC 2.4, CONC 2.10, CONC 4.6, CONC 6.4, CONC 7.3.16G, CONC 7.4.2R, CONC 7.5, CONC 7.6, CONC 7.9, CONC 7.10, CONC 7.11, CONC 7.13, CONC 7.15 and CONC 7.16.

### MCOB TP1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
42	<u>MCOB 5A, MCOB 6A and MCOB 7B</u>	R	<u>A firm that is a MCD mortgage lender or MCD credit intermediary may provide an illustration instead of an ESIS in relation to a MCD regulated mortgage contract that is not a second charge regulated mortgage contract.</u>  [Note: article 14(5) of the MCD]	<u>From 21 March 2016 until 21 March 2019</u>	<u>21 March 2016</u>
43	<u>MCOB 5A, MCOB 6A and MCOB 7B</u>	R	<u>A firm that applies TP 42 must in addition provide the following information:</u>  (1) <u>for a variable interest rate loan, the warning and the additional APRC required by Section 4 of MCOB 5A Annex 1 R and Sections 4(2) and (2A) of MCOB 5A Annex 2 R;</u>  (2) <u>for a foreign currency loan, the warning and illustrative</u>	<u>From 21 March 2016 until 21 March 2019</u>	<u>21 March 2016</u>

example required by Section 6 of MCOB 5A Annex 1 R and Section 6(5) of MCOB 5A Annex 2 R; and

(3) the reflection period required by MCOB 6A.3.4 R(1) and (2), Section 11 of MCOB 5A Annex 1 R and Section 11 of MCOB 5A Annex 2 R.

<u>44</u>	<u>MCOB 5A, MCOB 6A and MCOB 7B</u>	<u>R</u>	<u>A firm must provide the information required by TP 31 no later than when it provides the illustration.</u>	<u>From 21 March 2016 until 21 March 2019</u>	<u>21 March 2016</u>
<u>45</u>	<u>MCOB 5A, MCOB 6A and MCOB 7B</u>	<u>R</u>	<u>A firm may provide the information required by TP 43 either within the illustration or separately in a durable medium.</u>	<u>From 21 March 2016 until 21 March 2019</u>	<u>21 March 2016</u>
<u>46</u>	<u>MCOB 5A, MCOB 6A and MCOB 7B</u>	<u>R</u>	<u>A firm may cease to apply TP 42 at any time.</u>	<u>From 21 March 2016 until 21 March 2019</u>	<u>21 March 2016</u>
<u>47</u>	<u>MCOB 2A.6.1R</u>	<u>R</u>	<u>MCOB 2A.6.1R does not apply to information provided in relation to a contract entered into before 21 March 2016 that would be a MCD regulated mortgage contract if it were entered into on or after 21 March 2016</u>	<u>From 21 March 2016 indefinitely</u>	<u>21 March 2016</u>

## Annex E

### Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

#### Part 1: Comes into force on 21 December 2015

### 13 Exercise of passport rights by UK firms

...

#### 13.2 Introduction

...

13.2.2 G A UK firm should be aware that the *guidance* is the ~~FSA's~~ FCA's interpretation of the *Single Market Directives*, the *Act* and the legislation made under the *Act*. The *guidance* is not exhaustive and is not a substitute for firms consulting the legislation or taking their own legal advice in the *United Kingdom* and in the relevant *EEA States*.

...

13.2.6 G As set out in article 32(1) of the MCD, a UK firm will only be able to carry on MCD credit intermediation activity in relation to an MCD credit agreement offered by a non- credit institution in an EEA state if that EEA state permits non-credit institutions to offer MCD credit agreements.

#### 13.3 Establishing a branch in another EEA State

...

The conditions for establishing a branch

...

13.3.2 G A UK firm other than a UK pure reinsurer cannot establish a branch in another EEA State for the first time under an EEA right unless the relevant conditions in paragraphs 19(2), (4) and (5) of Part III of Schedule 3 to the Act are satisfied. It is an offence for a UK firm which is not an authorised person to contravene this prohibition (paragraph 21 of Part III of Schedule 3 to the Act). These conditions are that:

...

- (3) (a) if the *UK firm's EEA right* derives from the *Insurance Mediation Directive* or the *MCD* one month has elapsed beginning on the date on which the *UK firm* received notice that the *appropriate UK regulator* had given a *consent notice* as described in *SUP 13.3.6G (1)* (see *SUP 13.3.2AG*);

...

...

Issue of a consent notice to the Host State regulator

13.3.5 G ...

- (3) If the *UK firm's EEA right* derives from the *MCD*, the *FCA* will give the *Host State regulator* a *consent notice* within one month of the date on which it received the *UK firm's notice of intention*. The *Host State regulator* then has a further two months to prepare for the supervision of the *UK firm*.

13.3.6 G ...

- (5) Where a *consent notice* is given under the *MCD* in relation to a *tiered MCD article 3(1)(b) credit intermediary* or a *tiered MCD credit intermediary* it will include details of:
- (a) any *MCD article 3(1)(b) creditor, MCD mortgage lender* or *group* to which it is tied; and
- (b) whether the *MCD article 3(1)(b) creditor, MCD mortgage lender* or *group* take full and unconditional responsibility for the *tiered MCD article 3(1)(b) credit intermediary* or *tiered MCD credit intermediary's* activities.

...

#### 13.4 Providing cross border services into another EEA State

The conditions for providing cross border services into another EEA State

- 13.4.2 G A *UK firm*, other than a *UK pure reinsurer* or an *AIFM* exercising an *EEA right* to market an *AIF* under *AIFMD*, cannot start providing *cross border services* into another *EEA State* under an *EEA right* unless it satisfies the conditions in paragraphs 20(1) of Part III of Schedule 3 to the *Act* and, if it derives its *EEA right* from the *Insurance Directives, AIFMD, MiFID* or the *UCITS Directive*, paragraph 20(4B) of Part III of Schedule 3 to the *Act*. If a *UK firm* derives its *EEA right* from the *MCD*, it cannot start providing *cross border services* into another *EEA State* under an *EEA right* unless it satisfies the conditions in paragraphs 20(1) of Part III of Schedule 3 to the *Act* and paragraph 20(4BB) of Part III of Schedule 3 to the *Act*. It is an offence for a *UK firm* which is not an *authorised person* to breach this prohibition

(paragraph 21 of Part III of Schedule 3 to the Act). The conditions are that:

...

- (5) if the UK firm is passporting under the MCD, one month has elapsed, beginning with the date on which the firm receives the notice as described in SUP 13.4.5.

...

Issuing a consent notice or notifying the Host State regulator

13.4.4 G ...

- (3) If the UK firm's EEA right derives from the MCD, the FCA will give the Host State regulator a consent notice within one month of the date on which it received the UK firm's notice of intention.

- (4) Where a consent notice is given under the MCD in relation to a tied MCD article 3(1)(b) credit intermediary or a tied MCD credit intermediary the consent notice will include details of:

- (a) any MCD article 3(1)(b) creditor, MCD mortgage lender or group to which the firm is tied; and
- (b) whether the MCD article 3(1)(b) creditor, MCD mortgage lender or group take full and unconditional responsibility for the tied MCD article 3(1)(b) credit intermediary or tied MCD credit intermediary's activities.

...

Applicable provisions for cross border services

13.4.6A G If a UK firm is passporting under the MCD, then the Host State regulator will notify the UK firm if there are any applicable provisions within two months of receiving a consent notice.

...

## 13.5 Notices of intention

...

Specified contents: notice of intention to provide cross border services

- 13.5.2 R A *UK firm* wishing to provide *cross border services* into a particular *EEA State* for the first time under an *EEA right* other than under the *auction regulation* must submit a notice in the form set out in:

...

- (7) SUP13 Annex 9, if the *UK firm* is passporting under the *MCD*

...

## 13.6 Changes to branches

...

### Firms passporting under *MCD*

- 13.6.9D G (1) A *UK firm* which has exercised an *EEA right* deriving from the *MCD* to establish a *branch* must not make any material changes to the *requisite details* of the *branch* unless it has complied with the requirements in regulation 17(B)(2).

- (2) The requirements in regulation 17(B)(2) are that

(a) the *UK firm* has given notice to the *FCA* stating the details of the proposed change; and

(b) the period of one *month* beginning with the day on which the *UK firm* gave notice has elapsed.

- (3) Paragraph (1) does not apply to changes occasioned by circumstances beyond the control of the *UK firm*.

- 13.6.10 G ...

- (3) This *guidance* is not applicable to *MiFID investment firms*, firms passporting under the *MCD* or *AIFMs*.

### The process

- 13.6.11 G When the *appropriate UK regulator* receives a notice from a *UK firm* other than a *MiFID investment firm* (see SUP 13.6.5 G (1) and SUP 13.6.7 G (1)) a *pure reinsurer* (see SUP 13.6.9B R), a *UK firm* exercising an *EEA right* under the *MCD* (see (SUP 13.6.9D) or an *AIFM* (see SUP 13.6.9C G ) it is required by regulations 11(4) and 13(4) to either refuse, or consent to the change within a period of one *month* from the day on which it received the notice.

...

### The process: MCD

- 13.6.19 G When the FCA receives a notice from a UK firm it will, under regulation 17(B)(3), inform the relevant Host State regulator of the proposed change as soon as reasonably practicable. The UK firm in question may make the change once a period of one month has elapsed beginning with the day on which it gave notice.

## **13.7 Changes to cross border services**

- 13.7.1 G Where a UK firm is exercising an EEA right under the UCITS Directive, MiFID, the Insurance Directives, the MCD or AIFMD and is providing cross border services into another EEA State, any changes to the details of the services are governed by the EEA Passport Rights Regulations. References to regulations in this section are to the EEA Passport Rights Regulations. A UK firm which is not an authorised person should note that contravention of the prohibition imposed by regulation 12(1), 12A(1) or 16(1) is an offence. It is a defence, however, for the UK firm to show that it took all reasonable precautions and exercised due diligence to avoid committing the offence.

...

### Firms passporting under MCD

- 13.7.15 G (1) A UK firm which has exercised an EEA right deriving from the MCD to provide a cross border service must not make any material changes to the service unless it has complied with the requirements in regulation 17(B)(2).
- (2) The requirements in regulation 17(B)(2) are that:
- (a) the UK firm has given notice to the FCA stating the details of the proposed change; and
- (b) the period of one month has elapsed beginning with the day on which the UK firm gave.
- (3) Paragraph (1) does not apply to a changes occasioned by circumstances beyond the control of the UK firm.

## **13.8 Changes of details: provision of notices to the appropriate UK regulator**

- 13.8.1 R (1) Where a firm is required to submit a notice of a change to a branch referred to in SUP 13.6.5 G (1), SUP 13.6.5BG (1), SUP 13.6.7 G (1), SUP 13.6.8 G, SUP 13.6.9B R SUP 13.6.10 G (1), ~~and~~ SUP 13.6.9C G and SUP 13.6.9D G or a notice of a change to cross border services referred to in SUP 13.7.3 G (1), SUP 13.7.3AG (1), SUP 13.7.5 G (1)

*SUP 13.7.6 G, SUP 13.7.13B G, and SUP 13.7.14G and 13.7.15 G* it must complete and submit that notice in accordance with the procedures set out in *SUP 13.5* for notifying the establishing of a *branch* or the provision of *cross border services*.

...

**13 Annex 9**      Passporting: MCD

R

This annex consists of one or more forms. Forms can be completed online now by

[address to follow]:

Passporting: MCD - SUP 13 Annex 9

**13A      Qualifying for authorisation under the Act**

...

**13A.1.3      G**

- (1) Under the *Gibraltar Order* made under section 409 of the *Act* , a Gibraltar firm is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:

...

(g) authorised in Gibraltar under MCD

...

- (2) Gibraltar insurance companies, *credit institutions, insurance intermediaries , investment firms, management companies, and AIFMs, MCD credit intermediaries and MCD article 3(1)(b) credit intermediaries* are allowed to passport their services into the *United Kingdom* if they comply with the relevant notification procedures. So, any references in this chapter to *EEA State* or *EEA right* include references to Gibraltar and the entitlement under the *Gibraltar Order* where appropriate.

...

...

## 13A.4 EEA firms establishing a branch in the United Kingdom

...

The notification procedure

13A.4.4- G When the FCA receives a consent notice from the EEA firm's Home  
A State regulator in respect of a EEA firm within paragraph 5(i) of Part I  
of Schedule 3 to the Act, it will, under paragraph 13(3A);

(1) notify the firm of the applicable provisions (if any); and

(2) use the information received from the EEA firm's Home  
State regulator to enter the necessary information into the  
Financial Services Register.

...

...

The notification procedure

...

13A.5.4A ...

13A.5.4- G When the FCA receives a consent notice from the EEA firm's Home  
A State regulator in respect of a firm within paragraph 5(i) of Part I of  
Schedule 3 to the Act, it will, under paragraph 14(3ZA) use the  
information received from the EEA firm's Home State regulator to  
enter the necessary information into the Financial Services  
Register.;

13A.5.4A ...

...

## 13A.6 Which rules will an incoming EEA firm be subject to?

...

## 13A Annex 1 Application of the Handbook to Incoming EEA Firms

G

...		
<b>(1) Module of Handbook</b>	<b>(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom</b>	<b>(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom</b>
...		
<i>MCOB</i>	Applies where the activity is carried on with or for a <i>customer</i> resident in the <i>United Kingdom</i> or another <i>EEA State</i> at the time that the activity is carried on, but see the territorial scope in <i>MCOB 3.3</i> ( <del>Application: where?</del> ) <u>3.3A</u>	Applies where the activity is carried on with or for a <i>customer</i> resident in the <i>United Kingdom</i> at the time that the activity is carried on but see <i>MCOB 1.3.4R</i> (Distance contracts entered into from an establishment in another EEA State) and <i>MCOB 3.3</i> ( <del>Application: where?</del> ) <u>3.3A</u>
...		
<i>SUP</i>	<b>SUP 12 (Appointed representatives)</b> Applies only if the <i>firm</i> has <i>permission</i> to carry on <i>designated investment business, insurance mediation activity, or MCD credit intermediation activity</i> or <i>MCD article 3(1)(b) credit intermediation activity</i> <del><i>mortgage mediation activity</i></del> and wishes to appoint, or has appointed, an <i>appointed representative</i> ( <i>SUP 12.1.1R(1)</i> ).	<b>SUP 12 (Appointed representatives)</b> As column (2).
	...	

...		

**13A Annex 2G Matters reserved to a Home State regulator**

...	
Requirements in the interest of the general good	
2. [FCA/PRA]	The <i>Single Market Directives</i> , and the <i>Treaty</i> (as interpreted by the European Court of Justice) adopt broadly similar approaches to reserving responsibility to the <i>Home State regulator</i> . To summarise, the <i>FCA</i> or <i>PRA</i> , as <i>Host State regulator</i> , is entitled to impose requirements with respect to activities carried on within the <i>United Kingdom</i> if these can be justified in the interests of the

	"general good" and are imposed in a non-discriminatory way. This general proposition is subject to the following in relation to activities passported under the <i>Single Market Directives</i> :
	(1) the <i>Single Market Directives</i> expressly reserve responsibility for the prudential supervision of a <i>MiFID investment firm</i> , <i>CRD credit institution</i> , <i>UCITS management company AIFM</i> or <i>insurance undertaking</i> to the <i>Firm's Home State regulator</i> . The <i>Insurance Mediation Directive</i> and <i>MCD</i> reaches the same position without expressly referring to the concept of prudential supervision. Accordingly, the <i>FCA</i> , as <i>Host State regulator</i> , is entitled to regulate only the conduct of the firm's business within the <i>United Kingdom</i> ;
...	
<u>Requirements under MCD</u>	
<u>11L</u>	<u>Under article 34(2) of the MCD ensuring compliance with the obligations set out in articles 7(1), 8, 9, 10, 11, 13, 14, 15, 16, 17, 20, 22 and 39 of the MCD by incoming EEA branches is the responsibility of the Host State. Responsibilities for ensuring compliance with all other obligations are the responsibility of the Home State.</u>
<u>11M</u>	<u>Ensuring compliance with the obligations set out in articles 7(1), 8, 9, 10, 11, 13, 14, 15, 16, 17, 20, 22 and 39 of the MCD by EEA firms providing cross border services is the responsibility of the Home State.</u>

**14 Incoming EEA firms changing details, and cancelling qualification for authorisation**

...

14.1.3 G (1) Under the *Gibraltar Order* made under section 409 of the *Act*, a Gibraltar firm is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:

...

(g) authorised in Gibraltar under the MCD

- ...
- (2) Gibraltar insurance companies, *credit institutions, insurance intermediaries, investment firms, management companies, and AIFMs, MCD credit intermediaries and MCD Article 3(1)(b) credit intermediaries* are allowed to passport their services into the *United Kingdom* if they comply with the relevant notification procedures. So, any references in *SUP 14* to *EEA State* or *EEA right* include references to Gibraltar and the entitlement under the *Gibraltar Order* where appropriate.
- ...

## 14.2 Changes to branch details

...

### Firms Passporting under the MCD

- 14.2.17 G As required by regulation 7B(1), where an *incoming EEA firm* passporting under the *MCD* has established a *branch* in the *UK*, it must not make a material change to any of the matters referred to in regulation 2(8)(b) to (e) or regulation 3(6)(b) to (e) unless it has complied with the relevant requirements.
- 14.2.18 G The relevant requirements are set out in regulation 7B(4) or, where the change arises from circumstances beyond the *incoming EEA firms's* control, regulation 7B(5).
- 14.2.19 G The relevant requirements in regulation 7B(4) are that:
- (1) the *incoming EEA firm* has given a notice to the *FCA* and its *home state regulator* stating the details of the proposed changes; and
  - (2) either:
    - (a) the *FCA* has informed the *incoming EEA firm* that it may make the change; or
    - (b) a period of one *month* has elapsed beginning with the day on which the *incoming EEA firm* gave the notice under paragraph (1).
- 14.2.20 G Where the change arises from circumstances beyond the *incoming EEA firm's* control, the *incoming EEA firm* is required by regulation 7B(5) to give notice to the *FCA* and to its *Home State regulator* stating the details of the change as soon as reasonably practicable.
- 14.2.21 G The *FCA* believes that for a change to arise from circumstances beyond the control of an *incoming EEA firm*, the circumstances should be outside the control of the *incoming EEA firm* as a whole and not just its *UK branch*. For example, the *FCA* considers that this provision would be unlikely to apply to circumstances in which lack of planning at the *incoming EEA firm's* head office

resulted in a problem arising in a UK branch. In practice, therefore, use of this provision is likely to be rare.

### 14.3 Changes to cross border services

- 14.3.1 G Where an *incoming EEA firm* passporting under the *MiFID, UCITS Directive, Insurance Directives, MCD* or *AIFMD* is exercising an *EEA right* and is providing *cross border services* into the *United Kingdom*, the *EEA Passport Rights Regulations* govern any changes to the details of those services. Where an *incoming EEA firm* has complied with the *EEA Passport Rights Regulations*, then the *firm's permission* under Schedule 3 to the *Act* is to be treated as varied .

...

#### Firms Passporting under the MCD

- 14.3.11 G As required by regulation 7B(1), where an *incoming EEA firm* is providing *cross border services* under the *MCD* in the *UK*, it must not make a material change to any of the matters referred to in regulation 2(8)(b) to (e) or regulation 3(6)(b) to (e) unless it has complied with the relevant requirements.
- 14.3.12 G The relevant requirements are set out in regulation 7B(4) or, where the change arises from circumstances beyond the *incoming EEA firm's* control, regulation 7B(5).
- 14.3.13 G Where the change arises from circumstances within the control of the *incoming EEA firm*, the relevant requirements in regulation 7B(4) are that:
- (1) the *incoming EEA firm* has given a notice to the *FCA* and its *Home State regulator* stating the details of the proposed changes; and
  - (2) either:
    - (a) the *FCA* has informed the *incoming EEA firm* that it may make the change; or
    - (b) a period of one *month* has elapsed beginning with the day on which the *incoming EEA firm* gave the notice under paragraph 1
- 14.3.14 G Where the change arises from circumstances beyond the *incoming EEA firm's* control, the *incoming EEA firm* is required by regulation 7B(5) to give a notice to the *FCA* and to its *Home State regulator* stating the details of the change as soon as reasonably practicable.

### App 3 Guidance on passporting

...

App 3.3.6 G ...

(2) The European Commission has not produced an interpretative communication on the *Insurance Mediation Directive*, *AIFMD*, the *MCD* or the *UCITS Directive*

...

App 3.3.13 G The *Single Market Directives* require *credit institutions*, *insurance undertakings* (other than *reinsurance undertakings*, *MiFID investment firms*, *AIFMs*, *UCITS management companies*, ~~and~~ *insurance intermediaries*, *MCD credit intermediaries and MCD article 3(1)(b) credit intermediaries* to make a notification to the *Home State* before establishing a *branch* or providing *cross border services*.

...

...

**App 3.9 Mapping of MiFID, CRD, AIFMD, UCITS Directive, MCD and Insurance Mediation Directive to the Regulated Activities Order**

App 3.9.1 G The following Tables 1, 2, 2ZA 2A and 2B provide an outline of the *regulated activities* and *specified investments* that may be of relevance to *firms* considering undertaking *passport activities* under the *CRD*, *MiFID*, *AIFMD*, the *UCITS Directive*, the *MCD* and the *Insurance Mediation Directive*. The tables may be of assistance to *UK firms* that are thinking of offering financial services in another *EEA State* and to *EEA firms* that may offer those services in the *United Kingdom*.

App 3.9.2 G The tables provide a general indication of the *investments* and activities specified in the *Regulated Activities Order* that may correspond to categories provided for in the *CRD*, *MiFID*, *AIFMD*, the *UCITS Directive*, the *MCD* or the *Insurance Mediation Directive*. The tables do not provide definitive *guidance* as to whether a *firm* is carrying on an activity that is capable of being passported, nor do the tables take account of exceptions that remove the effect of articles. Whether a *firm* is carrying on a *passport activity* will depend on the particular circumstances of the *firm*. If a *firm's* activities give rise to potential passporting issues, it should obtain specialist advice on the relevant issues.

...

App 3.9.8 G Activities Set out in Article 4 of *MCD*

	<u>Table 3: <i>MCD</i> activities</u>	<u>Part II RAO specified activities</u>	<u>Part III RAO Investments</u>
<u>1.</u>	<u>Acting as creditor</u>	<u>Art 60B(1), Art 61(1)</u>	<u>Art 88 and Art</u>

		<u>and 61(2)</u>	<u>88D</u>
<u>2.</u>	<u>Acting as credit intermediary</u>	<u>Art 25A(1), Art 25 (2A), Art 53A, Art 36A(1)(d), (e), (f) and Art 53E</u>	<u>Art 88 and Art 88D</u>

**Part 2: Comes into force on 21 March 2016**

## 12 Appointed representatives

...

What is an appointed representative?

12.2.1 G ...

(4) If an appointed representative has entered into a contract with a MCD credit intermediary or a MCD article 3(1)(b) credit intermediary and is a person to whom section 39(1BA) of the Act applies he must also satisfy the conditions in section 39(1BB) of the Act in order to be an exempt person. See SUP 12.4.10CG for guidance on those conditions.

...

Business for which an appointed representative is exempt

12.2.7 G (1) The *Appointed Representatives Regulations*... describe, among other things, the business for which an *appointed representative* may be exempt ... which is business which comprises any of:

...

(d) *arranging (bringing about) a home finance transaction* (articles 25A(1), 25A(2A), 25B(1)...

...

(jaa) *advising on regulated credit agreements the purpose of which is to acquire land* (article 53E of the *Regulated Activities Order*);

...

What is an introducer appointed representative?

12.2.8 G ...

(2) The permitted scope of appointment of an *introducer appointed representative* does not include in particular:

...

(d) *advising on investments, giving basic advice on a stakeholder product, advising on a home finance transaction, advising on regulated credit agreements the purpose of which is to acquire land, or other activity ...;*

...

**12.4 What must a firm do when it appoints an appointed representative or an EEA tied agent?**

...

Appointed representative carrying on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity

12.4.10 A R Before a firm appoints a person as an appointed representative to carry on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity, it must ensure that the person has, and will maintain, professional indemnity insurance in accordance with the rules applicable to MCD credit intermediaries or MCD article 3(1)(b) credit intermediaries, as applicable. A firm will satisfy this requirement if:

(1) the appointed representative has professional indemnity insurance which satisfies the rules in MIPRU 3.2 applicable to the activities of the appointed representative, as if the appointed representative were a firm;

(2) professional indemnity insurance which would satisfy the requirements of SUP 12.4.10AR(1) is provided by the firm; or

(3) the appointed representative holds a comparable guarantee (as understood by reference to MIPRU 3.1.1R(3)(b)) provided by the firm.

[Note: article 31(2) of the MCD]

12.4.10B R (1) Before a firm appoints a person as an appointed representative to carry on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity, and on a continuing basis after appointment, it must in relation to such activities ensure that:

(a) if the appointed representative is an individual, the

individual:

- (i) has not been convicted of any serious criminal offences linked to crimes against property or other crimes related to financial activities (other than spent convictions under the Rehabilitation of Offenders Act 1974 or any other national equivalent); and
- (ii) has not been adjudged bankrupt (unless the bankruptcy has been discharged);

under the law of any part of the *United Kingdom* or under the law of a country or territory outside the *United Kingdom*; and

- (iii) possesses the appropriate level of knowledge and competence in accordance with the *rules in TC* applicable to the activities of the *appointed representative*;

- (b) if the *appointed representative* is a *body corporate*, the members of the board of the *appointed representative*, and *persons* performing equivalent tasks:

- (i) have not been convicted of any serious criminal offences linked to crimes against property or other crimes related to financial activities (other than spent convictions under the Rehabilitation of Offenders Act 1974 or any other national equivalent); and
- (ii) have not been adjudged bankrupt (unless the bankruptcy has been discharged);

under the law of any part of the *United Kingdom* or under the law of a country or territory outside the *United Kingdom*; and

- (iii) possess the appropriate level of knowledge and competence in accordance with the *rules in TC* applicable to the activities of the *appointed representative*.

**[Note: article 31(2) of the MCD]**

- 12.4.10C G
- (1) If an *appointed representative's* scope of appointment is to include *MCD credit intermediation activity* or *MCD article 3(1)(b) credit intermediation activity*, the *principal* must notify the *FCA* of the appointment before the *appointed representative* commences that activity (see *SUP 12.7.1R(1)*).
  - (2) An *appointed representative* must not commence a *MCD credit intermediation activity* or *MCD article 3(1)(b) credit intermediation activity* until he is included on the *Financial Services Register*.

- (3) If an appointed representative's scope of appointment is to include MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity, the Act provides that that appointed representative's principal may not be a tied MCD credit intermediary or a tied MCD article 3(1)(b) credit intermediary.

...

## 12.5 Contracts: required terms

...

### Prohibition of multiple principals for certain activities

- 12.5.6A R (1) A firm must ensure that, ..., its written contract prohibits the appointed representative from carrying on any of the specified activities as an appointed representative for another firm:
- ...
- (e) any home purchase activities: the prohibition must cover all home purchase activities;
- (f) any MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity: the prohibition must cover all MCD credit intermediation activity and MCD article 3(1)(b) credit intermediation activity.

...

- 12.5.6B G ...
- (2) The effect of the rule prohibiting multiple principals for certain activities is that, in relation to home finance activities, appointed representatives are restricted to having four principals: one for regulated mortgage contracts other than lifetime mortgages, one for lifetime mortgages, one for home reversion plans and one for home purchase plans and in relation to MCD credit intermediation activity and MCD article 3(1)(b) credit intermediation activity, appointed representatives are restricted to one principal.

...

### Required contract terms for appointed representatives of MCD credit intermediaries and MCD article 3(1)(b) credit intermediaries

- 12.5.10 R A firm must ensure that, if appointing an appointed representative to carry on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity, its written contract requires the appointed representative to provide such evidence to the FCA as to the knowledge and competence of the staff of the appointed representative as the FCA may

require from time to time.

[Note: article 9(4) of the MCD]

...

## **12.6 Continuing obligations of firms with appointed representatives or EEA tied agents**

...

12.6.1B R A firm that is a principal of an appointed representative that carries on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity must monitor the activities of that appointed representative so as to ensure compliance with obligations imposed under MCD (including those in MCOB and TC).

[Note: article 31(3) of the MCD]

12.6.1C G SUP 12.6.1BR requires a firm to which that rule applies to monitor the knowledge and competence of the appointed representative that carries on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity and its staff.

...

## **12.7 Notification requirements**

Notification of appointment of an appointed representative

- 12.7.1 R (1) This rule applies to a firm which intends to appoint:
- (a) an appointed representative to carry on insurance mediation activities; ~~or~~
  - (b) a tied agent; or
  - (c) an appointed representative to carry on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity.

...

Notification of changes in information given to the FCA

- 12.7.7 R ...
- (1B) If:
- (a) (i) the scope of appointment of an appointed representative is extended to cover MCD credit intermediation activity or MCD article 3(1)(b) credit

intermediation activity for the first time; and

(ii) the appointed representative is not included on the Financial Services Register; or

(b) the scope of appointment of an appointed representative ceases to include MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity;

the appointed representative's principal must give written notice to the FCA of that change before the appointed representative begins to carry on MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity under the contract (see SUP 12.4) or as soon as the scope of appointment of the appointed representative ceases to include MCD credit intermediation activity or MCD article 3(1)(b) credit intermediation activity.

[Note: article 31(4) of the MCD]

...

Notification of changes in conditions of appointment

12.7.8 R (1) As soon as a *firm* has reasonable grounds to believe that any of the conditions in SUP 12.4.2R, SUP 12.4.6R, or SUP 12.4.8AR, SUP 12.4.10AR or SUP 12.4.10BR (as applicable) are not satisfied ...

...

## **15.8 Notification in respect of particular products and services**

...

15.8.9 R ...

### **MCD credit intermediaries**

15.8.10 R A tied MCD credit intermediary or a tied MCD article 3(1)(b) credit intermediary must notify the FCA as soon as reasonably practicable if it intends to cease acting on behalf of and under the full responsibility of any firm.

15.8.11 R A MCD credit intermediary or a MCD article 3(1)(b) credit intermediary must notify the FCA as soon as reasonably practicable if it intends to start acting on behalf of and under the full responsibility of any firm.

....

## **16.11 Product Sales Data Reporting**

...

Reporting requirement

16.11.3 R ...

(2) The reporting periods are:

...

(b) ...; or

(c) for performance data reports in respect of second charge regulated mortgage contracts that are reported by manually keying in the information, each calendar year ending on 31 December.

...

**16.12 Integrated Regulatory Reporting**

...

16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

(1)		(2)	(3)	(4)
<i>RAG number</i>	<i>Regulated Activities</i>	Provisions containing:		
		<i>applicable data items</i>	reporting frequency/period	due date
...				
<i>RAG 5</i>	<i>home finance administration or home finance providing activity</i>	<i>SUP 16.12.18A R<sub>1</sub> and SUP 16.12.18BR and SUP 16.12.18CR</i>	<i>SUP 16.12.18A R<sub>1</sub> and SUP 16.12.18BR and SUP 16.12.18CR</i>	<i>SUP 16.12.18A R<sub>1</sub> and SUP 16.12.18BR and SUP 16.12.18CR</i>
...				

...

16.12.18A R (1) SUP 16.12.18BR and SUP 16.12.18CR ~~does~~ do not apply to:  
A

...

...

16.12.18 R The applicable *data items*, reporting frequencies and submission deadlines referred to in SUP 16.12.4R are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

Description of <i>data item</i>	<i>Data item</i> (note 1)	Frequency	Submission deadline
Capital Adequacy ( <u>note 4</u> )	...	...	...
...			
Credit Risk ( <del>note</del> <u>notes 2 and 4</u> )	...	...	...
Liquidity ( <del>note</del> <u>notes 3 and 4</u> )	...	...	...
...			
Note 1	... set out in SUP 16 Annex 19AR and SUP 16 Annex 19AA R. Guidance notes...		
...			
Note 4	<u>Not applicable if the firm exclusively carries on home finance administration or home finance providing activities in relation to second charge regulated mortgage contracts.</u>		

16.12.18C R Additional applicable *data items*, reporting frequencies and submission deadlines referred to in SUP 16.12.4 R are set out in the table below for a firm carrying on home finance administration or home finance providing activities in relation to second charge regulated mortgage contracts. Reporting frequencies are calculated from a firm's accounting reference date, unless indicated otherwise. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

Description of <i>data item</i>	<i>Data item</i> (note 1)	Frequency	Submission deadline
<u>Analysis of second charge loans to customers</u>	<u>Section A3(a) MLAR</u>	<u>Quarterly</u>	<u>20 business days</u>
<u>Second charge business flow and rates</u>	<u>Sections D1(a) and D2(a) MLAR</u>	<u>Quarterly</u>	<u>20 business days</u>
<u>Second charge lending to individuals</u>	<u>Sections E1(a) and E2(a)</u>	<u>Quarterly</u>	<u>20 business days</u>

<u>Second charge lending – arrears analysis</u>	<u>Section F(a)</u>	<u>Quarterly</u>	<u>20 business days</u>
<u>Second charge mortgage administration – arrears analysis</u>	<u>Sections H1(a) and H2(a)</u>	<u>Quarterly</u>	<u>20 business days</u>
<u>Note 1</u>	<u>When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Annex 19AR and SUP 16 Annex 19AAR. Guidance notes for the completion of the <i>data items</i> are set out in SUP 16 Annex 19BG.</u>		

# 16 Annex 18AR

**SECTION B: Profit and Loss account**

**B1: Regulated Business Revenue**

	A	B	C	D	E
	Commissions		Fees/Adviser charges/Contingency charges	Other income (reg activities)	Regulated business revenue
	Gross	Net			
1 Regulated mortgage contracts_of which:					
15 <u>Second (or subsequent) charge</u>					
2 Non-investment insurance					
3 Retail investment products					
4 TOTAL					

**B2: Other P&L**

5 Income from other regulated activities	
6 Other Revenue (income from non-regulated activities)	
7 TOTAL REVENUE	
8 TOTAL EXPENDITURE	
9 Profit(Loss) on ordinary activities before taxation	
10 Profit(Loss) on extraordinary activities before taxation	
11 Taxation	
12 Profit(Loss) for the period before dividends and appropriations	
13 Dividends and other appropriations	
14 Retained Profit	

**SECTION G: Training and Competence**

**Special Instructions**

	A	B	C	D	E
	Advising on mortgages	Advising on non-investment insurance (retail customers)	Advising on retail investment products	Advising on <u>second (and subsequent) charge mortgages</u>	Total
1	Total number of all staff				
	Of which:				
2	Number of staff that give advice				
3	Number of staff that give advice (Full time equivalent)				
4	Number of staff that supervise others to give advice				
5	Number of advisers that have been assessed as competent				
6	Number of advisers that have passed approved examinations				
7	Number of advisers that have left since the last reporting date				

**What types of advice were provided?**

	Mortgage	Non-Inv Insurance	Retail Investment Products	<u>Second (and subsequent) charge mortgage</u>
15	Independent			
8	Independent (w hole of market plus option of fee-only)			
9	Whole of market (w ithout fee-only option)			
10	On the basis of a fair analysis of the market			
11	Restricted / Multi-tie (the products of a limited number of providers)			
12	Restricted / Single-tie (the products of one provider)			
16	Restricted (limited types of products)			

**Clawed back commission (retail investment firms only)**

13	Clawed back commission by:	Number	
14		Value	

**16 Annex 18BG      Notes for Completion of the Retail Mediation Activities Return  
(‘RMAR’)**

**Section D: Capital Resources**

...

(i) Section **D1** covers the appropriate capital resources and connected requirements in *MIPRU* chapter 4 for *firms* carrying on *home finance mediation activity* (save in respect of *firms carrying on home finance mediation activities exclusively in relation to second charge regulated mortgage contracts*), and/or *insurance mediation activity* relating to *non-investment insurance contracts* (the requirements have to be completed for all applicable categories). ...

...

## 16 Annex 19AAR

### A(3)a BALANCE SHEET (SECOND CHARGE)

(£000s)

		c1	c2	c3	c4	c5	c6	c7
		<u>a Unsecured balances</u>			<u>b Securitised balances</u>			
		<i>Gross balances</i>	<i>Provisions</i>	<i>Net balances</i>	<i>Gross balances</i>	<i>Provisions</i>	<i>Non recourse finance</i>	<i>Net balances</i>
<b>A3a</b>	<b>Analysis of loans to customers</b>							
<b>A3a.1</b>	Residential loans to individuals, of which							
<b>A3a.2</b>	Second (or subsequent) charge							

D(1)a **SECOND CHARGE LENDING : Business flows & rates**

	c1	c2	c3	c4	c5	c6	c7	c8	c9	c10
	Balance at end of previous quarter	Advances made in quarter	Repayment of principal	Write offs in quarter	Other debits/ (credits) and transfers (net)	Balance at end of quarter	Of which: Loans excluding overdrafts	Overdrafts	Overdrafts: Aggregate of credit limits	
D1a <b>Loans: Advances/ Repayments</b>										
D1a.1 Residential loans to individuals, of which Second (or subsequent) charge										
<b>Transactions in quarter included in D1 [col 5]</b>						<b>Balance at end of quarter on loan assets subject to non-recourse funding</b>				
	Loans acquired	Loans sold	Loans securitised	Other	Total					
D2a <b>Loans: Book movements</b>										
D2a.1 Residential loans to individuals, of which Second (or subsequent) charge										
<b>Balances at end of quarter</b>							<b>Interest rates at end of quarter (to 2 decimal places)</b>			
	TOTAL	Of which at:		Of which at:			Weighted average nominal annual rate on:			
		Fixed rates	Variable rates	Less than 2% above BBR	2 < 3% above BBR	3 < 4% above BBR	4% or more above BBR	All balances	Balances at fixed rates	Balances at variable rates
D3a <b>Loans: Interest rates</b>	(£000's)	(£000's)	(£000's)	(£000's)	(£000's)	(£000's)	(£000's)	%	%	%
D3a.1 Second (or subsequent) charge Total book										
D3a.2 Advances in quarter										

D(2)a **SECOND CHARGE LENDING: Business flows**

	Commitments outstanding at end of previous quarter	Commitments made since end of previous quarter	Cancellations in quarter	Advances made in quarter	Other debits/ (credits) and transfers (net)	Commitments outstanding at end of quarter
	c1	c2	c3	c4	c5	c6
D4a <b>Loans: commitments</b>						
D4a.1 Residential loans to individuals, of which Second (or subsequent) charge						
a) New loan						
b) Remortgage						
d) Total						

**E(1)a SECOND CHARGE LOANS TO INDIVIDUALS: Income Multiple & LTV**

		<u>Gross advances in quarter : (amount) by LTV</u>			
		<u>&lt; = 75 %</u>	<u>Over 75 &lt; = 90 %</u>	<u>Over 90 &lt; = 95 %</u>	<u>Over 95 %</u>
		c1	c2	c3	c4
<b>E1a</b>	<b>SINGLE income multiple</b>				
	Second (or subsequent) charge mortgages				
E1a.1	Less than 2.50	_____	_____	_____	_____
E1a.2	2.50 < 3.00	_____	_____	_____	_____
E1a.3	3.00 < 3.50	_____	_____	_____	_____
E1a.4	3.50 < 4.00	_____	_____	_____	_____
E1a.5	4.00 or over	_____	_____	_____	_____
E1a.6	Other	_____	_____	_____	_____
E1a.7	TOTAL second (or subsequent) charge	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
E1a.7a	of which: Not evidenced	_____	_____	_____	_____

		<u>Gross advances in quarter : (amount) by LTV</u>			
		<u>&lt; = 75 %</u>	<u>Over 75 &lt; = 90 %</u>	<u>Over 90 &lt; = 95 %</u>	<u>Over 95 %</u>
		c1	c2	c3	c4
<b>E2a</b>	<b>JOINT income multiple</b>				
	Second (or subsequent) charge mortgages				
E2a.1	Less than 2.00	_____	_____	_____	_____
E2a.2	2.00 < 2.50	_____	_____	_____	_____
E2a.3	2.50 < 2.75	_____	_____	_____	_____
E2a.4	2.75 < 3.00	_____	_____	_____	_____
E2a.5	3.00 or over	_____	_____	_____	_____
E2a.6	Other	_____	_____	_____	_____
E2a.7	TOTAL second (or subsequent) charge	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
E2a.7a	of which: Not evidenced	_____	_____	_____	_____

**E(2)a SECOND CHARGE LOANS TO INDIVIDUALS: Nature of loan and purpose**

		<u>Second (or subsequent) charge mortgages</u>			
		<u>Gross advances in quarter</u>		<u>Balances outstanding</u>	
		<i>Number</i>	<i>Amount</i>	<i>Number</i>	<i>Amount</i>
		<b>c1</b>	<b>c2</b>	<b>c3</b>	<b>c4</b>
<b>E3a By credit history</b>					
E3a.1	Impaired credit history	_____	_____	_____	_____
E3a.2	Other	_____	_____	_____	_____
E3a.3	TOTAL second (or subsequent) charge	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<b>E4a By payment type</b>					
E4a.1	Repayment (capital & interest)	_____	_____	_____	_____
E4a.2	Interest only	_____	_____	_____	_____
E4a.3	Combined	_____	_____	_____	_____
E4a.4	Other	_____	_____	_____	_____
E4a.5	TOTAL second (or subsequent) charge	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<b>E5a By drawing facility</b>					
E5a.1 Loans with extra drawing facility :					
	(a) Loans including unused facility	_____	_____	_____	_____
	(b) Unused facility	_____	_____	_____	_____
	(c) Net loans (a - b)	_____	_____	_____	_____
E5a.2 Loans with no extra drawing facility					
E5a.3	TOTAL second (or subsequent) charge	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<b>E6a By purpose</b>					
House Purchase:					
E6a.1	Home improvement	_____	_____	_____	_____
E6a.2	Debt consolidation	_____	_____	_____	_____
E6a.3	Home improvement and debt consolidation	_____	_____	_____	_____
E6a.4	Other	_____	_____	_____	_____
E6a.5	TOTAL second (or subsequent) charge	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

**F(1)a SECOND CHARGE LENDING: Arrears analysis**

(£000s)

Arrears categorisation by type of loan	<u>Cases entering higher (ie more serious) arrears band in quarter</u>			<u>Position on all arrears cases at end of quarter</u>			Performance of current arrears cases during the quarter
	Number	Amount of arrears	Balance outstanding	Number	Amount of arrears	Balance outstanding	
F1a	Second (or subsequent) charge mortgages						%
F1a.1	1.5 < 2.5 %						
F1a.2	2.5 < 5 %						
F1a.3	5.0 < 7.5 %						
F1a.4	7.5 < 10 %						
F1a.5	10% or more						
F1a.6	In possession						
F1a.7	TOTAL						

**F(2)a LENDING: Arrears analysis**

(£000s)

F5a	Arrears management	Those cases no longer reported (ie not included in F1a)			Capitalisation of arrears cases in quarter			Arrears cases reported in F1a		
		<u>Possession sales during quarter</u>			<u>Number of cases for which there is in place:</u>					
		Number	Balance outstanding	Number	Amount of arrears	Balance outstanding	A temporary concession	A formal arrangement	No concession arrangement	
F5a.1	Residential loans to individuals, of which Second (or subsequent) charge									

H(1)a SECOND CHARGE MORTGAGE ADMINISTRATION: Arrears analysis		(£000s)						
		c1	c2	c3	c4	c5	c6	c7
Arrears categorisation by type of loan		<u>Cases entering higher (ie more serious) arrears band in quarter</u>			<u>Position on all arrears cases at end of quarter</u>			<u>Performance of current arrears cases during the quarter</u>
		<u>Number</u>	<u>Amount of arrears</u>	<u>Balance outstanding</u>	<u>Number</u>	<u>Amount of arrears</u>	<u>Balance outstanding</u>	%
H1a	Second (or subsequent) charge mortgages							
H1a.1	1.5 < 2.5 %							
H1a.2	2.5 < 5 %							
H1a.3	5.0 < 7.5 %							
H1a.4	7.5 < 10 %							
H1a.5	10% or more							
H1a.6	In possession							
H1a.7	TOTAL							

H(2)a MORTGAGE ADMINISTRATION: Arrears analysis		(£000s)								
		c1	c2	c3	c4	c5	c6	c7	c8	c9
Arrears categorisation by type of loan		<u>Those cases no longer reported (ie not included in H1 to H3.7)</u>			<u>Capitalisation of arrears cases in quarter</u>			<u>Arrears cases reported in H1 to H3.7 at end quarter</u>		
		<u>Possession sales during quarter</u>			<u>Number</u>			<u>Number of cases for which there is in place:</u>		
		<u>Number</u>	<u>Balance outstanding</u>	<u>Number</u>	<u>Amount of arrears</u>	<u>Balance outstanding</u>	<u>A temporary concession</u>	<u>A formal arrangement</u>	<u>No concession arrangement</u>	
H5a	Arrears management									
H5a.1	Residential loans to individuals, of which Second (or subsequent) charge									

**16 Annex 19BG      Notes for Completion of the Mortgage Lenders & Administrators Return ('MLAR')**

...

**1. Introduction**

This section covers a number of points that have relevance across the return generally:

...

- Loans made before 31 October 2004
- Second charge regulated mortgage contracts

...

**2. Overview of reporting requirements**

...

[Insert the following text into the appropriate numerical positions in the table:]

<b>Section</b>	<b>Applicability</b>
...	
<u>A3(a): Analysis of second charge loans to customers</u>	<u>Applies to all home finance activity firms in respect of second charge regulated mortgage contracts.</u>
...	
C: Capital	Applies to all <i>home finance activity firms</i> except:  ...  - <u>A firm which exclusively carries on home finance activities in relation to second charge regulated mortgage contracts, as set out in SUP 16.12.18BR (note 4).</u>
...	
<u>D(a): Second charge business flow and rates</u>	<u>Applies to all home finance providing activity firms in respect of second charge regulated mortgage contracts.</u>
...	
<u>E1(a) and E2(a): Second charge lending to individuals</u>	<u>Applies to all home finance providing activity firms in respect of second charge regulated mortgage contracts.</u>

...	
<u>F(a): Second charge lending – arrears analysis</u>	<u>Applies to all home finance providing activity firms in respect of second charge regulated mortgage contracts.</u>
...	
<u>H (a): Second charge mortgage administration – arrears analysis</u>	<u>Applies to all firms with permission to undertake administering a home finance transaction, in respect of second charge regulated mortgage contracts.</u>
...	
L: Credit Risk	Applies to a firm that meets the conditions of SUP 16.12.18BR (note notes 2 and 4).
M: Liquidity	Applies to a firm that meets the conditions of SUP 16.12.18BR (note notes 3 and 4).

...

#### 4. Regulated mortgage contracts and the wider mortgage market

...

##### (ii) Residential loans to individuals

...

Examples of **non-regulated mortgage contracts** which fall under the wider category of residential loans to individuals include: buy-to-let loans and other types of loan where the property is not for use by the borrower (or qualifying dependants); ~~and residential loans to individuals where the lender does not have a first charge. In the case where a lender takes a first and a second charge over the same residential property (for different purposes) we consider that generally the loan secured by the first charge will be a regulated mortgage contract, but that the loan secured by the second charge will invariably not and should be reported as non-regulated.~~

~~Pending the UK implementation of the Mortgage Credit Directive, even though loans secured by a second or subsequent charge on residential property may potentially be regulated credit agreements, firms completing the MLAR in the period after 1 April 2014 should continue to include second charge mortgage business as business falling within non-regulated mortgage contracts.~~

~~It is important, therefore, to separate this category from all other forms of secured lending.~~

...

(iv) **Regulated mortgage contract**

This is defined in the *Handbook* as follows:

- (a) (in relation to a contract) (in accordance with article 61(3) of the *Regulated Activities Order*) a contract which, at the time it was entered into, meets the following conditions:

...

- (ii) the obligation of the borrower to repay is secured by a ~~first legal mortgage on land (other than timeshare accommodation)~~ in the United Kingdom, at least 40% of which is used, or is intended to be used, as or in connection with a dwelling, ~~by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a person who is in relation to the borrower or (in the case of credit provided to trustees) a beneficiary of the trust:~~

~~(A) that person's spouse; or~~

~~(B) a person (whether or not of the opposite sex) whose relationship with that person has the characteristics of the relationship between husband and wife; or~~

~~(C) that person's parent, brother, sister, child, grandparent or grandchild.~~

...

This means that in relation to a *regulated mortgage contract*, the following conditions must all be satisfied:

- ...
- the lender must take a ~~first legal~~ mortgage over *UK EEA* property; and
- the property must be at least 40% occupied as a dwelling ~~by the borrower or his immediate family.~~

... For example, it includes a significant amount of short-term ~~first charge~~ lending. ...

...

(v) **Second charge regulated mortgage contracts**

A second charge regulated mortgage contract is defined in the *Handbook* as a regulated mortgage contract which is not a first charge legal mortgage. It therefore includes second and subsequent charge mortgages.

Data which is provided in relation to a *second charge regulated mortgage contract* in A3(a), D (a), E(1)(a), E(2)(a), F(a), or H(a) in SUP 16 Annex 19 AAR will also need to be provided as part of the *data items* in A3, D, E, F or H as the case may be in SUP 16 Annex 19AR.

The guidance on how to submit the *data items* in A3, D, E, F or H of SUP 16 Annex 19AR applies to A3(a), D(a), E(1)(a), E(2)(a), F(a) or H(a), as the case may be, of SUP 16 Annex 19AAR where the same terms are used in the corresponding parts of SUP 16 Annex 19AAR.

...

## 8. Loans made before 31 October 2004

This section does not apply to *second charge regulated mortgage contracts*.

### (i) Classifying the ‘back book’

...

### (ii) Specific treatment of residential loans to individuals

Any loans made before 31 October 2004, that otherwise satisfy the specific requirements of a *regulated mortgage contract*, should be reported as **non-regulated loans** in the various parts of the *MLAR* (~~since only those loans advanced after this date are required to be treated as a *regulated mortgage contract* for the purposes of *MLAR* reporting).~~

...

## 16 Annex 21R Reporting Fields

...

### 2 SPECIFIC REPORTING FIELDS

...

#### (c) Mortgages

**The following data reporting fields must be completed, where applicable for all relevant *regulated mortgage contracts* except any *second charge regulated mortgage contract* that is entered into before 21 March 2016.**

...

Data reporting	Code (where applicable)	Notes

<b>Sales Data (report for all <i>regulated mortgage contracts</i>)</b>		
...		
Type of mortgage	<p>...</p> <p>SE = secured overdraft</p> <p><u>SC = second charge regulated mortgage contract</u></p> <p>NA = not applicable</p>	...
Mortgage characteristics	<p>...</p> <p>OS = offset positive and/or negative balances</p> <p><u>EL = a second charge regulated mortgage contract that is a shared equity credit agreement</u></p> <p>NA = not applicable</p>	...
...		
Type of borrower	...	<p>Report 'O' for <i>lifetime mortgages</i>, <u>and bridging loans and second charge regulated mortgage contracts that are not for remortgage purposes.</u></p>
...		
<i>Procurator fee paid to mortgage intermediary or other third party</i>	...	

<u>Second charge regulated mortgage contracts only</u>	<u>H = home improvements</u> <u>D = debt consolidation</u> <u>O = other</u>	Use code to indicate the purpose of the <u>second charge regulated mortgage contract</u> <u>Only 1 code can be entered</u>
...		
<b>Affordability data</b>		
...		
...		
Were the <i>MCOB</i> 11.7 transitional arrangements used?	...	... as set out in <i>MCOB</i> 11.7. <u>Second charge regulated mortgage contracts must be reported as 'N'.</u>

## Annex F

### Amendments to Dispute Resolution: Complaints (DISP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

...

1.2.2A      G      If a MCD credit intermediary or MCD article 3(1)(b) credit intermediary has, prior to or at the point of sale, provided an eligible complainant with appropriate information in a durable medium regarding their internal procedures for the reasonable and prompt handling of complaints pursuant to another rule, the MCD credit intermediary or MCD article 3(1)(b) credit intermediary need not refer to the availability of that information again under DISP 1.2.1R(2)(b).

...

## Annex G

### Amendments to Compensation (COMP)

In this Annex, underlining indicates new text.

#### TP 1 Transitional Provisions

##### 1.1 Transitional Provisions Table

(1)	(2) Material to which the transitional applies	(3)	(4) Transitional Provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
<u>35</u>	<u>All the rules and guidance in COMP applicable to protected home finance mediation.</u>	<u>R</u>	<p><u>The compensation scheme does not provide cover for claims in respect of any mortgage mediation activity relating to a second charge regulated mortgage contract if:</u></p> <p><u>(1) the relevant person was in default before 21 March 2016; or</u></p> <p><u>(2) the basis for the claim arose before 21 March 2016.</u></p>	<u>From 21 March 2016 indefinitely</u>	<u>Not applicable</u>

## Annex H

### Amendments to the Perimeter Guidance Manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

...

2.3.2 G ...

- (4) The business element for all other *regulated activities* is that the activities are carried on by way of business. This applies to the activities of *effecting or carrying out contracts of insurance*, certain activities relating to the Lloyd's market, *entering as provider into a funeral plan contract, advising on regulated credit agreements the purpose of which is to acquire land, entering into a home finance transaction or administering a home finance transaction, operating a dormant account fund, credit-related regulated activities and operating an electronic system in relation to lending* carried on by persons other than *not-for-profit bodies*.

2.5 **Investments and activities: general**

(...)

#### **Modification of certain exclusions as a result of MiFID ~~and the Insurance Mediation Directives~~ and the Mortgage Credit Directive**

2.5.3 G The application of certain of the exclusions considered in *PERG 2.8* (Exclusions applicable to certain regulated activities) and *PERG 2.9* (Regulated activities: exclusions applicable to certain circumstances) is modified in relation to *persons* who are subject to ~~*MiFID* or the *Insurance Mediation Directive*~~ *MiFID*, the *Insurance Mediation Directive* and the *MCD*. The reasons for this and the consequences of it are explained in *PERG 2.5.4 G* as respects *MiFID*, ~~and~~ *PERG 5* (Insurance mediation activities), as respects the *Insurance Mediation Directive* and *PERG 4.10A*, as respects the *MCD*.

(...)

#### **Rights under a regulated mortgage contract**

2.6.27 G ...

- (1) the contract is one where the lender provides credit to an individual or trustees (the "borrower");

- (2) the obligation of the borrower to repay is secured by a first legal charge on land (~~other than timeshare accommodation~~) in the United Kingdom in the *EEA*; and
- (3) at least 40% of that land is used, or is intended to be used, as or in connection with a dwelling ~~by the borrower (or, where trustees are the borrower, by an individual who is a beneficiary of the trust) or by a related person.~~

Detailed guidance on this is set out in *PERG 4.4* (Guidance on regulated activities connected with mortgages), however generally speaking the definition of *regulated mortgage contract* does not include certain loans to commercial borrowers, second charge loans by a credit union and second charge bridging loans (see *PERG 4.4.1-A G*).

...

2.7.16E ...

**Advising on regulated credit agreements the purpose of which is to acquire land**

2.7.16F G Under article 53E of the *Regulated Activities Order* advising a person (“P”) is a *regulated activity* if:

- (1) the advice is given to P in P’s capacity as a recipient of credit, or potential recipient of credit, under a *regulated credit agreement*;
- (2) P intends to use the credit to acquire or retain property rights in *land* or in an existing or projected building; and
- (3) the advice consists of the provision of personal recommendations to P in respect of one or more transactions relating to *regulated credit agreements*.

...

2.7.19FA G The exclusion referred to in *PERG 2.7.19F G* will not be available to a *firm* that is an *MCD firm* (see *PERG 4.10A* (Activities Regulated under the Mortgage Credit Directive)).

...

2.7.19GA G The exclusion referred to in *PERG 2.7.19G G* will not be available to a *firm* that is an *MCD firm* (see *PERG 4.10A* (Activities Regulated under the Mortgage Credit Directive)).

...

- 2.7.19J G ...
- (2) the agreement is either: ~~either secured on land or for credit which exceeds £60,260;~~
- (a) secured on land; or
- (b) for credit which exceeds £60,260 and
- (i) for a purpose other than the renovation of residential property; or
- (ii) to acquire or retain property rights in land or in an existing or projected building
- 2.7.19JA G The exclusion referred to in PERG 2.7.19J G will not be available to a firm that is an MCD firm (see PERG 4.10A (Activities Regulated under the Mortgage Credit Directive)).
- ...
- 2.8.6 G ...
- (1) those relating to arranging a particular transaction or a contract, agreement or plan variation (articles 25(1), 25A(1), ~~25A(2A)~~ 25B(1), 25C(1) , and 25E(1) of the *Regulated Activities Order*); and
- ...
- ...
- 2.8.6BA G The exclusion referred to in PERG 2.8.6A G (4) will not be available to persons who, when carrying on an arranging activity, are MCD firms (see PERG 4.10A (Activities Regulated under the Mortgage Credit Directive)).
- ...
- 2.8.12 G ...
- (4) ~~advising on a home purchase plan; and~~
- (5) ~~advising on a regulated sale and rent back agreement; and~~
- (6) advising on regulated credit agreements the purpose of which is to acquire land.
- ...
- 2.8.12A G Advice given by an *unauthorised person* in relation to a home finance transaction or advising on regulated credit agreements the purpose of which

*is to acquire land* in the circumstances referred to in *PERG 2.8.6AG (5)(a)* or (b) (Arranging deals in investments and arranging a home finance transaction) is also excluded. In addition:

- (1) the following exclusions apply in specified circumstances where a *person is advising on investments, advising on regulated credit agreements the purpose of which is to acquire land or advising on a home finance transaction*:

...

2.9.3 G ...

(2A) ...

- (7) *advising on investments ~~or advising on regulated credit agreements the purpose of which is to acquire land~~ or advising on a home finance transaction.*

The exclusion is, however, disapplied where a *person* is carrying on *insurance mediation ~~or reinsurance mediation~~, reinsurance mediation* or the *person* would be a *MCD firm*. This is due to article 4(4A) and 4(4B) of the *Regulated Activities Order*. *Guidance* on exclusions relevant to *insurance mediation activities* is in *PERG 5 (Insurance mediation activities)* and *guidance* on activities and exclusions relevant to the *MCD* is in *PERG 4.10A (Activities regulated under the Mortgage Credit Directive)*.

...

2.9.5 G ...

- (5) *advising on investments ~~or advising on regulated credit agreements the purpose of which is to acquire land~~ or advising on a home finance transaction.*

...

The exclusion is also disapplied for *persons* who, when carrying on the relevant *regulated activity*, are *MiFID investment firms* or *third country investment firms* (see *PERG 2.5.4 G* to *PERG 2.5.5 G (Investment services and activities)*).

The exclusion is also disapplied for persons who, when carrying on the relevant regulated activity, are MCD firms (see PERG 4.10A (Activities regulated under the Mortgage Credit Directive)).

...

2.9.23 G ...

- (20A) *advising on regulated credit agreements the purpose of which is to acquire land*

...  
2.9.24 G (1) Subject to (2) ~~,(3)~~ and ~~(3)~~ (4), the exclusions apply, in relation to any activity carried on by a *local authority*.

...  
(3) The exclusion relating to *entering into a regulated credit agreement as lender and exercising, or having the right to exercise, the lender's rights and duties under a regulated credit agreement* applies only in so far these activities are not carried on for the purpose of acquiring or retaining property rights in land or in an existing or projected building and relate to credit agreements of a kind to which the Consumer Credit Directive does not apply under article 2(2) of that Directive. In summary, these include credit agreements:

(a) ~~which are secured by a legal or equitable mortgage on land;~~

(b) ~~the purpose of which is to acquire or retain property rights in land or in an existing or prospective building;~~

...  
(4) The exclusion relating to *entering into a regulated credit agreement as lender and exercising, or having the right to exercise, the lender's rights and duties under a regulated credit agreement* for activities that are carried on for the purpose of acquiring or retaining property rights in land or in an existing or projected building apply to local authorities and (in some cases) their subsidiaries only when the relevant credit agreement:

(a) is of a kind to which the Consumer Credit Directive does not apply under article 2(2) of that Directive, and

(b) meets one of the following conditions:

(i) it is an agreement listed in PERG 4.10A.5 G;

(ii) it is a bridging loan described in PERG 4.13.6 G; or

(iii) it is a restricted public loan described in PERG 4.13.7 G

...  
4.2.3 G ...

(5) ...

(5A) if so, is the exclusion on which I am relying disapplied because the business is subject to the Mortgage Credit Directive (see PERG 4.10A (Activities regulated under the Mortgage Credit Directive))?

...

...

4.3.1 G ...

(1) (articles 25A(1) and 25A(2A) (Arranging regulated mortgage contracts));

...

4.3.5 G Summary of which variant of the business test applies to the different regulated mortgage activities. This table belongs to PERG 4.3.4G.

By way of business	Carrying on the business
...	<i>Arranging (bringing about) regulated mortgage contracts (article 25A(1) <u>and arranging (bringing about) mortgage contracts behalf of a lender article 25A(2A)</u>)</i>
...	...
	...

...

4.4.1 G ...

(1) ...

(2) the contract provides for the obligation of the borrower to repay to be secured by a first legal mortgage on land (~~other than timeshare accommodation~~) in the EEA United Kingdom; and

(3) at least 40% of that land is used, or is intended to be used, as or in connection with a dwelling ~~by the borrower (or, where trustees are the borrower, by an individual who is a beneficiary of the trust) or by a related person.~~

This section ~~PERG 4.4.2G to PERG 4.4.9G~~ sets out the FCA's understanding of some key concepts contained in article 61(3)(a). ...

4.4.1-A G A contract is not a regulated mortgage contract if it is:

(1) a loan to a commercial borrower excluded as described in PERG

4.4.17G or PERG 4.4.21G; or

(2) a second charge loan by a credit union excluded as described in PERG 4.4.25G; or

(3) a second charge bridging loan excluded as described in PERG 4.4.28G; or

Provision of credit

4.4.1A G (1) ...

(2) In the *FCA's* view, an obligation to repay implies the existence, or the potential for the existence, of a debt owed by the individual to whom the financial accommodation is provided (the 'borrower') to the person who provides it (the 'lender'). Consequently, for any facility under which any form of financial accommodation is being provided, the test is whether it allows for the possibility that the person providing the financial accommodation may be placed in a position where he becomes a creditor of the individual to whom he is providing it. ~~An example of this would be the issue of a guarantee by a bank to a third party for an individual customer (such as a rent guarantee or a performance bond) where the guarantee is secured on a first legal charge over the customer's residential property. In the *FCA's* view, this would amount to a regulated mortgage contract as the customer would owe a debt to the bank in the event that the bank had to pay the third party under the guarantee.~~

...

4.4.2 G ...

4.4.2A G (1) A loan to a trustee is caught even if the trustee or the beneficiary is not an individual.

(2) Therefore it is possible that a loan to a trustee acting for a large commercial company is a regulated mortgage contract.

(3) In practice the exclusions for loans to commercial borrowers (in particular, see PERG 4.4.17G and PERG 4.4.21G) are likely to prevent such loans from being regulated mortgage contracts.

(4) If:

(a) the loan is made to a trustee;

(b) the trustee is a bare trustee or nominee; and

(c) the beneficiary of the trust is acting for commercial purposes;

it is likely that the trustee will also be acting for commercial purposes.

4.4.2B G A loan to a partnership may be a loan to an individual if the partnership is made up of real people (that is, natural, as opposed to legal, *persons*).

...

Land in the ~~EEA~~ United Kingdom

4.4.5 G The condition set out in *PERG* 4.4.1G(2) means that a *regulated mortgage contract* must be secured on land in the ~~EEA~~ United Kingdom. ...

Occupancy requirement

4.4.6 G The condition set out in *PERG* 4.4.1G(3) means that loans secured on property which is entirely used for business purposes (such as an office block) cannot fall within the definition. However, loans secured on 'mixed use' property could be covered, provided that the occupier borrower (or trust beneficiary, where the borrowers are trustees) or a 'related person' uses at least 40% of the total of the land as or in connection with a dwelling. Loans secured on a six-floor property, half of which was occupied by a family as their home ~~the borrower~~ and half let out for business purposes would therefore satisfy the definition. (Article 61(4)(b) makes it clear that 'land', in the context of a multi-storey building, means the aggregate of the floor area of each of the storeys.)

4.4.6A G The most obvious example of *regulated mortgage contract* is a loan made to an individual to enable the individual to buy a home for themselves where the loan is secured on that home. However, there is no requirement that the borrower should occupy the property. There is a requirement that at least 40% of the land should be used as a house but no requirement that it is the borrower who uses it as a house. So for example:

- (1) A loan may be a *regulated mortgage contract* if the property on which it is secured is to be occupied by the borrower's relatives as their home.
- (2) A loan may be a *regulated mortgage contract* if the borrower does not occupy the property on which the loan is secured and instead intends to sell the property to a third party, with the mortgage remaining on the house until then.
- (3) However if the borrower is acting on a commercial basis, the loan in (2) may be excluded as a loan to a commercial borrower under the exclusions in *PERG* 4.4.17G or *PERG* 4.4.21G.
- (4) A buy-to-let loan secured on the property to be let is potentially a *regulated mortgage contract*. However such a loan may be excluded as a loan to a commercial borrower under the exclusions referred to in (3) or under the buy to let exclusions.

4.4.7 G ...

- 4.4.8 G ~~The requirement that at least 40% of the land area be used as or in connection with a dwelling means that 'buy to let' loans secured on the property to be let will usually be excluded. However, such loans will not be excluded if: [Deleted]~~
- ~~(1) the lessee is a 'related person' to the borrower. This will be the case even if the borrower subsequently takes possession of the property, as the conditions set out in PERG 4.4.1G(1) to PERG 4.4.1G(3) were not satisfied at the outset of the contract (see PERG 4.4.3G); or~~
  - ~~(2) at the time the contract is entered into, the borrower has a real intention to use the land as, or in connection with, a dwelling (for example a member of the British Forces Posted Overseas who buys a property in the *United Kingdom* intending to live there on his return but which he lets out in the meantime).~~

- 4.4.9 G ~~'Related person' is defined in article 61(4)(c) of the *Regulated Activities Order* as meaning the borrower's spouse, civil partner, parents, grandparents, siblings, children and grandchildren. An unmarried partner of the borrower whose relationship with the borrower has the characteristics of the relationship between a husband and wife is also included; this can include a *person* of the same sex as the borrower. Stepchildren, however, would seem to be excluded. [Deleted]~~

...

- 4.4.11 G The definition of *regulated mortgage contract* also covers a variety of types of product. Apart from the normal mortgage loan for the purchase of property, the definition also includes other types of secured loan, such as secured overdraft facility, a *bridging loan* (although bridging loans described in PERG 4.4.28G are not regulated mortgage contracts), a secured credit card facility and *regulated lifetime mortgage contracts* under which the borrower (usually an older person) takes out a loan where repayment of the capital (and in some cases the interest) is not required until the property is sold, usually on the death of the borrower.

- 4.4.12 G ~~A number of products, however, are excluded from the definition, such as: Loans secured on commercial premises are not regulated mortgage contracts as the property will not be used as or in connection with a dwelling.~~

- ~~(1) loans secured by a second or subsequent charge (as the lender does not have a first charge); and~~
- ~~(2) loans secured on commercial premises (as the borrower will not be using the land as or in connection with a dwelling).~~
- ~~(3) [deleted]~~

~~Regulated mortgage contracts and contract variations~~

- 4.4.13 G ~~The effect of the *Regulated Activities Order* is that mortgage contracts which are varied can fall into one of the following categories: [deleted]~~
- ~~(1) a contract that was entered into before 31 October 2004, and that is subsequently varied on or after that date so that it satisfies the conditions set out in *PERG 4.4.1 G(1)* to *PERG 4.4.1G(3)*, will not be a *regulated mortgage contract* (because it was not a *regulated mortgage contract* at the time it was entered into);~~
  - ~~(2) a contract that was originally entered into before 31 October 2004, but is subsequently changed on or after that date such that a new contract is entered into, will be a *regulated mortgage contract* (provided, of course, that it meets the definition in the *Regulated Activities Order*); and~~
  - ~~(3) a *regulated mortgage contract* that was originally entered into on or after 31 October 2004, and which is subsequently varied by, for example, making a further advance, will remain a *regulated mortgage contract*.~~

- 4.4.14 G ~~It is possible for more than one mortgage contract to be secured by the same (first) charge. The first contract might be entered into before 31 October 2004 (and therefore not be a *regulated mortgage contract*) and a second contract entered into on or after 31 October 2004 (and be a *regulated mortgage contract*). [deleted]~~

#### Type of security

- 4.4.15 G A loan may be a *regulated mortgage contract* whether it is secured by a first, second or subsequent mortgage.

- 4.4.16 G A mortgage has a wide meaning for the purpose of the definition of a *regulated mortgage contract*. It includes:

- (1) a legal mortgage;
- (2) equitable security;
- (3) (in Scotland) a heritable security; and
- (4) security commonly used in another *EEA State* for loans secured on residential property.

#### Exclusions for lending to commercial borrowers

- 4.4.17 G A contract is excluded from the definition of *regulated mortgage contract* if, at the time it is entered into, it meets the following conditions:

- (1) it meets the conditions in *PERG 4.4.1G(1)* to (3); and
- (2) less than 40% of the land secured by the mortgage is used, or intended to be used, as or in connection with a dwelling by the

borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person; and

(3) the agreement is entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

4.4.18 G The RAO refers to this as an “investment property loan”.

4.4.19 G Related person means in relation to the borrower or (in the case of credit provided to trustees) a beneficiary of the trust:

(1) that person’s spouse or civil partner;

(2) a person (whether or not of the opposite sex) whose relationship with that person has the characteristics of the relationship between husband and wife; or

(3) that person’s parent, brother, sister, child, grandparent or grandchild.

4.4.20 G (1) This paragraph sets out examples of loans that are excluded from the definition of *regulated mortgage contract* by the exclusion of loans to commercial borrowers described in *PERG 4.4.17G*.

(2) If less than 40% of the land secured by the mortgage is used, or intended to be used, as or in connection with a dwelling then the exclusion is irrelevant as the loan falls outside *PERG 4.4.1* and so cannot be a *regulated mortgage contract*.

(3) The exclusion becomes relevant if at least 40% of the land secured by the mortgage is used, or intended to be used, as or in connection with a dwelling by:

(a) someone other than the borrower; or

(b) the borrower and someone else, if the percentage used by the borrower as residential property is less than 40%.

(4) Therefore the exclusion would for example cover a loan secured on residential property where the borrower is not going to occupy any of the property but is going to sell it to a third party.

4.4.21 G There is also an exclusion for loans to commercial borrowers secured by a second or subsequent security. A contract is excluded from the definition of *regulated mortgage contract* if, at the time it is entered into, it meets the following conditions:

(1) it meets the conditions in *PERG 4.4.1G*(1) to (3); and

(2) the lender provides the borrower with credit exceeding £25,000; and

- (3) the mortgage ranks in priority behind one or more other mortgages affecting the land in question; and
- (4) the agreement is entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

4.4.22 G The RAO refers to this as a “second charge business loan”.

4.4.23 G Many commercial borrowers will of course be *companies*. Secured loans to *companies* are not *regulated mortgage contracts* because a *regulated mortgage contract* only covers a loan to an individual (see *PERG* 4.4.1G(1)). Therefore a loan to a *company* is not a *regulated mortgage contract* even if it does not meet the conditions for the exclusions for loans to commercial borrowers.

- 4.4.24 G
- (1) There is no exclusion from the £25,000 floor in *PERG* 4.4.21G(2) for an item entering into the *total charge for credit*.
  - (2) Giving time for payment of interest if the borrower gets into difficulty does not affect the calculation of the sum as the definition relates to the time at which the contract is entered into.
  - (3) However, for example, if the credit includes a broker fee, that fee may be excluded in the calculation of the floor.

Exclusion for lending by credit unions

4.4.25 G A contract is excluded from the definition of *regulated mortgage contract* if, at the time it is entered into, it meets the following conditions:

- (1) it meets the conditions in *PERG* 4.4.1G(1) to (3); and
- (2) the lender is a *credit union*; and
- (3) it is a *borrower-lender agreement*; and
- (4) the mortgage ranks in priority behind one or more other mortgages affecting the land in question; and
- (5) the rate of the *total charge for credit* does not exceed 42.6 per cent.

4.4.26 G The RAO refers to this as a “limited interest second charge credit union loan”.

4.4.27 G The exclusion in *PERG* 4.4.25G only applies if the loan meets the following conditions:

- (1) the borrower receives timely information on the main features, risks and costs of the contract at the pre-contractual stage; and

- (2) any advertising of the contract is fair, clear and not misleading.

Exclusion for second charge bridging loans

4.4.28 G A contract is excluded from the definition of *regulated mortgage contract* if, at the time it is entered into, it meets the following conditions:

- (1) it meets the conditions in *PERG 4.4.1G*(1) to (3); and
- (2) it is a *borrower-lender-supplier agreement* financing the purchase of land; and
- (3) it is used by the borrower as a temporary financing solution while changing to another financial arrangement for the land secured by the mortgage; and
- (4) the mortgage ranks in priority behind one or more other mortgages affecting the land in question; and
- (5) the number of payments to be made by the borrower under the contract is not more than four.

4.4.29 G The *RAO* refers to this as a “limited payment second charge bridging loan”.

Certificate that borrower is not a consumer

4.4.31 G The two exclusions for loans to commercial borrowers (*PERG 4.4.17G* and *PERG 4.4.21G*) depend on the borrower not being a consumer. For these purposes, if an agreement includes a declaration which:

- (1) is made by the borrower; and
- (2) includes:
- (a) a statement that the agreement is entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower;
- (b) a statement that the borrower understands that the borrower will not have the benefit of the protection and remedies that would be available to the borrower under the *Act* if the agreement were a *regulated mortgage contract* under the *Act*; and
- (c) a statement that the borrower is aware that if the borrower is in any doubts as to the consequences of the agreement not being regulated by the *Act*, then the borrower should seek independent legal advice;

the agreement is to be presumed to have been entered into by the borrower wholly or predominantly for the purposes specified in (2)(a).

- 4.4.32      G However the presumption in PERG 4.4.31G does not apply if, when the agreement is entered into:
- (1) the lender (or, if there is more than one lender, any of the lenders); or
  - (2) any person who has acted on behalf of the lender (or, if there is more than one lender, any of the lenders) in connection with the entering into of the agreement;
- knows or has reasonable cause to suspect that the agreement is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

#### 4.4A      **Transitional issues**

Regulated mortgage contracts entered into before 2004: Variations

- 4.4A.1      G There are special provisions related to mortgages entered into before 31 October 2004.
- 4.4A.2      G The effect of the *Regulated Activities Order* is that mortgage contracts which are varied can fall into one of the following categories:
- (1) a contract that was entered into before 31 October 2004, and that is subsequently varied on or after that date so that it satisfies the conditions set out in:
    - (a) PERG 4.4.1G(1) to PERG 4.4.1G(3); or
    - (b) the old versions of those paragraphs as referred to in PERG 4.4A.5G;

will not be a regulated mortgage contract (because it was not a regulated mortgage contract at the time it was entered into);
  - (2) a contract that was originally entered into before 31 October 2004, but is subsequently changed on or after that date such that a new contract is entered into, will be a regulated mortgage contract (provided, of course, that it meets the definition in the *Regulated Activities Order*); and
  - (3) a regulated mortgage contract that was originally entered into on or after 31 October 2004, and which is subsequently varied by, for example, making a further advance, will remain a regulated mortgage contract.
- 4.4A.3      G It is possible for more than one mortgage contract to be secured by the same (first) charge. The first contract might be entered into before 31 October 2004 (and therefore not be a regulated mortgage contract) and a second contract entered into on or after 31 October 2004 (and be a regulated

mortgage contract).

Regulated mortgage contracts entered into before 2016

- 4.4A.4 G The definition of *regulated mortgage contract* entered into before 21st March 2016 is different from the one in *PERG 4.4* (What is a regulated mortgage contract?).
- 4.4A.5 G In some cases, the definition applicable to a contract that existed before 21st March 2016 excludes the changes made by the Mortgage Credit Directive Order 2015.
- 4.4A.6 G The definition applicable to pre-2016 contracts secured by a second or subsequent charge is the definition in *PERG 4.4* and not the pre-2016 version. More precisely, the current *PERG 4.4* definition applies to a contract which, immediately before 21st March 2016, met the following conditions:
- (1) it was a *regulated credit agreement*; and
  - (2) it provided for the obligation of the borrower to repay to be secured by a mortgage on land that ranked in priority behind one or more other mortgages affecting the land in question.
- 4.4A.7 G Except for the contracts mentioned in *PERG 4.4A.6G*, the definition applicable to pre-2016 contracts is the pre-2016 version of *PERG 4.4*.
- 4.4A.8 G The old definition referred to in *PERG 4.4A.7G* can be found in historical versions of *PERG*, which can be found on the *FCA*'s website along with the current version.
- 4.4A.9 G In summary, the old definition of a *regulated mortgage contract* was a contract that at the time it was entered into, met the following conditions:
- (1) the contract was one under which a person ("the lender") provided credit to an individual or to trustees ("the borrower");
  - (2) the contract provided for the obligation of the borrower to repay to be secured by a first legal mortgage on land (other than timeshare accommodation) in the *United Kingdom*;
  - (3) at least 40% of that land was used, or was intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who was a beneficiary of the trust, or by a related person.
- 4.4A.10 G As is still the case, the old definition excluded *regulated home purchase plans*.
- 4.4A.11 G In practice there may not be many pre-2016 contracts that are not *regulated mortgage contracts* but which would be *regulated mortgage contracts* if

they had been entered into after 2016. Examples include:

- (1) a loan secured by a first ranking mortgage on land elsewhere in the EEA;
- (2) a loan secured by first ranking equitable security;
- (3) a loan that was not a regulated credit agreement and is secured by second ranking security.

...

4.5.1 G ...

- (1) making arrangements ~~for another person to:~~
  - (a) for another person to enter into a regulated mortgage contract as borrower; or
  - (b) to enter into a regulated mortgage contract with a borrower on behalf of a lender; or vary the terms of a regulated mortgage contract entered into by him as borrower on or after 31 October 2004 in such a way as to vary his obligations under the contract; and
  - (c) for another person to vary the terms of a regulated mortgage contract entered into by him as borrower on or after 31 October 2004 in such a way as to vary his obligations under the contract; and

(2) ...

4.5.2 G ...

- (2) This activity is carried on only if the arrangements bring about, or would bring about a *regulated mortgage contract*. This is because of the exclusion in article 26 (see *PERG 4.5.4G*). As explained in *PERG 4.5.4AG*, this exclusion does not apply to the activity in *PERG 4.5.1G(1)(b)*.

...

4.5.4 G ...

- 4.5.4A G (1) Article 26 does not apply to the activity described in *PERG 4.5.1G(1)(b)*.
- (2) As this activity covers a person that concludes a regulated mortgage contract with a borrower on behalf of a lender, in most cases the activity will only apply if the arrangements bring about, or would bring about a regulated mortgage contract. Therefore in many cases the fact that article 26 does not apply will make no difference.

(3) However if a *person* enters into a *regulated mortgage contract* on behalf of a lender, that *person* carries out the *regulated activity* described in *PERG 4.5.1G(1)(b)*. That activity is not excluded just because most of the work is done by another.

...

4.5.7 G

4.5.7A G Article 28A does not apply to the activity described in *PERG 4.5.1G(1)(b)*. This is because the activity described in *PERG 4.5.1G(1)(b)* is defined so that it cannot apply to an activity carried out by the lender. There is therefore no need to apply article 28A.

Exclusion: article 25A(1) and (2) arrangements with or through authorised persons

4.5.8 G An *unauthorised person* who makes arrangements for or with a view to a *regulated mortgage contract* between a borrower and an *authorised person*, is excluded from article 25A(1), 25A(2A) and (2) by article 29 of the *Regulated Activities Order* (Arranging deals with or through authorised persons) if specified conditions as to advice and remuneration are satisfied.

...

4.5.8A G Article 29 does not apply if applying the exclusion would take activities outside article 25A that should be regulated under the *Mortgage Credit Directive*. Please see *PERG 4.10A (Activities regulated under the Mortgage Credit Directive)* for more details.

...

4.6.32 G The *Regulated Activities Order* contains a number of other exclusions which have the effect of preventing certain activities from amounting to advising on regulated mortgage contracts. These are referred to in *PERG 4.10 (Exclusions applying to more than one regulated activity)*.

...

4.7.2 G The *Regulated Activities Order* contains an exclusion which has the effect of preventing certain activities of trustees, nominees and personal representatives from amounting to *entering into a regulated mortgage contract*. There is also an exclusion for local authorities and their wholly-owned subsidiaries. These are referred to in *PERG 4.10 (Exclusions applying to more than one regulated activity)*. There is also an exclusion related to consumer buy-to-let lending. ...

...

4.8.8 G The *Regulated Activities Order* contains an exclusion which has the effect of preventing certain activities of trustees, nominees and personal representatives from amounting to *entering into a regulated mortgage*

*contract*. There is also an exclusion for *local authorities* and their wholly-owned subsidiaries. These are referred to in *PERG 4.10* (Exclusions applying to more than one regulated activity). There is also an exclusion related to consumer buy-to-let lending. ...

...

4.10.4 G ...

4.10.4A G (1) The exclusion in article 67 of the Regulated Activities Order (Activities carried on in the course of a profession or non-investment business) does not apply if applying the exclusion would take activities covered by the *Mortgage Credit Directive* outside the definition of certain *regulated mortgage activities*.

(2) Please see *PERG 4.10A* (Activities regulated under the Mortgage Credit Directive) for more details.

...

4.10.8 ...

4.10.8A G (1) The exclusion in article 66 of the *Regulated Activities Order* (Article 66 of the Regulated Activities Order (Trustees, nominees and personal representatives) does not apply if applying the exclusion would take activities covered by the *Mortgage Credit Directive* outside the definition of certain *regulated mortgage activities*.

(2) Please see *PERG 4.10A* (Activities regulated under the Mortgage Credit Directive) for more details.

...

4.10.10 G There are exclusions that apply, in relation to each of the *regulated mortgage activities* if the *person* carrying on the activity is a *local authority* or a wholly owned subsidiary of a *local authority*. They can be found in article 72G of the *Regulated Activities Order*.

Insert new section PERG 4.10A after PERG 4.10. The text is all new and is not underlined.

#### **4.10A Activities regulated under the Mortgage Credit Directive**

## General treatment for activities regulated under the Mortgage Credit Directive

- 4.10A.1 G Article 4(4B) of the *Regulated Activities Order* says that certain exclusions in the *Regulated Activities Order* do not apply in cases covered by the *Mortgage Credit Directive*. This section explains the situations in which this applies.
- 4.10A.2 G Article 4(4B) of the *Regulated Activities Order* says that where:
- (1) a *person* is:
    - (a) a mortgage creditor (see *PERG* 4.10A.6G); or
    - (b) a credit intermediary (see *PERG* 4.10A.12G); or
    - (c) a *person* providing advisory services (see *PERG* 4.10A.20G);under the *Mortgage Credit Directive*; and
  - (2) that *person* is (ignoring the exclusions in (3)) carrying on one of the following *regulated activities*:
    - (a) article 25A (*arranging (bringing about) regulated mortgage contracts and making arrangements with a view to regulated mortgage contracts*);
    - (b) article 53A (*advising on regulated mortgage contracts*); and
    - (c) article 61(1) (*entering into a regulated mortgage contract as lender*); and
  - (3) in acting as described in (1), that *person* is relying on one of the following exclusions to take it outside the *regulated activities* in (2):
    - (a) article 29 (Arranging deals with or through authorised persons);
    - (b) article 66 (Trustees, nominees and personal representatives);  
or
    - (c) article 67 (Activities carried on in the course of a profession or non-investment business);
- then the result is that:
- (4) the exclusions in (3) are switched off; and
  - (5) that *person* is treated as carrying on the *regulated activity* in (2) in question.

## The meaning of mortgage intermediary

- 4.10A.3 G The *Regulated Activities Order* refers to credit intermediaries (*PERG* 4.10A.2G(1)(b)) and providers of advisory services (*PERG* 4.10A.2G(1)(c)) as mortgage intermediaries.

What mortgages are covered by the Mortgage Credit Directive?: General

- 4.10A.4 G Article 4(4A) of the *Regulated Activities Order* only applies if the *regulated mortgage contract* is covered by the *Mortgage Credit Directive*. A *regulated mortgage contract* is covered if:

- (1) the lender is acting in the course of his trade, business or profession; and
- (2) the borrower is a natural *person*; and
- (3) the borrower is acting for purposes which are outside their trade, business or profession; and
- (4) the *regulated mortgage contract* does not come within one of the exclusions summarised in *PERG* 4.10A.5G.

- 4.10A.5 G (1) This paragraph lists the *regulated mortgage contracts* outside the *Mortgage Credit Directive*.
- (2) Equity release agreements are excluded from the *Mortgage Credit Directive* where the creditor:
- (a) contributes a lump sum, periodic payments or other forms of credit disbursement;
  - (b) contributes the sums in (a) in return for a sum deriving from the future sale of a residential property or a right relating to residential property; and
  - (c) will not seek repayment of the credit until the occurrence of one or more specified life events of the consumer, subject to (3).

The creditor may seek early repayment if the consumer breaches his contractual obligations and the breach allows the creditor to terminate the credit agreement.

In the *United Kingdom*, these are known as *lifetime mortgages*.

- (3) Agreements where:
- (a) the credit is granted by an employer to his employees;
  - (b) the employer does so as a secondary activity; and
  - (c) such a credit agreement is offered:

- (i) free of interest; or
- (ii) at an *APRC* lower than those prevailing on the market and not offered to the public generally;

are excluded from the *Mortgage Credit Directive*.

- (4) Agreements where the credit is granted free of interest and without any other charges except those that recover costs directly related to the securing of the credit are excluded from the *Mortgage Credit Directive*.
- (5) An *MCD exempt overdraft loan* is excluded from the *Mortgage Credit Directive*.
- (6) Agreements which are the outcome of a settlement reached in court or before another statutory authority are excluded from the *Mortgage Credit Directive*.
- (7) An *MCD exempt bridging loan* is excluded from the *Mortgage Credit Directive*.
- (8) An *MCD exempt credit union loan* is excluded from the *Mortgage Credit Directive*.

What mortgages are covered by the Mortgage Credit Directive?: Borrower as consumer

What effect does article 4(4A) have on lenders?

- 4.10A.6 G To work out the effect of article 4(4A) of the *Regulated Activities Order* on the *regulated activity* of *entering into a regulated mortgage contract as lender*, it is necessary to look at what a mortgage creditor means.
- 4.10A.7 G In relation to a *regulated mortgage contract*, mortgage creditor means a *person* who grants or promises to grant credit falling within the scope of the definition of a *regulated mortgage contract* in the course of its trade, business or profession.
- 4.10A.8 G Therefore, article 4(4A) means that the *Regulated Activities Order* exclusions in *PERG* 4.10A.2G(3) do not apply to *entering into a regulated mortgage contract as lender* unless:
  - (1) the *regulated mortgage contract* falls outside the *Mortgage Credit Directive* (see *PERG* 4.10A.4G); or
  - (2) the lender is not acting in the course of his trade, business or profession.

The effect of article 4(4A) on arrangers: The basics

- 4.10A.9 G Article 4(4A) of the *Regulated Activities Order* (see *PERG 4.10A.2G*) does not affect the *regulated activity* of *making arrangements with a view to regulated mortgage contracts*. This is because in the *FCA's* view the activities covered by this *regulated activity* are not covered by the *Mortgage Credit Directive*.
- 4.10A.10 G Article 4(4A) of the *Regulated Activities Order* disapplies the *Regulated Activities Order* exclusions in *PERG 4.10A.2G(3)* for the *regulated activity* of *arranging (bringing about) regulated mortgage contracts*, but only in relation to the credit intermediary activities described in *PERG 4.10A.19G*.
- 4.10A.11 G To work out the effect of article 4(4A) of the *Regulated Activities Order* on the *regulated activity* of *arranging (bringing about) regulated mortgage contracts*, it is necessary to look at what a credit intermediary (as referred to in *PERG 4.10A.2G(1)*) means.

The effect of article 4(4A) on arrangers: What does credit intermediary mean?:  
General

- 4.10A.12 G A credit intermediary means a *person* who:
- (1) is not acting as a creditor or notary; and
  - (2) is not merely introducing, either directly or indirectly, a consumer to a creditor or credit intermediary; and
  - (3) carries out the following activities:
    - (a) presenting or offering *regulated mortgage contracts* to consumers;
    - (b) assisting consumers by undertaking preparatory work or other pre-contractual administration in respect of *regulated mortgage contracts* other than as referred to in (a); or
    - (c) concluding *regulated mortgage contracts* with consumers on behalf of the creditor.
  - (4) carries out those activities in the course of his trade, business or profession, for remuneration;
- 4.10A.13 G The remuneration in *PERG 4.10A.19G* may take a pecuniary form or any other agreed form of financial consideration.
- 4.10A.14 G (1) A *person* who merely introduces or refers a consumer to a creditor or credit intermediary does not act as a credit intermediary.
- (2) An example of a *person* who merely introduces is someone who just indicates to a potential borrower:
- (a) the existence of a creditor or credit intermediary; or

- (b) a type of product provided by a particular creditor or credit intermediary;

without further advertising or engaging in the presentation, offering, preparatory work or conclusion of the *regulated mortgage contract*.

The effect of article 4(4A) on arrangers: Conclusion about the effect on arranging (bringing about) regulated mortgage contracts

4.10A.15 G In the *FCA's* view, credit intermediation under the *Mortgage Credit Directive* covers the same activities as the *regulated activity of arranging (bringing about) regulated mortgage contracts*, except that:

- (1) credit intermediation only applies if the intermediary acts for remuneration; and
- (2) the *Mortgage Credit Directive* only applies to the *regulated mortgage contracts* listed in *PERG 4.10A.4G*; and
- (3) the *Mortgage Credit Directive* does not cover the *regulated mortgage contracts* listed in *PERG 4.10A.5G*; and
- (4) the *Mortgage Credit Directive* only applies to services provided to consumers;
- (5) if the intermediary only acts for the creditor, the *Mortgage Credit Directive* intermediation activity is narrower, as described in *PERG 4.10A.17*.

4.10A.16 G Therefore, except as described in *PERG 4.10A.15G*, the *Regulated Activities Order* exclusions in *PERG 4.10A.2G(3)* do not apply to the *regulated activity of arranging (bringing about) regulated mortgage contracts*.

The effect of article 4(4A) on arrangers: Remuneration under the Mortgage Credit Directive

4.10A.17 G *PERG 5.4* (The business test for insurance mediation) has *guidance* on the meaning of remuneration in the *Insurance Mediation Directive*. That *guidance* is also applicable to the meaning of remuneration for the purpose of *PERG 4.10A.12G*.

4.10A.18 G Therefore article 4(4A) is not relevant to an intermediary that carries on its activities by way of business (see *PERG 4.3.3G* to *PERG 4.3.9G*) but does not act for remuneration. The *FCA* does not expect this distinction to apply in practice.

The effect of article 4(4A) on arrangers: Acting for the creditor

4.10A.19 G (1) The *Mortgage Credit Directive* applies to credit intermediation activities performed for the creditor as well as for the borrower.

- (2) However the activities carried out for the creditor are defined differently from the ones carried out for the borrower. They seem to be narrower. The activities are limited to concluding *regulated mortgage contracts* with consumers on behalf of the creditor.
- (3) Just assisting the creditor by undertaking preparatory work or other pre-contractual administration is not enough on its own.
- (4) The activity covers actually entering into the *regulated mortgage contract* on behalf of the creditor.
- (5) The activity also covers activities that result in the lender entering into the *regulated mortgage contracts* if the role of the creditor and any *person* acting for the creditor is minimal.
- (6) When deciding whether the intermediary is acting for the creditor alone the *FCA* will not just look at the contractual position. In particular the *FCA* will also look at whether a separate intermediary is acting for the borrower.
- (7) The *guidance* in *PERG 4.5.4AG (Guidance on making arrangements to enter into a regulated mortgage contract with a borrower on behalf of a lender)* applies here too.

The effect of article 4(4A) on advisers

- 4.10A.20 G To work out the effect of article 4(4A) of the *Regulated Activities Order* (see *PERG 4.10A.2G*) on the *regulated activity of advising on regulated mortgage contracts* it is necessary to look at what advisory services as referred to in *PERG 4.10A.2G(1)(a)* means.
- 4.10A.21 G Advisory services mean the provision of personal recommendations to a consumer in respect of one or more transactions relating to *regulated mortgage contracts* covered by the *Mortgage Credit Directive*.
- 4.10A.22 G Therefore the *Regulated Activities Order* exclusions in *PERG 4.10A.2G(3)* do not apply to the *regulated activity of advising on regulated mortgage contracts* except that:
- (1) if the adviser does not act for remuneration the *Mortgage Credit Directive* does not apply;
  - (2) the *Mortgage Credit Directive* only applies to the *regulated mortgage contracts* listed in *PERG 4.10A.4G*;
  - (3) the *Mortgage Credit Directive* does not cover the *regulated mortgage contracts* listed in *PERG 4.10A.5G*;
  - (4) the *Mortgage Credit Directive* only applies to advisory services provided to consumers;

(5) the *Mortgage Credit Directive* only applies to personal recommendations.

4.10A.23 G Giving personal recommendations is narrower than giving advice. The *guidance* on this point in relation to *MiFID* in Q18 to Q21 in *PERG* 13.3 (Investment Services and Activities) is relevant here.

4.10A.24 G Therefore a *firm* that does not give personal recommendations is not affected by article 4(4A).

4.10A.25 G A *firm* can provide advisory services even though it does not act as a credit intermediary.

The effect of article 4(4A) on professional firms

4.10A.26 G Article 4(4A) does not apply to activities if:

- (1) they are carried out on an incidental basis in the course of professional activity;
- (2) that professional activity is regulated; and
- (3) the rules governing that professional activity do not prohibit the carrying out, on an incidental basis, of credit intermediation activities.

4.10A.27 G Therefore work carried out by a *professional firm* which may reasonably be regarded as a necessary part of legal conveyancing services provided by that *professional firm* can still take advantage of the exclusion in article 67 (Activities carried on in the course of a profession or non-investment business).

4.10A.28 G Article 4(4A) does not cut back the *Part XX exemption*.

...

4.11.3 G A contract is only a *regulated mortgage contract* if the land is in the EEA United Kingdom (see *PERG* 4.4.5G (Land in the EEA United Kingdom)).

...

4.11.5 G ...

- (1) Section 418(2) refers to a case where a *UK*-based person carries on a *regulated activity* in another *EEA State* in the exercise of rights under a *Single Market Directive*. The only *Single Market Directives* which are ~~is~~ relevant to mortgages are ~~is~~ the CRD and the Mortgage Credit Directive.

...

4.11.6 G ...

(3) ...

of the borrower (and each of them, if more than one) is an individual and is normally resident outside the United Kingdom ~~overseas~~. In the case of arranging a variation of, or administration of, an existing *regulated mortgage contract*, each borrower must be an individual who was normally resident outside the United Kingdom ~~overseas~~ when he entered into the contract. ...

4.11.6A G The exclusion for overseas persons described in PERG 4.11.6G does not apply where the overseas person is a mortgage intermediary whose home Member State is the United Kingdom. A mortgage intermediary is defined in PERG 4.10A.3G.

...

4.11.9 G Simplified summary of the territorial scope of the regulated mortgage activities, to be read in conjunction with the rest of this section.

This table belongs to PERG 4.11.8G

		Individual borrower resident and located	
		in the UK	outside the UK
Service provider carrying on regulated activity from establishment:	in the UK	Yes	Yes
	outside the UK	Yes	No
Yes = <i>authorisation</i> or exemption required			
No = <i>authorisation</i> or exemption not required			

Regulated activities other than advice				
<u>Location of establishment of service provider:</u>	<u>Location of land:</u>	<u>Individual borrower resident and located:</u>		
<u>UK or non-UK person:</u>		<u>in the UK</u>	<u>in another EEA State</u>	<u>outside the EEA</u>

<u>Establishment in the UK</u>	<u>land in the UK</u>	<u>Yes</u>	<u>Yes</u>	<u>Yes</u>
	<u>land in another EEA State</u>	<u>Yes</u>	<u>Yes</u>	<u>Yes</u>
<u>UK person: Establishment in another EEA State or in a country outside the EEA</u>		<u>in the UK</u>	<u>in another EEA State</u>	<u>outside the EEA</u>
	<u>land in the UK</u>	<u>Yes</u>	<u>Yes</u>	<u>Yes</u>
	<u>land in another EEA State (Note 1)</u>	<u>No</u>	<u>No</u>	<u>No</u>
<u>Non-UK person: Establishment in another EEA State or in a country outside the EEA</u>		<u>in the UK</u>	<u>in another EEA State</u>	<u>outside the EEA</u>
	<u>land in the UK</u>	<u>Yes</u>	<u>No</u>	<u>No</u>
	<u>land in another EEA State</u>	<u>No</u>	<u>No</u>	<u>No</u>
<u>Yes = authorisation or exemption required</u>				
<u>No = authorisation or exemption not required</u>				
<u>Note 1: If the service provider is a UK firm operating from an office in another EEA State in the exercise of rights under a Single Market Directive the activities will be treated as taking place in the United Kingdom and the firm will need to make sure that its permission covers the regulated mortgage activities it is carrying out. See PERG 4.11.5G(1).</u>				

<u>The regulated activity of advice</u>				
<u>Location of establishment of service provider:</u>	<u>Location of land:</u>	<u>Individual borrower resident and located:</u>		
<u>UK or non-UK person: Establishment in the UK</u>		<u>in the UK</u>	<u>in another EEA State</u>	<u>outside the EEA</u>
	<u>land in the UK</u>	<u>Yes</u>	<u>Yes</u>	<u>Yes</u>
	<u>land in another EEA State</u>	<u>Yes</u>	<u>Yes</u>	<u>Yes</u>
<u>UK person: Establishment</u>		<u>in the UK</u>	<u>in another EEA State</u>	<u>outside the EEA</u>

<u>in another EEA State or in a country outside the EEA</u>	<u>land in the UK</u>	<u>Yes</u>	<u>No</u>	<u>No</u>
	<u>land in another EEA State</u>	<u>Yes</u>	<u>No</u>	<u>No</u>
<u>Non-UK person: Establishment in another EEA State or in a country outside the EEA</u>		<u>in the UK</u>	<u>in another EEA State</u>	<u>outside the EEA</u>
	<u>land in the UK</u>	<u>Yes</u>	<u>No</u>	<u>No</u>
	<u>land in another EEA State</u>	<u>Yes</u>	<u>No</u>	<u>No</u>
<u>Yes = authorisation or exemption required</u>				
<u>No = authorisation or exemption not required</u>				
<u>Note 1: If the service provider is a UK firm operating from an office in another EEA State in the exercise of rights under a Single Market Directive the activities will be treated as taking place in the United Kingdom and the firm will need to make sure that its permission covers the regulated mortgage activities it is carrying out. See PERG 4.11.5G(1).</u>				

...

4.11.12 G ...

4.11.12A G If the service provider is a UK firm exercising its rights under a Single Market Directive by providing services from another EEA State, section 418 of the Act means that the services are treated as being carried on in the United Kingdom. This factor is not covered further in the remainder of this section.

4.11.13 G When a person is arranging (bringing about) regulated mortgage contracts or making arrangements with a view to regulated mortgage contracts from overseas, the question of whether he will be carrying on regulated activities in the United Kingdom will depend on the relevant circumstances. In the FCA's view, factors to consider include:

- (1) the territorial limitation in the definition of *regulated mortgage contract* so that regulation only applies if the land is in the EEA United Kingdom;
- (2) ...

4.11.14 G In the FCA's view:

- (1) if the borrower is normally resident in the United Kingdom and the land is in the United Kingdom, the clear territorial limitation in the

definition of *regulated mortgage contract* carries most weight in determining where regulation should apply; it is likely that the arranger will be carrying on *regulated activities* in the *United Kingdom*;

- (2) if the borrower is *normally resident* overseas, the arrangements are excluded by the *overseas persons* exclusion if the lender is an overseas person.

...

4.11.17 G In the *FCA's* view, in circumstances other than those excluded by article 72(5D) of the *Regulated Activities Order*, the need for an overseas lender to be authorised or to have an exemption will depend on the location of the land is likely to carry on the regulated activity of entering into regulated mortgage contracts in the United Kingdom. This is because of:

- (1) the territorial limitation in the definition of *regulated mortgage contract* so that regulation applies only if the land is in the EEA United Kingdom;
- (2) the general principle and practice that contracts relating to land are usually governed by the law of the place where the land is situated; and
- (3) practical issues of conveyancing; a lender is likely to use the services of a lawyer solicitor or licensed conveyancer operating from the United Kingdom or the other EEA State in question, who enters into the *regulated mortgage contract* as agent for the lender in the United Kingdom or the other EEA State in question; and
- (4) the existence of the *overseas persons* exclusion in article 72(5D).

...

4.11.19 G In the *FCA's* view, in circumstances other than those excluded by article 72(5E) of the *Regulated Activities Order*, the need for an overseas administrator to be authorised or to have an exemption will depend on the location of the land is likely to carry on the regulated activity of administering a regulated mortgage contract in the United Kingdom. This is because:

- (1) the territorial limitation in the definition of *regulated mortgage contract* means that regulation applies only if the land is in the EEA United Kingdom;
- (2) when administrators notify borrowers resident in the *United Kingdom or the other EEA State in question* of matters pursuant to a *regulated mortgage contract*, such notification is likely to be carried on in the United Kingdom or the other EEA State in question;

- (3) the steps involved in collecting or recovering payments will generally include giving notice to the borrower at his ~~UK~~ address in the United Kingdom or the other EEA State in question;
- (4) legal action to recover sums due under *regulated mortgage contracts* will in many cases require proceedings before courts in the United Kingdom or the other EEA State in question, either to enforce *regulated mortgage contracts* subject to the jurisdiction of these courts or to register and enforce judgements obtained elsewhere, in the case of contracts subject to non-UK jurisdictions; and
- (5) of the existence of the exclusion in article 72(5E) (Overseas persons).

...

4.12.5 G ...

The mortgage register

4.12.6 G SUP 12.4.10A R to SUP 12.4.10C explain some special requirements that apply to an appointed representative for an MCD mortgage lender or MCD credit intermediary. For example it may be necessary for the appointed representative to be included in the Financial Services Register.

...

4.13.1 G Certain named *persons* are exempted by the *Exemption Order* from the need to obtain *authorisation*. The following bodies have exemptions ~~are exempt~~ in relation to carrying on by them of ~~any of~~ the *regulated mortgage activities*:

...

- ~~(4) The Office of Tenants and Social Landlords (known as the Tenant Services Authority) (paragraph 48(2)(c) of the Schedule to the Exemption Order);~~~~[deleted]~~
- (5) Scottish Homes (paragraph 48(2)(d) of the Schedule to the *Exemption Order*); ~~and~~
- (6) The Northern Ireland Housing Executive (paragraph 48(2)(e) of the Schedule to the Exemption Order);
- (7) Communities Scotland (paragraph 48(2)(f) of the Schedule to the Exemption Order); and
- (8) a housing association within the meaning of Part 2 of the Housing (Northern Ireland) Order 1992 (paragraph 48(2)(g) of the Schedule to the Exemption Order); and

(8) a wholly-owned subsidiary of a registered social landlord within the meaning of Part I of the Housing Act 1996 (paragraph 48(3) of the Schedule to the *Exemption Order*).

4.13.2 G The bodies in PERG 4.13.1G are exempt in relation to the regulated activity of arranging the variation of a regulated mortgage contract (article 25A(1)(b) of the *Regulated Activities Order*.

4.13.3 G The bodies in PERG 4.13.1G are exempt in relation to the following regulated activities:

(1) arranging (bringing about) regulated mortgage contracts (except in relation to variations) (articles 25A(1)(a) and (2A));

(2) advising on regulated mortgage contracts (article 53A);

(3) entering into a regulated mortgage contract (article 61(1)); and

(4) administering a regulated mortgage contract (article 61(2)).

4.13.4 G The exemption in PERG 4.13.3G only apply in relation to a limited range of regulated mortgage contracts. These are set out in the table in PERG 4.13.5G.

4.13.5 G Exempted regulated mortgage contracts

<u>Type of regulated mortgage contract</u>	<u>Explanation</u>
<u>Exempted under article 3(2) of the <i>Mortgage Credit Directive</i></u>	<u>See PERG 4.10A.5G(1) to (9)</u>
<u>Bridging loan</u>	<u>See PERG 4.13.6G</u>
<u>Restricted public loan</u>	<u>See PERG 4.13.7G</u>

4.13.6 G A bridging loan is exempt if it meets the following conditions:

(1) it is:

(a) either of no fixed duration; or

(b) is due to be repaid within 12 months; and

(2) the borrower is:

(a) a natural person; and

(b) acting for purposes which are outside their trade, business or

profession; and

(3) the loan is used by the borrower as a temporary financing solution while transitioning to another financial arrangement for the land.

4.13.7 G A restricted public loan must meet the following conditions:

(1) it is granted to a restricted public under a statutory provision with a general interest purpose; and

(2) it meets the condition in (a) or (b):

(a) it is:

(i) free of interest; or

(ii) at lower borrowing rates than those prevailing on the market; or

(b) it meets the condition in (i) and (ii):

(i) it is on other terms which are more favourable than those prevailing on the market; and

(ii) it is at borrowing rates not higher than those prevailing on the market; and

(3) the borrower receives timely information on the main features, risks and costs of the loan at the pre-contractual stage; and

(4) any advertising of the loan is fair, clear and not misleading.

...

4.14.2 G ...

4.14.2A G PERG 4.10A (Activities regulated under the Mortgage Credit Directive) explains that some of these exclusions do not apply to activities coming under the *Mortgage Credit Directive*.

...

4.16.1 G It is common practice in the mortgage industry for the original lender which makes the loan to pass on ownership of the loan to a third party through *securitisation*. *Securitisation* transactions take different forms, but the essence is that the original lender sells the beneficial interest (with or without the legal interest) in a mortgage portfolio to a special purpose vehicle ('SPV'), which raises finance to pay for the portfolio by selling its own *securities*. The original lender may (or may not) retain the ~~first~~ legal charge on each mortgage in the portfolio. ...

...

**4.17      Interaction with the Consumer Credit Act and consumer credit regulated activities**

...

14.17.4      G    ~~Unsecured loans, as well as loans secured on second and subsequent charges on property,~~ are not subject to carve-out described above and may be *regulated credit agreements* for the purposes of the CCA and the *credit-related regulated activities* for which a *person* may need *permission*.

...

4.17.16      G    ...

Consumer credit regulated activities

4.17.17      G    Whether a business decides that this chapter does or does not apply to its mortgage activities, it should go on to consider whether the activities are consumer credit regulated activities. PERG 2 has guidance on consumer credit regulated activities.

4.17.18      G    A number of Regulated Activities Order exclusions from the consumer credit regulated activities are relevant to lenders under loans secured on land. These include:

(1)      Article 60C(2) (regulated mortgage contract is an exempt credit agreement, as summarised in PERG 2.7.19CG(1));

(2)      article 60C(3) (commercial lending, as summarised in PERG 2.7.19CG(2));

(3)      article 60D (loans secured on non-residential property, as summarised in PERG 2.7.19EG);

(4)      article 60F (loans with a limited number of repayments, as summarised in PERG 2.7.19GG);

(5)      article 60H (high net worth borrowers, as summarised in PERG 2.7.19JG); and

(6)      articles 36E and 39H (exclusions for lenders in relation to credit broking, debt adjusting, debt counselling, debt collecting and debt administration, as summarised in PERG 2.8.6CG and PERG 2.8.7CG).

...

7.1.1      G    This chapter applies to anyone involved in publishing periodicals, or in providing news services or broadcasts, who gives (or proposes to give) advice about *securities*, *relevant investments* or *home finance transactions* and who wishes to determine whether he will be carrying on the *regulated activities* of *advising on investments*, *advising on regulated credit*

agreements the purpose of which is to acquire land or advising on a home finance transaction.

- 7.1.2 G ...
- (1) when a *person* involved in publishing periodicals, or in providing news services or broadcasts, requires *authorisation* to carry on the *regulated activities* of advising on investments, advising on regulated credit agreements the purpose of which is to acquire land or *advising on a home finance transaction* (see *PERG 7.3* (Does the activity require authorisation));
- ...
- 7.2.1 G Advice is excluded by article 54 of the *Regulated Activities Order* from the *regulated activities* of advising on investments, advising on regulated credit agreements the purpose of which is to acquire land and *advising on a home finance transaction* if:
- ...
- 7.2.2 G If a *person* would, but for the exclusion, be carrying on the *regulated activities* of advising on investments, advising on regulated credit agreements the purpose of which is to acquire land or *advising on a home finance transaction*, or any or each of them, and will be doing so as a business in the *United Kingdom* (see *PERG 7.3*), he may wish to apply to the *FCA* for a certificate that the exclusion applies (see *PERG 7.6*). However, a *person* does not need a certificate to get the benefit of the exclusion. In many cases it will be clear that the exclusion in article 54 applies and a certificate is not called for. A certificate may be appropriate, however, where the exclusion appears to apply but there may be an element of doubt. The granting of a certificate would remove any such doubt.
- ...
- 7.3.1DA G Under article 53E of the *Regulated Activities Order* (Advising on regulated credit agreements the purpose of which is to acquire land), advising a *person* (“P”) is a specified kind of activity if:
- (1) the advice is given to P in P’s capacity as a recipient of credit, or potential recipient of credit, under a *regulated credit agreement*;
- (2) P intends to use the credit to acquire or retain property rights in *land* or in an existing or projected building; and
- (3) the advice consists of the provision of personal recommendations to P in respect of one or more transactions relating to *regulated credit agreements*.
- 7.3.2 G Articles 53, 53A, 53B, 53C and ~~53D~~, 53D and 53E of the *Regulated Activities Order* contain a number of elements, all of which must be present before a *person* will require *authorisation*. For *guidance* on whether a

*person* is carrying on these *regulated activities*, see *PERG 8* (Financial promotion and related activities), *PERG 4* (Guidance on regulated activities connected with mortgages), *PERG 14.3*, *PERG 14.4* and *PERG 14.4A* (Guidance on home reversion, home purchase and regulated sale and rent back agreement activities). Guidance on the activity in article 53E (*advising on regulated credit agreements the purpose of which is to acquire land*) of the *Regulated activities order* is in *PERG 2.7.16F G*.

...

7.3.4A G For persons carrying on *advising on regulated credit agreements the purpose of which is to acquire land* the by way of business test is set out in *PERG 2.3.2 G (4)*

...

7.3.7 G But even if advice is given in the *United Kingdom*, the *general prohibition* will not be contravened if the giving of advice does not amount to the carrying on, in the *United Kingdom*, of the business of *advising on investments, advising on regulated credit agreements the purpose of which is to acquire land* or *advising on a home finance transaction*. Also, the *general prohibition* will not be contravened if the exclusion for *overseas persons* in article 72 of the *Regulated Activities Order* (*Overseas persons*) applies. That exclusion applies in relation to the giving of advice on *securities* or *relevant investments* by an *overseas person* as a result of a 'legitimate approach' (defined in article 72(7)). In many cases where publications or services are provided from outside the *United Kingdom* it is likely that they will fall within the terms of this exclusion. For example, this will exclude any advice in a publication or service from being a *regulated activity* if it is given in response to an approach that has not been solicited in any way. It should be noted, however, that the exclusions in article 72 do not apply to the regulated activities that involve *advising on a home finance transaction* or *advising on regulated credit agreements the purpose of which is to acquire land*. The effect of this is that, where the principal purpose of an overseas periodical publication is to offer advice on *securities* or *relevant investments* and *home finance transactions*, the exclusion for an *overseas person* who provides advice to *persons* in the *United Kingdom* as a result of a legitimate approach will not apply to the advice concerning *home finance transactions*.

...

7.3.8 G If a *person* is carrying on the business of *advising on investments, advising on regulated credit agreements the purpose of which is to acquire land* or *advising on a home finance transaction* in the *United Kingdom*, he will not require *authorisation* if:

(1) ...

(2) he is an *exempt person* (see *PERG 2.11* (What to do now? )); since *persons* are exempt only in relation to specified *regulated activities*,

his exemption must apply to the *regulated activity* of *advising on investments, advising on regulated credit agreements the purpose of which is to acquire land* or *advising on a home finance transaction* as the case may be.

7.3.9 G Many people may be involved in the production of a periodical publication, news service or broadcast. But if the *regulated activity* of *advising on investments, advising on regulated credit agreements the purpose of which is to acquire land* or *advising on a home finance transaction* is being carried on so that *authorisation* is required, the *FCA's* view is that the *person* carrying on the activity (and who will require *authorisation*) is the *person* whose business it is to have the editorial control over the content. In the case of a periodical publication, this will often be the proprietor. But particular circumstances may vary so that the responsibility for content and editorial control rests with a freelance journalist rather than with the proprietor. In such cases it may well be that the journalist may properly be viewed as carrying on his own business, using the periodical publication as the vehicle for doing so - in which case it is likely to be the journalist alone who needs the *authorisation*.

...

7.4.2 G ...

(1) ...

(2) ...

...

(f) to enter as a recipient of credit into a *regulated credit agreement* the purpose of which is to acquire or retain property rights in *land* or in an existing or projected building.

7.4.3 G (1) ...

...

(3) The second is that of a regularly updated news or information service. As with periodical publications, it does not matter how the service is accessed by, or delivered to, the user as long as it can be read. This will include, for example, a service provided through teletext, a fax retrieval system or a website (including websites that are used through handheld devices). The fact that it must be a 'regularly updated' service means that the provision of up-to-date news or information must be a primary feature of the service (for example, where it is likely to be of commercial value to the recipient). But, in the *FCA's* view, a news or information 'service' is not restricted only to the giving of news or information since this would not generally constitute the *regulated activity* of *advising on investments* (see *PERG 8.28* (*Advice or information*)), *advising on*

*regulated mortgage contracts* (see *PERG 4.6.13 G* to *PERG 4.6.16 G* (Advice or information), *advising on regulated credit agreements the purpose of which is to acquire land* (see *PERG 4.10A.20 G*), *advising on a home reversion plan*, *advising on a home purchase plan* or *advising on regulated sale and rent back agreements*. So the exclusion applies to services providing material in addition to news or information, such as comment or advice.

7.4.5 G ...

(1)

(2) ...

(f) to enter as a recipient of credit into a regulated credit agreement the purpose of which is to acquire or retain property rights in land or in an existing or projected building.

...

7.4.8 G Looking at the first disqualifying purpose set out in the exclusion, all the matters relevant to whether the *regulated activities of advising on investments, advising on regulated credit agreements the purpose of which is to acquire land* or *advising on a home finance transaction* are being carried on must be taken into account (see *PERG 8.24* (Advising on investments)). If the principal purpose of a publication or service is to give to *persons*, in their capacity as investors (or potential investors), as borrowers, as *reversion occupiers* or reversion providers or as *home purchasers* or as *SRB agreement sellers* or *SRB agreement providers* (as the case may be), advice as referred to in *PERG 7.4.5 G (1)*, then the publication or service will not be able to benefit from this exclusion.

7.4.9 G ...

(1) material in a publication or service that invites or seeks to procure *persons* to engage in a relevant transaction can be said to "lead" to those transactions even if it would not constitute the *regulated activities of advising on investments, advising on regulated credit agreements the purpose of which is to acquire land* or *advising on a home finance transaction*; this includes, for example, material that consists of generic *buy* or *sell* recommendations, corporate brochures or invitations to invest in particular products or with a particular broker or fund manager; and

(2) ...

...

## Appendix 2

# Example ESIS documents

The following pages contain examples to show how different types of mortgage products could be presented using the ESIS disclosure document. These are not definitive formats and firms will be free to develop their own documents provided that they comply with the rules.

### **Aardvark Mortgages**

This is a lender ESIS for a 25 year fixed rate capital repayment mortgage

### **Centipede Mortgages**

This is a lender ESIS for a 15 year multi-part mortgage (part capital and part interest only) with an initial discounted rate and an initial fixed rate for each part.

### **Dogfish Brokers**

This is an intermediary ESIS for a 25 year interest only variable rate mortgage with an initial five year discounted period. It includes a number of flexible features.

### **Oxpecker Mortgage Brokers**

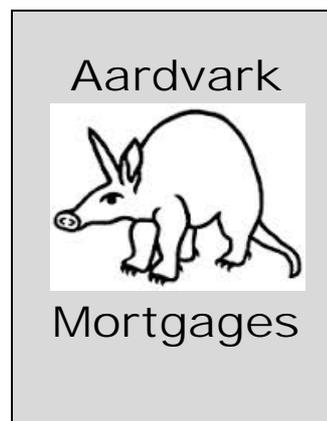
This is an intermediary ESIS for a 25 year flexible repayment mortgage which tracks Bank of England Base rate. It includes a number of flexible features including a linked current account facility

This document was produced for Anthony Eater on 21 March 2016.

This document was produced on the basis of the information that you have provided so far and on the current financial market conditions.

The information below remains valid until 21 April 2016. After that date, it may change in line with market conditions.

This document does not constitute an obligation for Aardvark Mortgages to grant you a loan.



#### 1. Lender

Aardvark Mortgages.

Tel: 0800 555 555

Aardvark Mortgages, 1 Noah's Ark, Antrim, AN1 1TT

Contact: I.B.A Platypus

We recommend, having assessed your needs and circumstances that you take out this mortgage.

#### 2. Main features of the loan

Amount and currency of the loan to be granted: GBP 90,000

Duration of the loan: 300 months

This is a 25 year fixed rate capital repayment mortgage. The interest rate is fixed for the life of the loan.

Total amount to be reimbursed: GBP 165,480

This means that you will pay back GBP 1.84 for every GBP 1.00 borrowed.

Value of the property assumed to prepare this information sheet: GBP 119,995

Minimum value of the property required to borrow the illustrated amount: GBP 115,000

This loan is secured on your home.

#### 3. Interest rate and other costs

The annual percentage rate of charge (APRC) is the total cost of the loan expressed as an annual percentage. The APRC is provided to help you to compare different offers.

The APRC applicable to your loan is 5.6%.

It comprises:

Interest rate: 5.48%

Costs to be paid on a one-off basis:

- Application fee – payable on application to Aardvark Mortgages GBP 295.00
- Conveyancing fee – payable to Aardvark Mortgages on receipt of a binding offer GBP 150.00

Costs to be paid regularly: None

Please make sure that you are aware of all other taxes and costs associated with your loan.

#### 4. Frequency and number of payments

Repayment frequency: Every month

Number of payments: 300

<b>5. Amount of each instalment</b>
GBP 551.60 Your income may change. Please consider whether you will still be able to afford your monthly repayment instalments if your income falls.

<b>6. Illustrative repayment table</b>				
This table shows the amount to be paid every month. The instalments (column 2) are the sum of interest to be paid (column 3), and capital paid (column 4)). Outstanding capital (column 5) is the amount of the loan that remains to be reimbursed after each instalment.				
Repayment schedule	Amount of the instalment	Interest to be paid per instalment	Capital repaid per instalment	Outstanding capital after each instalment
Month 1	551.60	411.0	140.60	89,859.40
Month 2	551.60	410.36	141.24	89,718.16
Month 3	551.60	409.71	141.89	89,576.27
Month 4	551.60	409.06	142.54	89,433.73
Month 5	551.60	408.41	143.19	89,290.54
Month 6	551.60	407.76	143.84	89,146.70
Month 7	551.60	407.10	144.50	89,002.20
Month 8	551.60	406.44	145.16	88,857.04
Month 9	551.60	405.78	145.82	88,711.22
Month 10	551.60	405.11	146.49	88,564.73
Month 11	551.60	404.45	147.15	88,417.58
Month 12	551.60	403.77	147.83	88,269.75
<b><i>Year 1 subtotal</i></b>	<b>6,619.20</b>	<b>4888.95</b>	<b>1730.25</b>	<b>88,269.75</b>
Year 2	6,619.20	4,791.73	1,827.52	86,442.20
Year 3	6,619.20	4,689.03	1,930.22	84,511.98
Year 4	6,619.20	4,580.56	2,038.70	82,473.28
Year 5	6,619.20	4,465.99	2,153.26	80,320.02
Year 6	6,619.20	4,344.98	2,274.27	78,045.74
Year 7	6,619.20	4,217.17	2,402.08	75,643.66
Year 8	6,619.20	4,082.18	2,537.07	73,106.59
Year 9	6,619.20	3,939.60	2,679.65	70,426.94
Year 10	6,619.20	3,789.01	2,830.24	67,596.70
Year 11	6,619.20	3,629.96	2,989.29	64,607.41
Year 12	6,619.20	3,461.97	3,157.28	61,450.12
Year 13	6,619.20	3,284.54	3,334.72	58,115.41
Year 14	6,619.20	3,097.13	3,522.12	54,593.29
Year 15	6,619.20	2,899.20	3,720.05	50,873.24
Year 16	6,619.20	2,690.14	3,929.11	46,944.13
Year 17	6,619.20	2,469.34	4,149.92	42,794.21
Year 18	6,619.20	2,236.12	4,383.13	38,411.08
Year 19	6,619.20	1,989.80	4,629.45	33,781.63
Year 20	6,619.20	1,729.63	4,889.62	28,892.01
Year 21	6,619.20	1,454.85	5,164.40	23,727.61
Year 22	6,619.20	1,164.62	5,454.63	18,272.98

Year 23	6,619.20	858.09	5,761.17	12,511.82
Year 24	6,619.20	534.32	6,084.93	6,426.89
Year 25	6,619.20	192.36	6,426.89	0.00
<b>Total of instalments</b>	<b>£165,480</b>			

## 7. Additional obligations

The borrower must comply with the following obligations in order to benefit from the lending conditions described in this document.

You must have appropriate buildings insurance for your property for the duration of this mortgage, and confirm to us that you have this cover in place. However, you are not obliged to buy this insurance from us.

## 8. Early repayment

You have the possibility to repay this loan early, either fully or partially.

Exit charge: Early repayment charges are payable on this mortgage until 21 March 2037.

The table below illustrates the maximum charge that might apply within specified periods but you can repay the loan in full without paying an early repayment charge during April in years 6, 8, 10, 12, 14, 16 and 18. An administration fee and deeds sealing fee is also payable if you repay this loan early. The current level of these fees is GBP 85.00

Date of repayment	Basis of charge	Amount of charge (GBP)
21 March 2016 – 20 March 2021	5% of the loan amount plus fees	4,585.00
21 March 2021 – 20 March 2025*	4% of the loan amount plus fees	3,685.00
21 March 2025 – 20 March 2029*	3% of the loan amount plus fees	2,785.00
21 March 2029 – 20 March 2033*	2% of the loan amount plus fees	1,885.00
21 March 2033 – 20 March 2037*	1% of the loan amount plus fees	985.00
*April 2020, 2023, 2025, 2027, 2029, 2031, 2033	Admin & deeds fees only	85.00

Should you decide to repay this loan early, please contact us to ascertain the exact level of the exit charge at that moment.

## 9. Flexible features

You have the possibility to transfer this loan to another property. This portability is subject to you meeting our lending criteria at that time

Overpayments/Underpayments

- You can make lump sum or regular overpayments of up to £5,000 per 12 month period – amounts above this are subject to an early repayment charge (see Section 8 for basis of charge). Following receipt of a regular overpayment or a lump sum repayment, we will immediately recalculate the amount that you owe and the amount of interest that you pay. This means that you will get the benefit straight away.
- Regular underpayments are possible if you have overpaid previously (7 days notice required).

Payment holidays

- Payment holidays are available if you have overpaid previously (7 days notice required).

#### Borrow back

- Lump sum withdrawals can be made against accrued overpayments. Minimum withdrawal is £500 and maximum is £25,000 per transaction (7 days notice required).

#### Incentives

- Free standard mortgage valuation (or an equivalent contribution to an approved Building Survey). Free Accident, Sickness and Unemployment cover for 3 months.

### 10. Other rights of the borrower

You have seven days after we have confirmed our binding offer to you to reflect before committing yourself to taking out this loan.

### 11. Complaints

If you have a complaint please contact Aardvark Mortgage's Customer Service Department on 0800 555 556. Details of our complaints process can be found at [www.mortgagesareaardvark/complaints](http://www.mortgagesareaardvark/complaints)

Maximum time for handling the complaint: 8 weeks

If we do not resolve the complaint to your satisfaction internally, you can also contact: The Financial Ombudsman Service.

### 12. Non-compliance with the commitments linked to the loan: consequences for the borrower

We will provide you with a booklet of the terms and conditions relating to this mortgage. This will provide further information on your obligations under the contract. We would particularly highlight that failing to meet the required payments (or to make such payments on time) may mean further costs where this results in further work for us.

**Continuing to miss payments or increase your debts under the contract may ultimately lead us to take action to repossess.**

You are also obliged to keep the property in good condition and to have appropriate buildings insurance. Failing to do either may cause us to take action on your behalf (e.g. to insure the property) and you will be liable for our costs should we need to do this. If you fail to make your payments then this information will be passed to credit reference agencies, which may impact on your ability to take out further loans.

Should you encounter difficulties in making your monthly payments, please contact us straight away to explore possible solutions.

**As a last resort, your home may be repossessed if you do not keep up with payments.**

### 13. Additional information

We will give you a copy of the draft credit agreement when we make a binding offer to you.

### 14. Supervisor

This lender is supervised by The Financial Conduct Authority, [www.fca.org.uk](http://www.fca.org.uk)

This document was produced for Milli Pede on 21 March 2016.  
This document was produced on the basis of the information that you have provided so far and on the current financial market conditions.

**The information below remains valid until 22 March 2016.**

After that date, it may change in line with market conditions.

This document does not constitute an obligation for Centipede Mortgages to grant you a loan.



## 1. Lender

Centipede Mortgages

Tel 0000 00000050 Shoepairs Drive, Creepy Crawley CR3 3PY

[www.centipedemortgages.com](http://www.centipedemortgages.com)

We recommend, having assessed your needs and circumstances, that you take out this mortgage.

## 2. Main features of the loan

Amount and currency of the loan to be granted: £90,000

Duration of the loan: 15 years and 5 months

This is a multi-part (part capital repayment and part interest-only) mortgage.

- Part 1 is an interest-only loan of £60,000 with a variable rate, which we determine, that has an initial discount for a period of 3 years.
- Part 2 is a capital repayment loan of £30,000 with a variable rate, which we determine, that is initially fixed for 5 years.

Total amount to be reimbursed: £154,545.40

This means that you will pay back £1.72 for every £1 borrowed. **This amount is illustrative and may vary, in particular in relation with the variation of the interest rate.**

Value of the property assumed to prepare this information sheet: £100,000

Maximum available loan amount relative to the value of the property: 90%

This mortgage would be secured on your home – 13 Old Tree Lane, Deadwood

**Part of this is an interest-only loan. You will still owe £60,000 at the end of the mortgage term.**

## 3. Interest rate and other costs

The annual percentage rate of charge (APRC) is the total cost of the loan expressed as an annual percentage. The APRC is provided to help you to compare different offers.

The APRC applicable to your loan is 6.4%.

It comprises:

- Part 1 - a variable rate currently 6.00%, with a discount of 1.75% for 3 years, giving a current rate payable of 4.25%
- Part 2 - a variable rate of 7% that is initially fixed for 5 years before reverting to a variable rate.
- Both Parts 1 and 2 revert to Centipede Mortgages Standard Variable Rate, currently 6%, at the end of their respective incentive periods.

*Costs to be paid on a one-off basis*

Arrangement fee payable to Centipede Mortgages on application	£295.00
A higher lending charge is payable because you are borrowing 90% of the property's price. This is payable to Centipede Mortgages at the start of the mortgage	£900.00
A non-refundable legal fee to your conveyancer before the loan starts. The figure quoted here is an estimate – the total fee for conveyancing may be higher	£117.00
You will need to pay a fee to register the mortgage. This is likely to be	£140.00

*Costs to be paid regularly*

None

**This APRC is calculated using assumptions regarding the interest rate. Because part of your loan is a variable interest rate loan, the actual APRC could be different from this APRC if the interest rate for your loan changes. For example, if the interest rate rose to 17.75% the APRC could increase to 19.2%.**

Please make sure that you are aware of all other taxes and costs associated with your loan.

#### 4. Frequency and number of payments

Repayment frequency: Monthly

Number of payments: 179 payments on Part 1, 120 payments on Part 2

#### 5. Amount of each instalment

For the first 36 months you will have a total installment of £ 560.83 (Part 1 = £212.50 and Part 2 = 348.33)

After 3 years your discount on part 1 will end, and assuming rates do not change, your new payment on the total loan will be £648.33

After 22 March 2021 your fixed rate on part 2 will end, and assuming rates do not change, your new payment on the total loan will be £633.06

**Your income may change. Please consider whether you will still be able to afford your monthly repayment instalments if your income falls.**

Because part of this is an interest-only loan you will need to make separate arrangements to repay the £60,000 you will owe at the end of the mortgage term. Remember to add any extra payments you will need to make to the instalment amount shown here.

**The interest rate on this loan can change. This means the amount of your instalments could increase or decrease. For example, if the interest rate rose to 17.75% your payments could increase to £1,433.22.**

#### 6. Additional obligations

The borrower must comply with the following obligations in order to benefit from the lending conditions described in this document.

You are required to fully insure your property while you have a mortgage with us.

## 7. Early repayment

You have the possibility to repay this loan early, either fully or partially.

Exit charge: There will be a charge during the incentive periods of either part of the mortgage. The charge basis is illustrated in the example below. Please note the early repayment charge for repaying part 1 of the loan is based on current interest rates. Rates may vary and so the amount payable may change subject to the maximum amount shown.

Part	Loan amount	Basis of the charge	Cash examples		
			The maximum charge you could pay	Charge payable in first 3 years	Charge payable after 3 years but before the end of 5 years
1	£60,000	6 months interest on the amount repaid at the discounted variable rate for the first 3 years	£3,825	£1,275	Nil
2	£30,000	5% of original balance for the first 5 years	£1,500	£1,500	£1,500
	£90,000		£5,325	£2,775	£1,500

Should you decide to repay this loan early, please contact us to ascertain the exact level of the exit charge at that moment.

## 8. Flexible features

You have the possibility to transfer this loan to another property. If you think you might like to do this, please contact us so that we can confirm if this will be possible. We will need to check that at the time you wish to transfer the mortgage you meet our current lending criteria

## 9. Other rights of the borrower

You have seven days after we have given you a binding offer, or confirmed our willingness to be bound by a previous conditional offer, to reflect before committing yourself to taking out this loan.

## 10. Complaints

If you have a complaint please contact our complaints department at 50 Shoepairs Drive, Creepy Crawley CR3 3PY or Tel 0000 00000100. You can find full details of our complaints processes by asking for details in any branch or by going to: [www.centipedemortgages/complaintsstuff](http://www.centipedemortgages/complaintsstuff)

Maximum time for handling the complaint: 8 weeks

If we do not resolve the complaint to your satisfaction internally, you can also contact: The Financial Ombudsman Service.

## **11. Non-compliance with the commitments linked to the loan: consequences for the borrower**

We expect you to:

- Maintain the regular repayments on your mortgage
- Make and keep to arrangements for repaying the capital outstanding at the end of the interest-only part of this mortgage
- Look after the property and keep it in a good state of repair
- Insure the property using an appropriate policy

Where you fail to meet these (or other) obligations there may be additional costs for you where we have to carry out further work. Details of any fees and charges can be found in our tariff of fees and charges - [www.centipedemortgages/feesandcharges](http://www.centipedemortgages/feesandcharges)  
**In the event of severe breaches of your obligations the ultimate consequence may be legal action by us to take possession of your property**

Your full obligations are spelt out in the Terms and Conditions document we will give you. You can see these online at [www.centipedemortgages/tandcs](http://www.centipedemortgages/tandcs)  
Should you encounter difficulties in making your monthly payments, please contact us straight away to explore possible solutions.

**As a last resort, your home may be repossessed if you do not keep up with payments.**

## **12. Additional information**

We will give you a copy of the draft mortgage agreement when we make you a binding mortgage offer.

## **13. Supervisor**

This lender is supervised by the Financial Conduct Authority – [www.fca.org.uk](http://www.fca.org.uk)

This document was produced for Mr & Mrs Yogi-Bare on 21 March 2016.

This document was produced on the basis of the information that you have provided so far and on the current financial market conditions.

The information below remains valid until **21 March 2016**. After that date, it may change in line with market conditions.

This document does not constitute an obligation for Intellectual Flounder to grant you a loan.

## 1. Lender

Intellectual Flounder Tel: 01391 7777 7777

Intellectual Flounder, C Floor, 40 Fathoms Deep, Ocean Drive, S3A B3D

Contact Mrs Gill Breather

## 2. Credit intermediary

Dogfish Brokers

Tel: 0800 555 5555

4 Foot Square

Fishtank-on-the-Sideboard

F1 5HY

Rock@dogfishthemortgagebrokers.com

Contact Rock Salmon – Mortgage Adviser

Dogfish Brokers recommend, having assessed your needs and circumstances, that you take out this mortgage.

Our fee is described in Section 4. In addition, Intellectual Flounder will pay us £450 for arranging this mortgage.

## 3. Main features of the loan

Amount and currency of the loan to be granted: £90,300.

Duration of the loan: 25 years.

This is a variable rate interest-only mortgage with a discount rate applying for the first five years. The rate varies in accordance with changes made at the discretion Intellectual Flounder to its Standard Variable Rate

Total amount to be reimbursed: £208,950.60 **This amount is illustrative and may vary, in particular in relation with the variation of the interest rate.**

This means that you will pay back £2.31 for every £1 borrowed.

**This is an interest-only loan. You will still owe £90,300 at the end of the mortgage term.**

Value of the property assumed to prepare this information sheet: £120,000

Minimum value of the property required to borrow the illustrated amount £115,000

The mortgage will be secured against your current home, The Old Cave, Yellowstone, YO G1

#### 4. Interest rate and other costs

The annual percentage rate of charge (APRC) is the total cost of the loan expressed as an annual percentage. The APRC is provided to help you to compare different offers.

The APRC applicable to your loan is 6.9%.

It comprises:

Interest rate Currently 5.49% with a discount of 1.50% for 5 years, giving a current rate payable of 3.99%. After 5 years, the rate that will apply is Intellectual Flounder's standard variable rate, currently 5.49%, for the remaining term of the mortgage.

##### Costs to be paid on a one-off basis

Intellectual Flounder's application fee (you want to add this to the mortgage)	£300
Valuation fee payable to Intellectual Flounder on application	£102
Advice fee payable to Dogfish Brokers on application	£250
Fee payable to Intellectual Flounder on final repayment. Please note that this is the current fee and may change.	£95

You will need to pay a fee to register the mortgage. The precise amount of this is not known, but you should assume a figure of around £400 based on fees charged to register similar loans, the size of the loan and other relevant considerations

##### Costs to be paid regularly

None – but see section 5 for the loan repayments

This APRC is calculated using assumptions regarding the interest rate.

**Because your loan is a variable interest rate loan, the actual APRC could be different from this APRC if the interest rate for your loan changes.** For example, if the interest rate rose to 17%, the APRC could increase to 17.9%.

Please make sure that you are aware of all other taxes and costs associated with your loan.

#### 5. Frequency and number of payments

Repayment frequency: monthly

Number of payments: 300

#### 6. Amount of each instalment

You will have to make 60 payments of £300.25 at a variable rate currently 3.99% followed by 240 payments of £413.12 at a variable rate currently 5.49%

Your income may change. Please consider whether you will still be able to afford your monthly repayment instalments if your income falls.

The interest rate on this loan can change. This means the amount of your instalments could increase or decrease. For example, if the interest rate rose to 17% your payments could increase to £1,316 per month.

**Because this is an interest-only loan you will need to make separate arrangements to repay the £90,300 you will owe at the end of the mortgage term. Remember to add any extra payments you will need to make to the instalment amount shown here.**

## 7. Additional obligations

The borrower must comply with the following obligations in order to benefit from the lending conditions described in this document.

While you keep this mortgage you must insure the property, with the insurance cover at least meeting the standards set out in our model policy document. We offer insurance to meet these standards – and if you opt to take out insurance elsewhere there will be a £50 fee for checking that this insurance meets the required standards

## 8. Early repayment

You have the possibility to repay this loan early, either fully or partially.

Exit charge: An early repayment charge is payable on this mortgage during the first 5 years, calculated as 3% of the original loan plus the repayment of the cashback referred to in section 9. An administration fee, currently £95 is also payable if you repay this mortgage early. This charge will be £3,054 during the first 5 years.

Should you decide to repay this loan early, please contact us to ascertain the exact level of the exit charge at that moment.

## 9. Flexible features

You have the possibility to transfer this loan to another property, subject to the new property and your circumstances meeting our lending criteria at that time.

You do not have the possibility to transfer this loan to another lender.

### Additional features:

#### *Overpayments/Underpayments*

- You can make overpayments or lump sum payments of up to 10% of the original loan amount in the first 5 years and for any amount after this without having to pay an early repayment charge. Otherwise an early repayment charge will apply on the basis set out in Section 8
- The amount you owe and the interest you pay is not recalculated immediately following any regular or lump sum overpayment, but is recalculated annually on 31<sup>st</sup> December.
- Underpayments can be made if sufficient overpayments have previously been made.

#### *Payment holidays*

- Payment holidays are available if sufficient overpayments have previously been made.

#### *Incentives*

- You will receive a Cashback of £250 within 7 days of the start of your mortgage.
- We will pay your standard legal fees.
- 

## 10. Other rights of the borrower

You have 7 days after you have been given a binding mortgage offer to reflect before committing yourself to taking out this loan.

## 11. Complaints

If you have a complaint please contact our complaints supervisor, Capt. Haddock at Dogfish Brokers, 4 Foot Square, Fishtank-on-the-Sideboard, F1 5HY. You can find details on our complaints procedure at [www.dogfishthemortgagebroker.com/complaintshandling](http://www.dogfishthemortgagebroker.com/complaintshandling)

Maximum time for handling the complaint      8 weeks

If we do not resolve the complaint to your satisfaction internally, you can also contact the Financial Ombudsman Service.

## 12. Non-compliance with the commitments linked to the loan: consequences for the borrower

Late payments or defaulting on the loan will result in additional costs for you to reflect the extra work for the lender. Full details of these costs will be included in the terms and conditions of your mortgage offer and the tariff of fees and charges.

If you do not take out and maintain insurance for the property the lender will instead take out similar insurance cover and you will have to pay for this.

If you fail to adequately maintain the property, or if you take actions that negatively affect the property's value the lender has the right to take remedial steps and for the cost of these and to recover these costs from you.

For further information please use the contact details in Section 1 or you can visit [www.intellectualflounder.co.uk/stuff](http://www.intellectualflounder.co.uk/stuff)

Should you encounter difficulties in making your monthly payments, please contact us straight away to explore possible solutions.

**As a last resort, your home may be repossessed if you do not keep up with payments.**

## 13. Additional information

Intellectual Flounder will give you a copy of the draft credit agreement when they provide you with a binding mortgage offer

## 14. Supervisor

This lender is supervised by the Financial Conduct Authority – [www.fca.org.uk](http://www.fca.org.uk)

This credit intermediary is supervised by the Financial Conduct Authority – [www.fca.org.uk](http://www.fca.org.uk)

This document was produced for **Mr S.Y. & Mrs M. Biotic** on 21 March 2016.

This document was produced on the basis of the information that you have provided so far and on the current financial market conditions.



**Oxpecker Mortgage Brokers**

**The information below remains valid until 21 April 2016.**

After that date, it may change in line with market conditions.

This document does not constitute an obligation for Red Offsetter Finance to grant you a loan.

### 1. Lender

Red Offsetter Finance, a division of The Badger Mortgage Group  
Phone number: 0444 4444 4444  
Hector's House  
London  
W1 WM

### 2. Credit intermediary

Oxpecker Mortgage Brokers  
Phone number: 0444 4444 4444  
1 Beak Row  
Oxford OX9 3CK  
Contact Woody Oxpecker  
Oxpecker Mortgage Brokers recommend, having assessed your needs and circumstances, that you take out this mortgage.

Based on your desired loan size Red Offsetter Finance will pay Oxpecker Mortgage Brokers £400 in cash and/or benefits if you take out this mortgage.

### 3. Main features of the loan

Amount and currency of the loan to be granted: £90,000  
Duration of the loan: 25 years  
This is a flexible 'One-pot' capital repayment mortgage. The interest rate is a variable one which tracks the Bank of England Base Rate  
Total amount to be reimbursed: £157,803  
**This amount is illustrative and may vary, in particular in relation with the variation of the interest rate.**  
This means that you will pay back £1.75 for every £1 borrowed.  
Value of the property assumed to prepare this information sheet: £150,000  
Maximum available loan amount relative to the value of the property: 90%. The maximum theoretically possible to borrow would be £135,000.  
This loan would be secured on your home – 10 Mistletoe Court, Greater Lamprey, Beds

### 4. Interest rate and other costs

The annual percentage rate of charge (APRC) is the total cost of the loan expressed as an annual percentage. The APRC is provided to help you to compare different offers.

The APRC applicable to your loan is 5%.

It comprises:

Interest rate - 4.45% above Bank of England Base Rate for the term of the mortgage, to give a current rate payable of 4.95%.

Costs to be paid on a one-off basis

- Valuation Fee (payable to Red Offsetter on application) £300

- Solicitors fees (payable to your Solicitor when the mortgage starts) £450
- You will need to pay a fee to register the mortgage. For the purposes of this document this fee is assumed to be included in the solicitors fees.

Costs to be paid regularly

- None

**This APRC is calculated using assumptions regarding the interest rate. Because your loan is a variable interest rate loan, the actual APRC could be different from this APRC if the interest rate for your loan changes. For example, if the interest rate rose to 19.45% the APRC could increase to 21.4%.**

Please make sure that you are aware of all other taxes and costs associated with your loan.

## 5. Frequency and number of payments

Repayment frequency: Monthly

Number of payments: 300

## 6. Amount of each instalment

£523.51

**Your income may change. Please consider whether you will still be able to afford your monthly repayment instalments if your income falls.**

The interest rate on this loan can change. This means the amount of your instalments could increase or decrease. For example, if the interest rate rose to 19.45% your payments could increase to £1,323.51.

## 7. Additional obligations

The borrower must comply with the following obligations in order to benefit from the lending conditions described in this document.

Possession of valid buildings insurance for the life of the mortgage. You can choose to buy this insurance from any authorised insurer.

Please note that the lending conditions described in this document (including the interest rate) may change if these obligations are not complied with.

## 8. Early repayment

You have the possibility to repay this loan early, either fully or partially. There are no conditions or charges that apply to this right.

## 9. Flexible features

You have the possibility to transfer this loan to another property. This transfer will subject to Red Offsetter Finance's normal lending requirements at the time that you apply to make the change. These requirements may not be the same as those existing today.

### **Additional features:**

Overpayments/underpayments - There are no restrictions to making overpayments at any time. If you overpay or make a lump sum repayment, the amount you owe and the amount of interest you pay is recalculated and reduced immediately. You can make underpayments up to the total value of previous overpayments.

Payment holidays - Payment holidays can be arranged if you have made previous overpayments of at least £500.

Additional borrowing available without further approval - You can borrow up to an additional £10,000, secured on your home, without the need for further approval. This additional borrowing would be regulated in the same way and be on the same terms and conditions as the mortgage and so would need to be repaid if the mortgage was repaid in full. There are no early repayment charges. The maximum

amount available, the interest rate payable, and so the total monthly payments are subject to change. This would increase your payment as follows: Total loan of £100,000 and a Monthly payment of £581.69

Linked current account - You have indicated that you wish to take advantage of our Red Offsetter's optional linked current account facility. Money in your current account has the effect of reducing the balance of your mortgage and so the amount of interest you will pay. This example shows the effect on your mortgage of managing your account as you have indicated:

Amount paid in each month	Amount spent each month	Amount saved each month	Total amount you must pay back reduced by	Effective term of mortgage reduced by
£2,000	£1,900 evenly throughout the month.	£100	£21,107	6 years and 9 months

The amount spent includes your monthly mortgage payment. This example assumes that you save £100 in your current account every month for the term of the mortgage.

#### 10. Other rights of the borrower

You have seven days after being given a binding mortgage offer to reflect before committing yourself to taking out this loan.

#### 11. Complaints

If you have a complaint please contact Oxpecker Mortgage Broker's Customer Hotline on 0800 555 5557. Our complaints guide and further information can be found at [www.oxpeckermortgagebrokerssrrus.com/resolvingcomplaints](http://www.oxpeckermortgagebrokerssrrus.com/resolvingcomplaints)

Maximum time for handling the complaint: 8 weeks

If we do not resolve the complaint to your satisfaction internally, you can also contact: The Financial Ombudsman Service.

#### 12. Non-compliance with the commitments linked to the loan: consequences for the borrower

You are responsible for meeting your mortgage payments in a timely fashion. If you don't do this you will also be liable for the costs of any extra work we have to do.

You are responsible for arranging buildings insurance. If you don't do this, we may take out cover on your behalf and charge you the cost of this.

You must not let out this property or use it as a place of business. A consequence of breaching either of these conditions is that we may ask you to repay the loan within 60 days.

For further information on the consequences of non-compliance please see Red Offsetter's lending conditions or go to [www.redoffsetterfinance.org/help](http://www.redoffsetterfinance.org/help)

Should you encounter difficulties in making your monthly payments, please contact us straight away to explore possible solutions.

**As a last resort, your home may be repossessed if you do not keep up with payments.**

#### 13. Additional information

Red Offsetter will give you a draft credit agreement when they give you a binding mortgage offer.

#### 14. Supervisor

This lender is supervised by The Financial Conduct Authority – [www.fca.org.uk](http://www.fca.org.uk)  
This credit intermediary is supervised by The Financial Conduct Authority – [www.fca.org.uk](http://www.fca.org.uk)

Financial Conduct Authority



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