Factsheet No.040

For second charge mortgage lenders and administrators

New regulation affecting firms arranging or advising on second charge mortgages

From 21 March 2016, second charge mortgage regulation will change significantly as it is brought within scope of the FCA mortgage rules, as part of our implementation of the Mortgage Credit Directive (MCD). This factsheet highlights some of the points that second charge lenders and administrators should consider in getting ready for these changes. Lenders which also arrange or advise on second charge mortgages should refer to the factsheet for second charge intermediaries[1] as well as this one.

What are the main changes?

From 21 March 2016, second charge mortgages, including regulated loans entered into prior to that date, will be subject to FCA mortgage rules. These rules are tailored to the risks present in secured lending. For instance, the vast majority of sales will require advice, and lenders will be expected to carry out detailed affordability assessments, as well as deal with customers who experience payment difficulty in a way that considers their individual circumstances.

Although implementation of the MCD is largely based on the FCA's existing mortgage rules, we are having to introduce **some new requirements**. For example, firms will be required to provide an adequate explanation of a product's essential features, issue a binding offer, provide a seven day reflection period, and give customers a European Standardised Information Sheet (ESIS) disclosure document.

The change in regulatory treatment means that firms will need relevant **mortgage permissions** if they wish to arrange, advise on, enter into or administer second charge mortgages from 21 March 2016. Further information is set out in the flowchart[2] on the FCA's website. The FCA recommends firms apply as soon as possible. Firms that fail to apply will be operating illegally and committing a criminal offence if they arrange, advise on, enter into or administer second charge mortgages after 20 March 2016.

What does this mean for me?

You should now be considering the extent to which your business is affected by the changes.

1 https://www.fca.org.uk/firms/firm-types/mortgage-brokers-and-home-finance-lenders/mcd/factsheet-no-041

2 www.fca.org.uk/your-fca/documents/mortgage-credit-directive-the-authorisation-process

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You should familiarise yourself with **how the FCA expects firms to deal with customers and conduct themselves throughout the life of a mortgage**. The FCA's Mortgages and Home Finance: Conduct of Business (MCOB) rules are tailored to lending secured on a customer's home and in some instances are more prescriptive than what is required under the consumer credit regime. To view the rules that will apply from 21 March 2016 you can use the 'time travel' function[3] on the FCA Handbook website.

You will also need to factor in the amendments made to the FCA's other sourcebooks in order to implement the MCD[4] – for example, the Training and Competence sourcebook (TC) for MCD knowledge and competence requirements, which apply to a range of staff, and the associated transitional provisions.

In addition to these detailed mortgage-specific rules, the FCA's Handbook sets **high-level standards** that apply to all regulated firms – for example, the FCA Principles for Business (PRIN) and Senior Management Arrangements, Systems and Controls (SYSC).

The FCA encourages firms to plan ahead as far as possible to ensure that they can conduct compliant business from March 2016. Where you rely on others (such as mortgage sourcing systems) to support your business process, the FCA encourages you to have regular dialogue.

Will I need to underwrite mortgages differently?

MCOB 11 establishes a framework for how the FCA expects firms to lend responsibly. Essentially, a lender cannot enter into a transaction (either a new mortgage or a contract variation that involves additional borrowing) unless it can show that the mortgage is affordable for the customer.

This involves taking into account the verified income of the customer, net of tax and national insurance, as well as their expenditure, including committed expenditure (e.g. credit cards, loans), basic essential expenditure (e.g. food, utilities) and basic household quality of living costs. A lender will also need to consider the impact of any future interest rate rises on higher ranking mortgages, as well as its own loan.

What happens to second charge mortgages entered into before 21 March 2016?

If a second charge mortgage was regulated under the consumer credit regime as at 20 March 2016, it will become a regulated mortgage contract and relevant MCOB provisions will apply from 21 March 2016 – for example, the rules on post-sale disclosure (MCOB 7) and charges (MCOB 12). In addition, some Consumer Credit Act (CCA) provisions will be retained for these loans, including the prohibition on interest being increased on default (section 93), the right to complete payments ahead of time (section 94) and the right to a rebate on early settlement (section 95)[5].

How will I be expected to deal with my customers when they are in payment difficulties?

It is important that firms treat customers with a mortgage payment shortfall fairly. Your firm will need to put in place and operate a written policy for doing so. MCOB 13 sets out the steps a firm needs to follow once a customer is in payment shortfall and prior to taking any possession action.

What systems changes will I need to focus on?

This will ultimately be determined by your firm's business model and current practices. However, there are two areas of change that will be common to all second charge firms and will be likely to require systems changes.

- ESIS. Second charge firms will need to issue the ESIS for all new second charge mortgage sales that are subject to the new MCD rules.

3 To view a consolidated version of the FCA Handbook as it will be at a particular date in the future, use the 'Show timeline' calendar at the left side of the page and choose the relevant future date.
4 See Appendix 1 of PS15/9.

5 See Article 29 of the Mortgage Credit Directive Order 2015. This Article also retains the potential unenforceability impact of certain CCA breaches pending correction of those breaches.

For more information and the latest news, see the firms section of our website: www.fca.org.uk/firms

- Data reporting. Although the FCA delayed until 2nd Quarter 2017 the collection of transaction-level second charge data from lenders, you will need to report aggregated data for all your regulated activities in both the Mortgage Lenders and Administrators Return forms and second charge 'sub-forms' from March 2016. Technical documentation will be released to firms in due course, but the specific reporting fields are set out in the FCA Handbook.[6] Further information on how to report data to us is on the FCA website.

How can I manage pipeline applications received before 21 March 2016, when the new MCD rules and second charge regulation take effect, but where the agreement comes into existence after this date?

The MCD does not provide transitional arrangements for 'pipeline' applications. The rules implementing the MCD will apply to the granting of credit from 21 March 2016, unless the credit is granted under an agreement existing before that date. This will be the case even if the sales process started before 21 March 2016. You should plan for how you might deal with such cases to ensure that they progress smoothly and to minimise the need for duplicated disclosure. It is up to firms to decide how best to do this, whilst having regard to both the regulatory requirements and the customer experience.

To help firms manage their sales pipeline, those with mortgage permissions and interim permissions for consumer credit can choose to apply the new rules up to six months early, from 21 September 2015.[7] If a firm adopts the new mortgage rules early for a second charge mortgage transaction, the loan will be treated as a regulated mortgage rather than a regulated credit agreement and the CCA will not apply - although, as explained above, some CCA obligations will be retained. The FCA encourages those planning to adopt early to maintain dialogue with their business partners (e.g. intermediaries) in the sales process.

What are the key milestones I need to consider ahead of these regulatory changes?

The following are some of the key dates for second charge lenders and administrators.

Milestone	Date
Firms to begin applying for mortgage permissions	From 20 April 2015
Voluntary early adoption of post-March 2016 rules	From 21 September 2015
MCD implementation and transfer of second charge regulation – firms are required to comply with the new rules from this date	21 March 2016
Quarterly aggregate reporting though MLAR	From 21 March 2016
Transitional arrangements for MCD knowledge and competency requirements	Until 21 March 2017
Quarterly transaction-level data reporting through Product Sales Data	From 1 April 2017
Transitional arrangements for second charge mortgage sellers in post at 21 March 2016 to gain Level 3 qualifications	Until 21 September 2018[8]
Professional experience of staff can be relied upon to meet MCD knowledge and competency requirements	Until 21 March 2019

Where can I find out more information?

The information provided in this factsheet is not exhaustive. Full details of the changes are set out in the FCA's Policy Statement PS15/9 (and the accompanying Consultation Paper CP14/20) as well as in the FCA Handbook – all of which are available on the FCA website. To view the rules that will apply from 21 March 2016 you can use the 'time travel' function[9] on the FCA Handbook website. You will want to familiarise yourself with the detail of all the changes in order to understand the changes you will need to make.

You should consider whether this change will require that you have different FCA permissions and take steps to expedite your application. To inform your own assessment, Chapter 4 of the FCA's Perimeter Guidance Manual[10] gives some further information on what constitutes regulated mortgage activity.

If you cannot find the information you need on the FCA website and accompanying documents, you can contact us on 0300 500 0597 or mcdqueries@fca.org.uk

6 See SUP 16 Annexes 19A and 19AA. Notes to aid completion are in SUP 16 Annex 19B.
7 See MCOB TP 1.1.
8 After 21 March 2016, new mortgage sellers have 30 months to obtain the Level 3 qualification. See TC TP 8.
9 To view a consolidated version of the FCA Handbook as it will be at a particular date in the future, use the 'Show timeline' calendar at the left side of the page and choose the relevant future date.
10 https://www.handbook.fca.org.uk/handbook/PERG/4/