Factsheet No.037

For house builders

New regulation affecting shared equity or second charge schemes

The Mortgage Credit Directive, which comes into force on 21 March 2016, will affect second charge and shared equity schemes. If you have past or present schemes, or are planning to offer these schemes, this factsheet sets out important information about the action you may need to take.

From the implementation in the UK of the EU Mortgage Credit Directive (MCD) on 21 March 2016, the FCA rules will change to bring second charge mortgage lending into the wider mortgage regime rather than the consumer credit regime. This will mean all lending secured on the borrower's home is subject to FCA mortgage regulation.

What are the implications for house builders?

House builders sometimes offer shared equity loans or incentives of a similar nature, resulting in a second or subsequent charge being taken over the consumer's property. Shared equity loans are second charge loans usually provided to help consumers, often first time buyers, buy a home with a lower deposit than otherwise required. Typically, they are provided jointly by a house builder and government (e.g. HomeBuy Direct, FirstBuy, Scottish Government New Supply Shared Equity with Developers) or through a government scheme (such as the Help to Buy equity loan), to help fund the purchase of new build properties although they could also be offered by other providers such as mortgage lenders.

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).

Back book loans that were previously exempt under the consumer credit regime will remain as such, but all other regulated second charge loans that are already in existence will transfer into our new regime from 21 March 2016 and become subject to our Handbook rules for Mortgage Conduct of Business (MCOB)[1] . This will mean MCOB protections 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 regulated loans, as well as to all new loans made. Additional requirements under MCOB will apply to any new second charge loans that come into existence after 21 March 2016.

Any house builder that has an existing back book of second charge or shared equity loans, or plans to

1 http://fshandbook.info/FS/html/FCA/MCOB

How the mortgage credit directive affects house builders

provide these loans, after 21 March 2016, will need to meet these requirements and either be authorised by the Financial Conduct Authority to hold permission to carry out these regulated activities, or appoint a regulated third-party to administer the loans (only available in certain circumstances, see below).

Regulated activities for house builders

Examples of the types of FCA mortgage permissions that house builders may need, depending on the regulated activities undertaken, are:

- Entering into a regulated mortgage contract as lender, and/or
- Administering a regulated mortgage contract, and/or
- Advising on regulated mortgage contracts

Exemptions

Government schemes such as Help to Buy are and will remain exempt following the introduction of the MCD. However, for joint schemes between government and house builders (e.g. HomeBuy Direct and FirstBuy) the exemption only covers the government portion and therefore house builders will need to consider the options below for their portion.

Any other exemptions which may apply will be detailed in the FCA Handbook. If you are unsure about whether or not exemptions apply to your firm you should take appropriate legal or professional advice.

Options for house builders

1. Do not offer shared equity or similar incentive schemes

If your firm does not currently hold a back book of shared equity or second charge loans and you do not wish to offer these loans in future you do not need to take any action in response to this factsheet.

2. Obtain FCA authorisation

If your firm wishes to continue to administer a back book of shared equity or second charge loans, and/or would like to originate new loans and hold these loans after 21 March 2016, then you must apply to the FCA for authorisation to carry out this activity. See "How do I become authorised?" below.

If your back book is held across more than one entity within your firm and/or you intend to lend in the future across more than one entity you will need to apply for FCA authorisation for each entity. Under these circumstances you may wish to consolidate these loans into a single entity. In this case, you would only need to apply for FCA authorisation for that single entity alone.

3. Outsource to a third party

If you hold a back book of shared equity or second charge loans and do not plan to originate any new loans, one option may be to employ a third party who does hold the required permission to administer your back book. This is a way for house builders to retain their back books, without having to directly seek FCA authorisation for administration. Do note, however: any firm that does want to originate new loans has to be directly authorised by the FCA for all its regulated activities (including administration of its back book).

4. Write off loan and release charge

If you currently hold a book of shared equity or second charge loans, and do not intend to offer these loans in the future, one option would be to release the second charge you hold on your existing loans before the new rules come into operation on 21 March 2016. This is a commercial decision for your firm.

How do I become FCA authorised?

Many house builders currently hold interim permission for their second charge business. If you intend to submit an application for FCA authorisation of required mortgage permissions you can apply now or within your allocated application period.

If you fail to apply within your application period, your second charge business interim permission will lapse, which means that you will no longer be permitted to carry out any related FCA regulated activity after 20 March 2016. After this date you must stop carrying on this regulated activity second charge business (which includes holding and administering any back loan book) or you will be operating illegally and committing a criminal offence.

If you do intend to allow your interim permission to lapse, we expect you to take steps to ensure an orderly wind-down of your firm's regulated business, in line with your existing responsibilities: to pay due regard to the interests of your customers, treat them fairly, to be transparent in communications and to ensure customers' interests are not adversely affected.

If you do not currently hold interim permission for your second charge business, you may be operating illegally. You should contact the FCA immediately to clarify the position and you may be required to apply for full authorisation.

To apply to become authorised or registered by the FCA you need to submit an application to us. The authorisation process is substantive and you will need to build in sufficient time to prepare your application and any supporting documentation. Please see the MCD2[2] section of our website for further information.

Next steps

You will need to decide on the options available to you in the light of your current business and future plans. If you are unsure whether your firm needs to be authorised you should take appropriate legal and professional advice.

Want to know more

For more information and the latest news, see the MCD section of our website. Trade bodies, warranty companies including HBF (Home Builders Federation), Homes for Scotland and NHBC (National House Building Council), may also provide updates and information on the introduction of the MCD through their websites and other media such as newsletters. Further information is available from our policy statement PS 15/9: Implementation of the Mortgage Credit Directive and the new regime for second charge mortgages[3] and the earlier consultation paper CP14/20[4]

You can also call our Firm Contact Centre on UK: 0300 500 0597 or Email: firm.queries@fca.org.uk.

2 www.fca.org.uk/firms/firm-types/mortgage-brokers-and-home-finance-lenders/mcd

3 www.fca.org.uk/your-fca/documents/policy-statements/ps15-09

4 www.fca.org.uk/news/cp14-20-mcd