Factsheet No.041

For second charge mortgage intermediaries

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's mortgage rules, as part of our implementation of the Mortgage Credit Directive (MCD). This factsheet highlights some of the points second charge intermediaries should consider in getting ready for these changes. It will also be of interest to second charge mortgage lenders that carry out mortgage intermediation.

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.

Although FCA implementation of the MCD is largely based on existing mortgage rules, we are having to introduce **some new requirements**. Most notably for advisers and arrangers, these include the need to provide an adequate explanation of a product's essential features and the firm's disclosures (such as remuneration and scope of service), and give customers a European Standardised Information Sheet (ESIS) designed to help them shop around.

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. The arranging and advising permissions will be of relevance to intermediaries. Further information is set out in the flowchart on the FCA's website.[1] 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.

You should familiarise yourself with the FCA's Mortgages and Home Finance: Conduct of Business (MCOB) sourcebook. To view the rules that will apply from 21 March 2016 you can use the 'time travel' function[2] on the FCA Handbook website.

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

2 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.

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Among the key provisions that will apply to mortgage intermediaries are **advised sales (MCOB 4.7A), initial disclosure (MCOB 4.4A), adequate explanations (MCOB 4A) and remuneration (MCOB 2A.1)**. Firms have a responsibility to consider the practical implications of these requirements for their business models. For example, do existing sales processes need to be modified to ensure your customers get the required information about your service, the range of loans you offer and how you will be paid? Equally, you will need to be able to provide customers with the ESIS and, for the majority of sales, give advice that complies with FCA requirements. You will also need to factor in the amendments the FCA has made to other parts of the Handbook.[3] For example:

- Training and Competence (TC) – for **MCD knowledge and competence requirements**, which apply to a range of staff, and the associated transitional provisions
- Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU) - MCD second charge intermediaries will require **PII cover**
- Supervision Manual (SUP) - for the **aggregate data** you will have to report using the Retail Activities Mediation Return, which has been amended to capture second charge activity.

In addition to these detailed mortgage-specific rules, the FCA 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).

You should plan ahead to ensure that you can conduct compliant business from next March. Where you rely on others to support your business process, the FCA encourages you to have regular dialogue.

How does the FCA expect me to advise second charge mortgage customers?

Advice must be given if there is interactive dialogue between the firm and the customer during the sale, or if debt consolidation is the main purpose of the loan[4]. FCA rules require an adviser to recommend a product, or products, that are suitable for the customer based on an assessment of their needs and circumstances. If you do not have a suitable product within your range, you cannot recommend the 'least worst' product. However, the FCA does not require firms to recommend a single *most* suitable product.

Mortgage advisers must consider a range of factors in arriving at their recommendation, including whether it is appropriate for a customer to: have payment stability; take out a mortgage of a particular term; or make early repayments.[5] Although the FCA expects advisers to consider a lender's eligibility criteria, this does not extend to carrying out a full affordability assessment against the lender's responsible lending criteria – assessing affordability is the lender's responsibility.

The FCA requires mortgage sellers (including advisers) to obtain a relevant Level 3 qualification.[6] These staff in post at 21 March 2016 will have until 21 September 2018 to ensure they meet this requirement. After 21 March 2016, staff will have 30 months from starting to carry out the relevant activities to become qualified.

The FCA recently undertook a review of how firms are providing mortgage advice. Although this review did not cover second charge firms, you may find it useful to consider any read-across to your own business.

Will I be expected to advise on both first and second charge mortgages?

FCA rules do not require firms to broaden their scope of service to include both first and second charge mortgages; however, where a firm does offer both, it will need to take these different products into account when giving advice.

If an existing mortgage holder wishes to borrow more, the rules require firms to make the customer aware that other forms of borrowing are available that may also meet the need. For example, if a customer is considering

3 See Appendix 1 of PS15/9.

4 See PERG 4.6 for more information on what constitutes regulated advice.
5 See MCOB 4.7A.6R for a full list of factors.
6 See TC App 4.1.1E.

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a second charge mortgage, the firm must make the customer aware that it might be possible to obtain a further advance. However, a firm is not required to provide advice on the suitability of possible alternative options if they are not within its scope of service.[7]

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.[8] 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 Consumer Credit Act (CCA) will not apply. However, some CCA obligations will be retained[9]. The FCA encourages those planning to adopt early to maintain dialogue with their business partners (e.g. lenders) 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 firms. Further information is provided in PS15/9 and in the updated Handbook rules.

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
Regular reporting though Retail Mediation Activities Return (RMAR)	From 21 March 2016
Transitional arrangements for MCD knowledge and competency requirements	Until 21 March 2017
Transitional arrangements for second charge mortgage sellers in post at 21 March 2016 to gain Level 3 qualifications	Until 21 September 2018[10]
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[11] 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[12] 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

7 See MCOB 4.4A.8AR.
8 See MCOB TP 1.1.
9 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.

10 After 21 March 2016, new mortgage sellers have 30 months to obtain the Level 3 qualification.
11 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.
12 https://www.handbook.fca.org.uk/handbook/PERG/4/