

# Fairness of changes to mortgage contracts

July 2014





# Contents

Abbreviations used in this paper	3
Foreword	5
<b>1</b> Overview	6
<b>2</b> The regulatory framework	11
<b>3</b> Consumer experiences of the mortgage market	16
<b>4</b> Applying the regulatory framework in practice	22
<b>5</b> Options	38
<b>6</b> Conclusion	41
<b>Annex</b>	
<b>1</b> List of questions	42
<b>Appendix</b>	
<b>1</b> Summary of key handbook provisions relevant to considering the fairness of changes to regulated mortgage contracts and other relevant considerations	45
<b>Glossary</b>	
Definitions used in this document	50

We are asking for comments on this Discussion Paper by 30 September 2014.

You can send them to us using the form on our website at:  
[www.fca.org.uk/your-fca/documents/discussion-papers/dp14-02-response-form](http://www.fca.org.uk/your-fca/documents/discussion-papers/dp14-02-response-form).

**Or in writing to:**

Kate Richards  
Consumer Contracts Team, Supervision Division  
Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Telephone:** 020 7066 4194  
**Email:** [mortgage.dp@fca.org.uk](mailto:mortgage.dp@fca.org.uk)

---

We make all responses 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 Discussion Paper from our website: [www.fca.org.uk](http://www.fca.org.uk).

## Abbreviations used in this paper

<b>CONC</b>	Consumer Credit sourcebook
<b>DISP</b>	Dispute Resolution: Complaints (sourcebook)
<b>FCA</b>	Financial Conduct Authority
<b>FOS</b>	Financial Ombudsman Service
<b>FSA</b>	Financial Services Authority
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>MMR</b>	Mortgage Market Review
<b>MCOB</b>	Mortgages and Home Finance: Conduct of Business sourcebook
<b>SVR</b>	standard variable rate
<b>TCF</b>	Treating Customers Fairly
<b>UNFCOG</b>	The Unfair Contract Terms Regulatory Guide
<b>UTCCRs</b>	Unfair Terms in Consumer Contracts Regulations 1999

### Glossary - helping to explain financial terms

As with many industries, the financial services industry uses terminology that has a specific meaning, but which may not be commonly understood outside the industry. We have included a glossary at the end of this discussion paper with plain language explanations of some of the terminology used in this paper, and also of some of the legislation which we refer to.

### Disclaimer

This document is provided solely for discussion purposes. It is not intended to be a statement of the law, or of regulatory provisions, relevant to our functions in relation to mortgage contracts.



# Foreword

The mortgage market has undergone significant reforms over recent years that have fundamentally changed the way the industry operates; helping to ensure that mortgage lending is both affordable and sustainable in the future.

For many consumers, a mortgage will be one of their largest financial commitments and, as a result, any change to their mortgage has the potential to have a significant impact on their finances.

For a number of reasons, including the prevailing economic environment and the potential for the Bank of England to raise interest rates, many mortgage lenders are contacting us to discuss changing their standard variable rates (SVRs) or making other changes to their mortgage contracts.

We recognise that for the mortgage market to be sustainable there are valid reasons why firms build flexibility into their mortgage contracts and why they might seek to use that flexibility. We are concerned, however, that in some instances consumers might not have been reasonably able to anticipate these changes when they took out their mortgage and that the proposed changes may, therefore, be unfair.

Given the importance of this topic to both the mortgage industry and consumers, we want to have an open discussion about the fairness of changes to mortgage contracts. This will also give us a chance to be more transparent about our approach to assessing fairness.

This paper sets out the regulatory framework and how we apply our Principles for Businesses in practice when we consider the fairness of a change to a firm's mortgage contract. It provides an opportunity for consumers and firms to share their experiences and give views on what factors should be taken into account in assessing the fairness of changes to mortgage contracts, as well as the relative importance of these factors.

As a demonstration we use fictional case studies to illustrate the factors that may be relevant to an assessment of fairness.

We have no plans for new rules, nor changes to existing ones; instead we seek your views on how we currently, and how we could in future, approach fairness in the context of changes to mortgage contracts.

Across financial services, we recognise there is the wider challenge of complexity of terms and conditions, which mean that some consumers may fail to understand the full implications of what they are signing. Responses to this paper will also inform the FCA's broader work to understand consumer expectations, and how the industry can bridge this gap by better meeting the information needs of consumers.

This is an important debate and I would encourage anyone with an interest in these issues to contribute to the discussion.

**Linda Woodall**  
**Director of Mortgages and Consumer Lending**

# 1. Overview

## Introduction

---

- 1.1** This discussion paper aims to provide an opportunity for firms and consumers to discuss the meaning of fairness when considering a change to a regulated mortgage contract. We consider the fairness of firms' changes to their regulated mortgage contracts on a case-by-case basis. However, we are not able, in every case, to disclose the factors that we considered when assessing the fairness of changes to regulated mortgage contracts, as this may include confidential information.<sup>1</sup>
- 1.2** To give this discussion some context, we give examples and discuss a non-exhaustive range of changes that firms may wish to make to their mortgage contracts, including variations to interest rates, changes to their lending criteria or the withdrawal of a particular product or feature. We ask what factors may be relevant when considering whether a particular change is fair. We want the discussion to be as open as possible and we invite comments from readers in relation to any type of change to a regulated mortgage contract, even if we have not included it as an example.
- 1.3** We see this paper as an opportunity to open up the discussion and be transparent about the factors that may be relevant when considering the fairness of changes to regulated mortgage contracts and to seek views from firms and consumers on this topic. This paper considers the fairness of changes to regulated mortgage contracts only. For the purposes of the discussion, this means certain mortgage contracts entered into on or after 31 October 2004 which fall within the Financial Conduct Authority (FCA's) remit.<sup>2</sup> We are not considering contracts that are not regulated by the FCA, such as buy-to-let mortgages.<sup>3</sup>

## Who does this document affect?

---

- 1.4** You should read this paper if you are:
- a mortgage lender<sup>4</sup>
  - a mortgage intermediary<sup>5</sup>
  - a trade body
  - a consumer or a representative of consumers.

---

<sup>1</sup> Restrictions on the disclosure of confidential information are set out in s348 of the Financial Services and Markets Act 2000 (FSMA).

<sup>2</sup> See Glossary, on pages 50-51.

<sup>3</sup> See Glossary, on pages 50-51.

<sup>4</sup> See Glossary, on pages 50-51.

<sup>5</sup> See Glossary, on pages 50-51.

---

### Is this of interest to consumers?

---

- 1.5** Yes, this paper covers a topic that will be of interest to retail consumers and those who represent consumer groups because it discusses the application of the FCA's current regulatory framework and asks whether this framework is sufficient to ensure appropriate protection for consumers.
- 1.6** We want to make it as straightforward as possible for consumers to participate in this discussion. With this in mind, we have a chapter aimed specifically at our consumer readers on pages 16 to 21.

### Context

---

- 1.7** The FCA has the following three operational objectives:
- To secure an appropriate degree of protection for consumers
  - To protect and enhance the integrity of the UK financial system
  - To promote effective competition in the interests of consumers.
- 1.8** The objective of securing an appropriate degree of consumer protection is central to this discussion paper: we want to ensure that lenders have consumers' interests at the heart of their businesses both when they write their mortgage contracts and when they seek to make changes to them.
- 1.9** During the rapid growth phase of the mortgage market over the 15 years leading up to 2008, lenders competed hard to win new business. They did this by offering both competitive headline interest rates and additional features to attract consumers. Such offerings included fixed or low interest rates for limited periods (e.g. discounted rates), assurances (e.g. lifetime guarantees and tracker mortgages) and other features (e.g. the ability to draw down more money against the mortgage).
- 1.10** While offering these features, many lenders also built such terms – often known as variation terms – into their contracts which enabled them to change or simply switch off these facilities if market conditions changed. In many cases, firms have legitimate reasons for including variation terms in their contracts. Mortgage contracts are typically of long duration and it is difficult for firms to foresee how future market conditions may affect their contracts. In order for it to be sustainable for firms to offer longer-term mortgage contracts, it is necessary that firms have some flexibility to react to changes in the market. The discussion is based around whether the level of flexibility that firms reserve for themselves is fair, and what factors may be relevant when we make an assessment of the fairness of a change to a regulated mortgage contract.
- 1.11** Consumers may have entered into contracts at discounted rates without fully appreciating the potential impact if these rates were to increase or if the property market were to suffer a downturn. In fact, market conditions changed significantly in 2008/9 and some lenders have sought to rely upon these contractual terms in order to keep their business viable; not all changes are motivated by a desire to improve a firm's financial position.

- 1.12** The Bank of England base rate at the date of publication is at 0.5% and has been at this historically low level for more than five years. This has created a challenging market for lenders. It is especially difficult if lenders are bound by the 'headline' features of the original mortgage sale. Some lenders may therefore seek to rely on the 'fine print' of mortgage terms and conditions which, in some cases, allow them to make variations to their mortgage contracts. The reasons why firms make these changes may be legitimate and intended to keep their businesses profitable. However, we are interested in hearing about the reasons why firms are making changes to their contracts and your views about whether you consider these reasons to be fair. One consequence of these changes is that it may make the mortgage contract less attractive to consumers. Interest rates can be expected to increase as the economy improves and this may have a further impact on consumers and/or the changes that firms may wish to make to their mortgage contracts.

### Summary of the discussion

---

- 1.13** This discussion paper aims to provide the opportunity for firms and consumers to comment on the factors that may be relevant to the fairness of a change to a regulated mortgage contract. This paper is structured as follows:

- Chapter 2 (pages 11-15) sets out an overview of the current regulatory framework. This particularly focuses on Principles 6 and 7<sup>6</sup> of the FCA's Principles for Businesses (the Principles) as many of the factors that may be relevant to an assessment of the fairness of a change to a regulated mortgage contract are likely to be derived from these Principles. The overview of the current regulatory framework is not intended to be fully comprehensive or to provide guidance; it is intended to set out the parameters of the discussion.
- Chapter 3 (pages 16-21) is specifically aimed at consumers. It asks about consumers' experiences and expectations of the mortgage market.
- Chapter 4 (pages 22-37) provides the opportunity to discuss how the FCA's regulatory framework applies in practice and invites discussion about the factors that may be relevant to an assessment of the fairness of a change to a regulated mortgage contract and the relative importance of each of these factors.

We set the discussion around some fictional case studies in order to give the discussion more context, and to provide a flavour of some of the issues that firms, consumers, and we as a regulator, have encountered or may come across in the future. We also set out our view as to how we think the current regulatory framework is working in practice and invite views from consumers and firms about this.

- Chapter 5 (pages 38-40) provides the chance to discuss what options are open to the FCA if it is considered that the current regulatory framework does not ensure fair outcomes for consumers. We are seeking your views on how we currently, and how we should in future, approach fairness in the context of changes to regulated mortgage contracts.

---

<sup>6</sup> See 'Introduction to Principles 6 and 7' on pages 12-13.

---

## Equality and Diversity

---

- 1.14** In compliance with the Public Sector Equality Duty of the Equality Act 2010, the FCA has due regard to the need to eliminate discrimination, advance equality of opportunity and foster good relations in the exercise of our functions. As such, we consider the equality and diversity implications of our proposals throughout our policy-making process.
- 1.15** The Equality Act 2010 sets out 9 protected characteristics: age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; and marriage or civil partnership status.
- 1.16** We would welcome any examples of, as well as your views on, the equality and diversity implications of the ideas set out in this discussion paper.

---

## Competition

---

- 1.17** In addition to our competition objective, we also have a competition duty<sup>7</sup> which applies when we are determining the general policy and principles by which we perform our functions under the Financial Services and Markets Act 2000 (FSMA) (as well as when we are making rules or giving general guidance).
- 1.18** Fairness considerations, which form the heart of this paper, have to be seen in the broader context of how the mortgage market works. If a consumer has access to a broad range of products from a wide range of competing providers, then this may affect the weighting that is given to some of the factors that we will discuss. For instance, if a lender removes a product feature from an existing mortgage, but that customer is able to re-mortgage without detriment to obtain that same (or a better) competitive offering elsewhere, then this may affect the importance that is attributed to that factor when assessing fairness. However, we note that competition is not a consideration for an evaluation of whether or not a contract variation is fair.
- 1.19** In terms of evaluating contract variation in the broader context of competition, we want to stress the importance of clear and timely communications to consumers in relation to what they can expect from the lender. This is relevant both at the point of purchase and when contract variations are introduced. It is only when consumers have all the necessary information that they are in a position to make informed choices and to drive competition. Clear and timely communications from firms are a central aspect of making markets work well for consumers. They are also a key consideration in any assessment of fairness.
- 1.20** Whilst we do not regard competition as a factor in the evaluation of fairness in itself, it is important to understand the economic impact of contract variation at the level of the firm and at the level of the market.

---

<sup>7</sup> See Glossary, on pages 50-51.

### Next steps

---

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

- 1.21** We want to know your views about the fairness of changes to regulated mortgage contracts and the factors that may be relevant in an assessment of whether a change to a regulated mortgage contract is fair. Throughout this discussion paper (and summarised on pages 42-44) we set out a number of questions inviting you to participate in this discussion. Please send us your comments by **30 September 2014**.

#### How?

- 1.22** We set out our contact details and how you can respond to us on page 2.

- 1.23** You can also use the online response form on our website.

#### What will we do?

- 1.24** We intend to proactively engage with both the mortgage industry and consumers during the discussion period. We plan to run a number of consumer focus groups in order to speak to consumers directly about their views on this topic. We also intend to work with firms and trade bodies to speak face-to-face about any issues that are raised as a result of this discussion. This is intended to complement, and not replace, the written feedback that we are seeking.
- 1.25** We will consider all views and comments we are given and aim to publish a Feedback Statement in due course.

## 2. The regulatory framework

### Overview

---

**2.1** This chapter provides a summary of the current regulatory framework which applies to changes to regulated mortgage contracts with a particular focus on Principles 6 and 7. This provides the background and context for the discussion about the fairness of changes to regulated mortgage contracts in:

- Chapter 3: consumer readers
- Chapter 4: for all of our readers.<sup>8</sup>

### Introduction to the regulatory framework

---

**2.2** For mortgages sold before 31 October 2004, the Principles and the FCA's other rules do not apply.<sup>9</sup> For regulated mortgage contracts sold after that date, a lender's conduct and its dealings with its customers will be considered under:

- the Principles, taking into account the Treating Customers Fairly (TCF) Outcomes that our predecessor, the Financial Services Authority (FSA), published in July 2006<sup>10</sup>; and
- the Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB) rules.

For example, there are requirements in MCOB that relate to:

- how a lender communicates with its customers
- disclosure of key product risks and features
- the quality of advice (for advised sales).<sup>11</sup>

**2.3** The Principles and other rules apply to the way lenders sell, advise on and market mortgage products to customers, as well as how lenders treat customers once they have bought the product. This includes when varying any element of a mortgage product.

---

<sup>8</sup> Further information about the regulatory framework is set out in Appendix 1.

<sup>9</sup> The position is more complex in relation to complaints handling (see Appendix 1).

<sup>10</sup> [www.fca.org.uk/static/fca/documents/fsa-tcf-towards.pdf](http://www.fca.org.uk/static/fca/documents/fsa-tcf-towards.pdf).

<sup>11</sup> We anticipate that, following the implementation of MMR on 26 April 2014, most mortgage sales will be advised sales.

- 2.4** In addition to the Principles, mortgage lenders should consider:
- other provisions of the FCA Handbook (which includes the Principles and MCOB) such as the Dispute Resolution: Complaints (DISP) sourcebook
  - The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs).<sup>12</sup>
- 2.5** This paper does not consider the UTCCRs because the FSA published guidance about improving standards in consumer contracts relatively recently in 2012.<sup>13</sup> Also, we do not want to debate the UTCCRs as these regulations are subject to change due to the Consumer Rights Bill which, at the time of publication, is making its way through Parliament. The Bill covers a number of different areas of consumer law. Assuming the Bill becomes law, the UTCCRs will be revoked and the Unfair Terms in Consumer Contracts Directive will be re-implemented by Part 2 of and Schedule 2 to the Bill. We plan to publish further guidance about unfair terms if and when the Bill becomes law.
- 2.6** A more detailed summary of some of the key Handbook provisions can be found in Appendix 1.

### Introduction to Principles 6 and 7

---

- 2.7** Both Principle 6 and 7 are wide, flexible rules which allow for a number of factors to be taken into account when assessing the fairness of a lender's conduct. From the FCA's perspective, this flexibility allows for principles-based, outcome-focused regulation. It allows us to assess a lender's conduct, taking into account a wide range of factors (which we will explore further in chapter 4) and assess the fairness of the final consumer outcome likely to arise from that conduct. From the lender's perspective, this flexibility allows a lender to judge, based on the particular circumstances it faces, what action it needs to take to deliver a fair outcome to its customers.

#### Principle 6

- 2.8** Principle 6 provides that firms must pay due regard to the interests of their customers and treat them fairly.
- 2.9** In July 2006, the FSA published a paper entitled "Treating customers fairly- towards fair outcomes for consumers".<sup>14</sup> The paper referred to the six consumer outcomes which explain what the FSA wanted the Treating Customers Fairly (TCF) initiative to achieve for consumers.
- 2.10** These six outcomes remain core to what we expect of lenders, and are an important guiding factor in our regulatory decisions and actions.

#### TCF Outcome 5

- 2.11** TCF Outcome 5 derives from Principle 6. It aims to ensure "customers are provided with products that perform as firms have led them to expect and the associated service is both of an acceptable standard and as they have been led to expect".

<sup>12</sup> This paper does not consider changes to second-charge mortgages. We have regulated certain second charge since 1 April 2014. The Consumer Credit sourcebook (CONC) sets out further provisions in relation to certain second change mortgages. As a general matter, we would also expect similar principles to those discussed in this paper to apply when assessing the fairness of changes to second charge mortgages.

<sup>13</sup> A link to this guidance is here: [www.fca.org.uk/static/pubs/guidance/fg12\\_02.pdf](http://www.fca.org.uk/static/pubs/guidance/fg12_02.pdf)

<sup>14</sup> [www.fca.org.uk/static/fca/documents/fsa-tcf-towards.pdf](http://www.fca.org.uk/static/fca/documents/fsa-tcf-towards.pdf).

**2.12** As stated in the FSA's July 2006 paper, TCF Outcome 5 involves being clear about:

- what product or service is being provided
- the range of possible results and experiences for the consumer.

**2.13** Lenders can change their regulated mortgage contracts after the point of sale without treating their customers unfairly. However, there can be fairness issues if, for example, the lender misled the consumer about the likely operation of a mortgage during its term.

**Principle 7**

**2.14** Principle 7 says that firms must pay due regard to the information needs of their clients and communicate information to them in a way that is clear, fair and not misleading.

**TCF Outcome 3**

**2.15** Outcome 3 of the TCF Outcomes derives from Principle 7. It aims to ensure that "customers are provided with clear information and are kept appropriately informed before, during and after the point of sale."

**2.16** Clear communication is a key component of firms' approaches to TCF, as well as to Principle 7. Before and at the point of sale we expect that all financial promotions should be clear, fair and not misleading. Effective point of sale disclosure is also essential for customers to understand the characteristics of the product they are buying and how it meets their requirements. Post-sale disclosure helps keep consumers aware of product performance, their opportunities to act at certain points in the product lifecycle, and changes in the terms and conditions.

### **The distinction between an assessment of fairness under Principles 6 and 7 and contractual fairness under the UTCCRs**

As explained, we will not cover the UTCCRs in this discussion paper. However, we consider that there are some distinctions between the assessment of contractual fairness under the UTCCRs and the assessment of fairness under the Principles that are worth highlighting.

The UTCCRs set out, in Regulation 5, the test of fairness which states that: "A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer."

The test of fairness applies to the way in which contract terms are written and considers all the circumstances affecting the contract.<sup>15</sup>

Regulation 5 sets out the three elements of the test of fairness which should be considered when assessing whether or not a term is unfair:

- the term has to be contrary to the requirement of good faith;
- it has to cause a significant imbalance between the parties' rights;
- to the detriment of the consumer.

Therefore the concept of 'fairness' under the UTCCRs has a more prescribed, structured meaning than under the Principles.

Principles 6 and 7 are more flexible and take into account a lender's conduct before, during and after the conclusion of the contract. This flexibility allows for principles-based regulation, with a focus on the consumer outcome.

Fairness under Principles 6 and 7 is assessed according to a number of different factors. The relevance of each factor will depend on the circumstances of the particular case.

We would generally expect that an analysis of fairness under the UTCCRs and Principles 6 and 7 would produce broadly the same result. However, there may be circumstances in which terms might be fair under the UTCCRs but produce an unfair result under Principles 6 and 7.

<sup>15</sup> Regulation 6(1): "Without prejudice to regulation 12, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent."

For example:

1. A lender may have the right to increase the interest rate applicable to its regulated mortgage contract, and the respective contract term might be fair under the UTCCRs. However, if the lender uses that right to take advantage of the fact that many of its customers are 'trapped' borrowers and will be unable to exit the contract and refinance, the lender may be in breach of Principle 6.<sup>16</sup>
2. A lender might comply with a contractual requirement to provide notice to its customers of a change to its regulated mortgage contract, and the term that states this requirement might be fair under the UTCCRs. However, if the notice is not clear, not fair or is misleading (for example, the relevant information about the change is not sufficiently prominent), the firm may be in breach of Principle 7.

<sup>16</sup> As set out in evidential provision MCOB 11.8.1E

# 3.

## Consumer experiences of the mortgage market

### Introduction

---

- 3.1** This discussion paper aims to consider the factors that may be relevant when assessing the fairness of a change to a regulated mortgage contract. We are interested in hearing your views, particularly about your own experiences or expectations of the mortgage market and regulated mortgage contracts.
- 3.2** In this chapter we will explain the role of the FCA and introduce our rules and Principles, then set out some questions about your experiences and expectations of the mortgage market. This chapter contains all the information you will need as a consumer, so you can consider the questions without needing to read the rest of the paper.

### The role of the FCA

---

- 3.3** We regulate most firms and individuals that advise on, sell and arrange financial products and services in the UK. Our aim is to protect consumers, protect and enhance the integrity of the UK financial system and promote effective competition between financial services providers. We have rule-making, investigative and enforcement powers that we use to protect and regulate the financial services industry. We are fair and principled in our approach to regulation.<sup>17</sup> We do not act for individual consumers or represent people in individual complaints; the Financial Ombudsman Service (FOS) assists consumers with individual complaints, if they are unable to resolve a dispute with a firm.<sup>18</sup>

### The FCA's rules

---

- 3.4** The FCA has a number of rules that are intended to protect consumers. We have rules relating to different sectors within the financial services industry: for example, for mortgages, we have the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).<sup>19</sup> Some of our rules come from European Directives.<sup>20</sup> We also use our rule-making powers, which we use to make our own rules that are specific to the UK financial services market. An example is our Principles for Businesses, a general statement of the fundamental obligations firms have.<sup>21</sup>

---

<sup>17</sup> Further information about the FCA's role can be found on our website: [www.fca.org.uk/about/what](http://www.fca.org.uk/about/what)

<sup>18</sup> Information about the role of the Financial Ombudsman Service is available on their website: [www.financial-ombudsman.org.uk](http://www.financial-ombudsman.org.uk)

<sup>19</sup> Further information about the FCA handbook, including MCOB, is available here: <http://fshandbook.info/FS/html/FCA/>

<sup>20</sup> Countries that are members of the European Union need to have, as a minimum, rules that implement the relevant Directive.

<sup>21</sup> Further information about the FCA's Principles for Businesses can be found here: [www.fca.org.uk/about/what/regulating/principles-for-businesses](http://www.fca.org.uk/about/what/regulating/principles-for-businesses)

**The FCA's Principles for Businesses**

**3.5** This discussion paper looks at some of the factors that may be relevant when assessing the fairness of a change to a regulated mortgage contract. Most of these factors are based on the FCA's Principles for Businesses – mainly Principles 6 and 7, which relate to the fair treatment of customers and the provision of fair and clear information.

**Principle 6** says that a firm must pay due regard to the interests of its customers and treat them fairly.

**Principle 7** says that a firm must communicate information to consumers in a way which is clear, fair and not misleading.



<sup>22</sup> These elements are not ranked in order of priority and there may be other legal issues (including other Principles) that are relevant in a particular case.

## Factors that may be relevant when assessing the fairness of a change to a regulated mortgage contract

---

### Your experiences and expectations

- 3.6** We are interested to hear your experiences with regulated mortgage contracts and your views about what you expect from the mortgage market, including what factors may be relevant when considering the fairness of a change to a regulated mortgage contract.

### Your expectations

---

- 3.7** It may be that you don't have any direct experience of a change to your mortgage contract. However, you may still have expectations about how you think a mortgage contract should operate. We are interested in your views about what factors may make a change to a mortgage contract fair or unfair.
- 3.8** We have set out some questions below to prompt discussion about what factors may be relevant. For these questions, assume that the lender has the right under the regulated mortgage contract to make the change. What we are interested in is your views on the fairness of the change itself.
- 3.9** Please feel free to answer as many or as few of the questions as you would like. Where we ask about your expectations of a product, please explain, if possible, why you expected the product would perform in a certain way (for example, because of your communications with a firm, or because of the way that the product was marketed).

#### Question 1: Your experiences

- **Has your mortgage contract been changed at any time?**
- **What change was made?**
- **Did you think the change was fair or unfair? Please explain why. Think about how the firm has treated you, how they communicated the change to you, and if you think they considered your needs or situation.**

### Question 2: Change to a standard variable rate (SVR)

Imagine you have a mortgage contract where the interest rate is the lender's standard variable rate (SVR).<sup>23</sup> This is a rate set by the lender which can be increased or decreased. The lender should set out the reasons why the interest rate may be changed in the mortgage contract.

- What do you think are fair reasons for a lender to increase the SVR?
- Is there anything that the lender could do to make sure the increase is fair? For example, does the lender give you notice of the change; do they clearly set out their intention to increase the SVR; do they set out your options if you do not like the change?

See page 27 for a case study on SVR increases.

### Question 3: Change to a fixed-rate contract before the end of the fixed term

Imagine you have a mortgage contract with an interest rate that is fixed for five years.

- Would you expect the interest rate to be changed before the end of the five-year period? If so, in what circumstances do you think this could be fair?

See page 29 for a case study based on an increase to the interest rate of a product that is described as fixed.

<sup>23</sup> See Glossary, on pages 50-51.

#### Question 4: The removal of a feature from a mortgage contract

Imagine there is a term in your mortgage contract allowing you to rent the property out to someone else. There is also a term in the contract allowing the lender to withdraw your right to rent out the property at any time.

- Do you think that it is fair for the lender to be able to withdraw your right to rent the property out during the term of the contract? Please explain your reasons.

See page 31 for a case study about the withdrawal of a feature in a mortgage contract.

#### Question 5: The removal of a feature from a mortgage contract

Imagine you have a mortgage that has a bank current account linked to it. The mortgage agreement allows you to borrow money from the current account, up to an agreed limit. This loan is repaid as part of your mortgage repayments.

- If you took out a mortgage that had this facility, would you expect that there may be a term in the contract that allows the lender to withdraw it?
- Do you think that it is fair for the lender to be able to withdraw this feature? Please explain your reasons.

See page 32 for a case study on the withdrawal of a loan facility in a mortgage contract.

**Question 6: A variation caused by your mortgage provider changing**

**Imagine that your mortgage is taken over by another provider, perhaps because two mortgage lenders have merged to become one company.**

- **Would you expect your mortgage terms to remain the same for the duration of your mortgage?**
- **Do you think it is fair for the new provider, who has taken over your existing lender, to be able to change your contract? Please explain why.**
- **Do you think that it is fair for the lender to be able to withdraw a feature? Please explain your reasons.**

**See page 35 for a case study on a lender taking over another lender's mortgages.**

**Next Steps**

- 3.10** We welcome your views on any of the questions we have set out, as it helps us to understand your experiences and see the sort of issues that you are coming across with changes to your mortgage contracts.
- 3.11** Please note, however, that we are unable to assist in relation to any individual disputes with firms, as explained in paragraph 3.3. Any responses that we gather as a result of this discussion paper will, however, help us in achieving our statutory aim of protecting consumers in general.
- 3.12** As well as asking for your written feedback to these questions, we also plan to run some consumer focus groups so that we can hear from consumers directly about their experiences. It is likely that we will be engaging a market research company to assist us in carrying out this exercise.

**Other sections of the Discussion Paper**

---

- 3.13** We welcome your comments on any other part of this discussion paper.

## 4.

# Applying the regulatory framework in practice

### Introduction

---

- 4.1** Chapter 2 provides an overview of the current regulatory framework that applies when lenders consider making changes to their regulated mortgage contracts. This chapter explores how Principles 6 and 7 of the current regulatory regime work in practice and introduces a number of factors which lenders may wish to consider when making changes to their regulated mortgage contracts.
- 4.2** We are discussing how the current framework applies to regulated mortgage contracts.<sup>24</sup>
- 4.3** This discussion is an opportunity to be more transparent about the factors that may be relevant to the fairness of a change to a regulated mortgage contract.
- 4.4** In this chapter we will:
- set out factors that may be relevant under Principles 6 and 7 when considering the fairness of changes to a regulated mortgage contract
  - set out some fictional case studies on applying those Principles in practice
  - set out our views about the factors that we consider are most likely to be relevant in relation to each of these case studies, and whether we consider the change is likely to be fair or unfair
  - ask you about the relative importance of each of these factors.

### Summary of factors that may be relevant to an assessment of fairness of a change to a regulated mortgage contract under Principles 6 and 7

---

- 4.5** In the fictional case studies that follow, we consider some factors that may be relevant to assessing the fairness of a change to a regulated mortgage contract. We ask for your views about whether these factors are relevant and whether there are any other factors that should be taken into account. We also ask which factors you consider to be the most important and why.
- 4.6** As we consider the fairness of changes on a case-by-case basis, the factors that may be relevant will differ, depending on the facts of each case. It also means that we cannot provide an exhaustive list of factors that may be considered.
- 4.7** By way of summary, we have set out a list of the factors that may be relevant to an assessment of fairness of a change to a regulated mortgage contract, categorised into headings for ease of reference. We hope that the list will open up the discussion about factors you think are relevant.

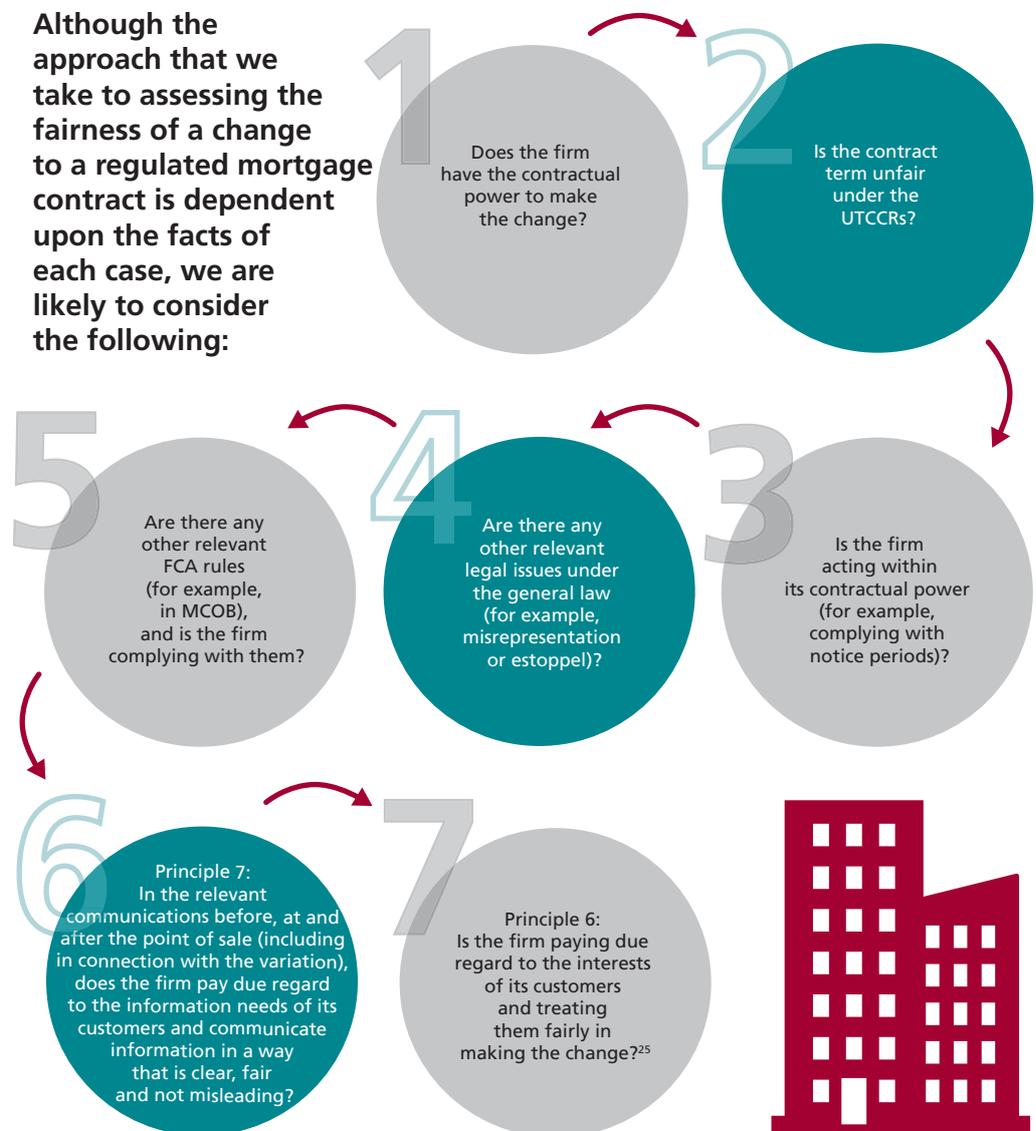
---

<sup>24</sup> See Glossary, on pages 50-51.

**Likely approach to considering the fairness of a change to a regulated mortgage contract**

**We would like to put the discussion about Principles 6 and 7 into context so that you can see where we consider they fit into our overall approach**

Although the approach that we take to assessing the fairness of a change to a regulated mortgage contract is dependent upon the facts of each case, we are likely to consider the following:



This discussion focuses on considering the factors that may be relevant under Principles 6 and 7.

<sup>25</sup> These elements are not ranked in order of priority, and there may be other legal issues (including under other Principles) that are relevant in a particular case.

**Factors that may be relevant:*****The contract term itself***

- The lender's contractual right to carry out the change under the regulated mortgage contract
- The lender's reason for making a change to its regulated mortgage contract, as well as the benefits they will derive from the change
- The way the lender chooses to implement the change (for example, the timing of the change, or the stages it follows until full implementation)

***Expectations about the operation of the product***

- Customers' reasonable expectations regarding the mortgage product. Factors which are likely to drive these expectations may include:
  - The name of the mortgage product (for example, a 'tracker mortgage') as well as the contents of any pre-contractual documentation, such as the Key Facts Illustration
  - What the distributor or the lender's branch staff told customers when they bought the mortgage: did this lead customers to believe that the product would continue to operate in a certain way during its life?
  - The lenders' actions (both orally and in writing) before and after the sale
- The content of the marketing material used by the lender or the distributor
- The content of the contractual documentation
- How the variation impacts upon how the product is expected to operate
- Any post-contractual documentation and communications (for example, annual statements)
- The likely reason why customers bought this particular product and any features of the product that may have influenced this decision

***Communications about the product***

- The consistency between the marketing material and the mortgage terms and conditions, both at the time of sale and following any variation
- The information the lender provides customers at the time a variation is carried out, in terms of both explaining the basis for the variation and the impact on the customer's individual product

***Impact of the change***

- How useful the product is to customers when a feature is removed

- The impact the change will have on customers, including any impact that is caused by how the change is implemented (for example, whether customers are able to respond to the change without incurring significant detriment)
- The impact the change will have on different consumer groups<sup>26</sup>
- How the lender proposes to mitigate any detriment the change may cause
- How the lender will deal with any customers in financial difficulties<sup>27</sup>
- Can customers easily exit this product? Is there a cost for them to do so?
- Whether the lender will exclude certain customers from the change – are customers given the opportunity to put forward a case why they should be excluded (for example, if they are making significant use of the feature)?
- What is the impact for the lender if it is unable to make the change?

**4.8** The above list is not exhaustive. Instead it is only indicative of factors that are likely to inform an assessment of whether a lender's change to a regulated mortgage contract is fair or unfair. Lenders should give careful consideration to their obligations under Principles 6 and 7 when carrying out a change to their regulated mortgage contracts, and should also be able to demonstrate that any such change delivers fair consumer outcomes.

**Please see page 37, where we seek your views about these factors.**

### Case studies: applying the Principles in practice

- 4.9** We appreciate that it is difficult to consider what factors may be relevant, and what weighting should be given to each factor when we try to assess what 'fairness' is in the abstract. We think the discussion will be helped by considering example case studies showing how Principles 6 and 7, and factors derived from those Principles, may apply.
- 4.10** All the case studies are fictional and based on the assumption that the mortgages in question are regulated mortgages. This means they are first charge residential mortgages and were entered into on or after 31 October 2004, and therefore the FCA's rules and Principles apply to them. The case studies refer to the experiences of fictional individuals in order to make them more immediate and life-like. In individual cases, we recognise that there may be factors,

<sup>26</sup> The FCA is currently carrying out work using a consumer segmentation model. See the speech by Chris Woolard published on 13 November 2013, which discusses the FCA's consumer segmentation model and how different categories of consumers may be affected in different ways [www.fca.org.uk/news/improving-the-consumer-experience](http://www.fca.org.uk/news/improving-the-consumer-experience)

<sup>27</sup> The FCA has begun work to address the needs of consumers in vulnerable circumstances. We intend to publish an occasional paper that will explore the concept further, supported by qualitative research. The paper will outline the impact on consumers of bad practice by industry and set expectations for the future, based on what good looks like in this area.

such as potential mis-selling, that the individual in question may wish to complain to the firm about and, possibly, in due course, the FOS. However, the FCA's role (and therefore the focus of the case studies) is on how the Principles may apply to consumers generally or classes of consumers.

**4.11** After each case study, we set out some of the factors that we consider may be relevant to considering the fairness of that scenario. We then set out our view as to whether the change would be likely to be fair or unfair. In recognition that even a small variation to the facts could result in a different view about the fairness of a change, we also ask whether differing circumstances would change the assessment.

**4.12** The list of factors is not intended to be definitive. Each case study is intended to be a starting point for discussion. Therefore they are not fully comprehensive and do not set out all facts that may be relevant for a full consideration of the scenario.

#### **Assumptions**

**4.13** Because the focus of the case studies is whether a change to a regulated mortgage contract is likely to be fair under Principle 6 or 7, we are making a number of assumptions about the position under the regulated mortgage contract. In each case we are assuming that elements 1 to 5 in the box on page 23 "Likely approach to considering the fairness of a change to a regulated mortgage contract" do not call into question the ability of the lender to make the change, or the fairness of that change.

#### **Consumer responsibility**

**4.14** We acknowledge that consumers need to take some responsibility for protecting their own interests when buying financial products, (see Appendix 1). For the purposes of the case studies below, we take the view that it is reasonable for lenders to expect that customers have taken an appropriate degree of responsibility when entering into the regulated mortgage contract, and that they will also do so in relation to the proposed change. This includes making a reasonable effort to understand communications about the change from the lender, and acting properly and in good time to protect their own interests.

#### **Basis of the case studies**

**4.15** It is important to note that the fictional case studies set out below have been designed for the purposes of this discussion paper. All names and situations are fictitious. Any resemblance to real persons living or dead is purely coincidental. They highlight factors that we consider are most likely to be relevant in a case of that type, but all relevant factors would be considered. The case studies give an indication of our likely view of the fairness of the change for the purposes of discussion, and should not be relied on for other purposes. We cannot be more definitive because a real case would depend on its own facts and a consideration of those facts.

### Change to a standard variable rate (SVR)

**Background:** Mr and Mrs Sall take out a two-year fixed rate mortgage, at a 5% interest rate. At the end of the two-year term, the interest rate reverts to the lender's standard variable rate (SVR). There is a term in their mortgage contract which provides that the SVR may be changed.

Mr and Mrs Sall keep up to date with all of their payments during the two-year fixed rate term. At the time they revert to the SVR rate, this is also 5%. Mrs Sall does some research and finds that, in the market at the time, SVR rates vary between 4.5% and 7%.

**Proposed change:** Following an increase in the Bank of England base rate and LIBOR, the lender's wholesale funding costs increase. It also decides that it needs to raise the rates it pays on deposits to remain competitive. To fund these increases the lender would like to increase the SVR rate to 6%. The lender has a single SVR rate and it is making the same increase for all customers that are subject to the SVR. The lender intends to treat all its customers in the same way, and to provide one month's notice through advertisements in the national press, on its website and in its branches. It already has procedures for dealing sympathetically with customers who face financial difficulties, and arrangements are in place to deal with an anticipated rise in cases as a result of the increase in SVR. Other lenders are increasing their SVR rates by similar amounts.

### Factors most relevant to assessing the fairness of this change

**Contract term:**

The lender's reason for making the change to its contract, as well as the benefits it will derive from the change.

**Expectations about the operation of the product:**

Customers' reasonable expectations regarding the mortgage product, including the fact that all products linked to the lender's SVR are called a "Standard Variable Rate" mortgage or described as reverting to "Standard Variable Rate".

**Impact of the change:**

How will the lender deal with any customers in financial difficulties?

The impact on the lender if it is unable to make the change.

**Our view**

We consider that the proposed change is likely to be **fair** under Principle 6. In particular, the lender has good reasons for making the change, the products will be performing as customers might reasonably expect and the lender has arrangements for dealing fairly with customers in financial difficulties.

**Question 7:**

- (a) Do you agree that the factors we have listed are the most relevant in this case study?
- (b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.
- (c) Do you agree with our view about the likely fairness of the change in this case?
- (d) How would your view on fairness change with different facts?

For example, what if there is no change in the Bank of England base rate and:

- the lender is in financial difficulties caused by a significant increase in wholesale funding costs affecting all lenders; depositors are at risk if the firm fails; as part of its financial recovery plan, the lender increases its SVR by 1%; and other lenders are increasing their SVR at the same time, or
- as above, but other lenders are not increasing their SVR at the same time, or
- the lender is under pressure from an activist investor to increase dividends; in response the lender wishes to increase its margins by raising its SVR, or
- Mr and Mrs Sall's mortgage forms part of a book of mortgages acquired by another firm; the acquiring firm has a lower credit rating, higher funding costs and a higher SVR; the acquiring firm wishes to raise the SVR on the acquired book of mortgages to match its own SVR, justifying this by reference to its higher funding costs.

### Change to a fixed rate of interest during the fixed rate term

**Background:** Helen Frawley takes out a mortgage that is marketed as a “fixed rate mortgage”. Helen likes to plan her finances in advance and she was attracted to the product by the lender’s headline marketing: “Guaranteed certainty in your mortgage payments for five years”.

There is a variation term in the mortgage contract that provides that the interest rate can be changed. However, the contract term was not referred to in the firm’s marketing materials or the offer letter.

**Proposed change:** Three years into the initial five year fixed term, the lender wishes to increase the interest rate. There has been an increase in base rates and the lender has not fully hedged its exposure in relation to this particular portfolio of mortgages. As a result, it faces substantial losses on the portfolio if it does not increase the fixed interest rate. The lender puts in place arrangements to deal with customers that may be in financial difficulty as a result of the change. A large number of customers are affected, including Helen.

### Factors most relevant to assessing the fairness of this change

**Contract term:**

The lender’s reason for making the change to the mortgage contract, as well as the benefits the lender will derive from the change.

**Expectations about the operation of the product:**

Customers’ reasonable expectations regarding the mortgage product, including the name of the product as well as the contents of the pre-contractual documentation.

The (lack of) consistency between the marketing material and the mortgage terms and conditions.

**Impact of the change:**

How useful is the product to customers when the feature is removed.

The impact of the change on customers, for example, whether customers are able to respond to the change without incurring significant detriment.

**Our view**

We consider that the proposed change is likely to be **unfair**. In particular, the communications relating to the fixed nature of the interest rate were likely to be in breach of Principle 7 when the mortgages were entered into. The variation of the rate would in our view be likely to be unfair under Principle 6, taking into account customers’ reasonable expectations of how the product would perform, notwithstanding the lender’s exposure following the increase in rates.

**Question 8:**

- (a) Do you agree that the factors we have listed are the most relevant in this case study?
- (b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.
- (c) Do you agree with our view about the likely fairness of the change in this case?
- (d) Please think about whether your view would change if:
  - the lender is in severe financial difficulties and its depositors are at risk if the firm fails, or
  - the lender had clearly set out its variation term in both its marketing material and its offer letter.

### Change to a feature of a mortgage: ability to rent out the property

**Background:** Charlie Else takes out a variable rate mortgage. The firm's marketing material in relation to this mortgage says that, if the customer wishes to rent their property out, they would be able to do so subject to the firm's consent in accordance with its "lending criteria at the time". The marketing material makes clear that these lending criteria are subject to change, and the offer letter and mortgage contract are both consistent with this. Charlie's job means that he is likely to be offered an overseas posting at some stage in his career and the ability to rent out his property was one reason he selected this particular mortgage.

**Proposed change:** During the term of the mortgage, the lender proposes to change its lending criteria, with the result that a significant number of customers are unlikely to be permitted to rent their properties out. The lender decides to do so as a result of its adverse experience where properties have been rented out. Charlie is one of a significant numbers of customers affected by this change. The lender provides a substantial notice period before the change to the lending criteria becomes effective and explains the reasons for the change. The change does not affect customers who already have consent to rent out their properties. The firm agrees to waive its administration fee for any borrower who wishes to move their mortgage during the notice period. The lender also sets up a dedicated helpline for customers who wish to discuss their options and agrees to waive its application fee for any customer that decides to move to one of the firm's buy-to-let mortgages.

### Factors most relevant to assessing the fairness of this change

**Contract term:**

The way the lender chooses to implement the change (for example, the timing of the change, and the stages it follows until full implementation).

**Expectations about the operation of the product:**

The content of the marketing material used by the lender.

The content of the contractual documentation.

**Communications about the product:**

The consistency between the marketing material and the mortgage terms and conditions.

The information the lender provides to customers at the time the variation is carried out, in terms of explaining both the basis for the variation and the impact on the customer's individual product.

**Impact of the change:**

How the lender proposes to mitigate any detriment that the change may result in.

**Our view**

We consider that the proposed change is likely to be **fair**. In particular, the lender's communications before and at the time the mortgage contracts were entered into were clear about the possibility of the lending criteria changing and were consistent with each other. Accordingly, the lender would be likely to have complied with Principle 7. The lender has good reasons for changing its lending criteria. The lender provides sufficient notice of the change and puts in place arrangements to assist customers who may be adversely affected.

**Question 9:**

- (a) Do you agree that the factors we have listed are the most relevant in this case study?
- (b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.
- (c) Do you agree with our view about the likely fairness of the change in this case?
- (d) Please think about whether your view would change if:
- The marketing materials and/or offer letter do not make it clear to customers that the lending criteria are subject to change, or
  - The firm only intends to withdraw the feature of being able to rent out the property for certain categories of customer. These categories are based on age (the facility is withdrawn for over 65s) and income (the facility is withdrawn for customers who have a household income of less than £25,000 per annum).

### Change to a feature of a mortgage: ability to draw down additional funds against the mortgage

**Background:** James and Susie Kennedy take out a repayment mortgage under which they can make additional voluntary repayments of principal, but are able to redraw any voluntary repayments they have made. In practice, their monthly statements indicate that they can redraw all of the principal they have repaid – monthly contractual repayments as well as voluntary repayments. James and Susie have used the redraw facility previously and are currently considering a further redraw in order to pay for renovations to their house.

**Proposed change:** The ability to redraw contractual repayments of principal was not intended by the lender. It arose from a systems failure. The lender wishes to limit the redraw facility for all its customers so that it will no longer allow redraws of contractual repayments of principal, relying on the original contract terms. The lender wants to do this as it is worried about customers drawing down amounts that they will be unable to repay, and in particular that customers may be left with outstanding principal at the end of the mortgage term. It also wants to provide certainty on its capital position.

The ability to redraw contractual repayments of principal was not specifically highlighted in the marketing material, nor explicitly drawn to the customer's attention in the offer letter. However, customers are likely to have been relying on their monthly statements as accurately indicating the amount they can redraw, and as indicating how this would increase in the future.

In the light of this, the lender will allow all customers to keep existing amounts available for redraw, and customers who have already used the redraw facility will be allowed to 'opt out' of the change; that is, if they opt out they will keep the facility as it currently operates. For customers who do not 'opt out', future increases in the redraw facility will be limited to voluntary repayments. A helpline will be provided to give them a range of ways of dealing with this limitation, including access to other loan facilities. The lender intends to notify customers of the proposed change by providing a clear explanation along with three-monthly statements. The lender will also apply relevant parts of the FCA's guidance on dealing with customers with interest-only mortgages who risk being unable to repay their loan at the end of the mortgage term.<sup>28</sup>

### **Factors most relevant to assessing the fairness of this change**

#### ***The contract term:***

The lender's reason for making a change to its mortgage contract, as well as the benefits that the lender will derive from the change.

#### ***Expectations about the operation of the product:***

Customers' reasonable expectations regarding the mortgage product. Factors which are likely to drive these expectations may include the content of marketing material, post-contractual documentation and communications, including monthly statements.

#### ***Impact of the change:***

How useful the product is to customers when a feature is removed.

The impact the change will have on customers (for example, whether customers are able to respond to the change without incurring significant detriment).

How the lender proposes to mitigate any detriment the change may result in.

#### **Our view**

We consider that the proposed change would be likely to be **fair**. In particular, the ability to redraw contractual capital repayments was not mentioned in marketing material or the contract, customers will keep any existing amount available to redraw, and customers who have used the facility (and are therefore most likely to be relying on it) may 'opt out' of the change. Other customers who may have been relying on future increases in the redraw facility will have their attention drawn to other loan products.

<sup>28</sup> [www.fca.org.uk/your-fca/documents/finalised-guidance/fg13-07](http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg13-07)

**Question 10:**

- (a) Do you agree that the factors we have listed are the most relevant in this case study?
- (b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.
- (c) Do you agree with our view about the likely fairness of the change in this case?
- (d) Please think about whether your view would change if:
- The ability to redraw contractual repayments of principal did not result from a systems failure but was a contractual feature of a new product range that the firm marketed extensively (with a particular focus on the ability to redraw funds), and the firm is relying on a general contract variation term, or
  - The lender was only limiting the use of the re-draw facility for certain categories of customers: those who have a household income of less than £25,000 per annum and those with a loan-to-value ratio of greater than 80%. These customers cannot 'opt out' of the change, or
  - The lender is not allowing any customers to keep existing unused amounts available for redraw; it will reduce unused redraw amounts down to the amounts of any voluntary repayments of principal.

## A change to terms and conditions following the takeover of one firm by another

**Background:** Lender B acquires Lender A's mortgage business as part of a transfer under Part VII of the Financial Services and Markets Act 2000. Lender A offered customers the option to take 'repayment holidays' whereby customers would be entitled to take a break from making their mortgage payments for three months. This was one of the key features of the mortgage that was highlighted in Lender A's marketing material. Reginald Brown had a mortgage with Lender A, which has been transferred to Lender B.

**Proposed change:** One year after taking over Lender A's mortgage book, Lender B decides to withdraw the 'repayment holiday' feature from Lender A's contract. The IT systems used by Lender B do not support 'repayment holidays'. Instead, they need to be implemented by manual overrides, which Lender B is keen to minimise due to their cost and the possibility of mistakes being made. In addition, Lender B also has a different 'risk profile' to Lender A, so Lender B is more cautious about providing repayment holidays to its customers.

Lender B relies on a variation term in Lender A's contract, which allows the firm to make variations in how the mortgage is 'operated'.

Lender A's variation term was not specifically highlighted in the marketing material, nor explicitly drawn to the customer's attention in the offer letter.

Lender B intends to notify customers of the proposed change 12 weeks before it takes effect, stating that the changes were required because of the difference in technology between Lender B's and Lender A's systems.

Reginald has recently been given notice that he is going to be made redundant from his job. He is considering using the repayment holiday to ease his financial burden while he looks for a new job.

### Factors that may be relevant considerations to assessing the fairness of this change

We think that factors that would be likely to be relevant to assessing fairness in this case would include in particular:

#### ***The contract term:***

The lender's reason for making a change to its mortgage contract, as well as the benefits that the lender will derive from the change.

#### ***Expectations about the operation of the product:***

Customers' reasonable expectations regarding the mortgage product, including the marketing material used by Lender A and the content of the contractual documentation.

**Impact of the change:**

How useful the product is to customers when a feature is removed.

The impact the change will have on customers (for example, whether customers are able to respond to the change without incurring significant detriment).

How the lender will deal with any customers in financial difficulties.<sup>29</sup>

**Our view**

We consider that the proposed change is likely to be **unfair**. In particular, Lender B should have been aware of the IT systems difficulties before it acquired the business, so should have factored the costs and risks into its pricing. Customers are likely to have a reasonable expectation that they can take repayment holidays in the future, and this is likely to be an important feature for many customers. The risks from customers from taking repayment holidays can be managed in other ways.

**Question 11:**

- (a) Do you agree that the factors we have listed are the most relevant in this case study?
- (b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.
- (c) Do you agree with our view about the likely fairness of the change in this case?
- (d) Please think about whether your view would change if:
- Lender B will allow any customer to 'opt out' of the proposed change. For customers who have already used the ability to take a repayment holiday, Lender B will ask them to 'opt in' to the proposed change, so that those who do not 'opt in' are still able to make use of repayment holidays, and will offer £100 worth of vouchers to those who opt in. In addition, for those customers from whom the ability to make repayment holidays is withdrawn, but subsequently are in arrears, Lender B commits to the FCA that it will take into account the fact that those customers would have had access to a repayment holiday when determining whether to exercise forbearance, or
  - Lender A is in severe financial difficulties and its depositors are at risk if it fails. Lender B is the only firm that is willing to take over the business of Lender A, and the only alternative is resolution under the Banking Act 2009 with the consequent risk to public funds. Lender B is not willing to 'rescue' Lender A unless it can make this (and similar) changes to the terms of Lender A's book of mortgages.

<sup>29</sup> The FCA has begun work to address the needs of consumers in vulnerable circumstances. We intend to publish an occasional paper that will explore the concept further, supported by qualitative research. The paper will outline the impact on consumers of bad practice by industry and set expectations for the future, based on what good looks like in this area.

### Considering all the relevant factors

- 4.16** We think that, when making or proposing to make a change to customers' regulated mortgage contracts, lenders should consider all relevant factors and weigh them up against each other in order to make an assessment of the fairness of their own conduct under Principles 6 and 7.

#### Questions 12-14:

Please use the case studies to consider all of the factors that are outlined on pages 24-25.

12. Do you think these factors are relevant when assessing whether a change to a regulated mortgage contract is fair?
13. Are there any other factors that you consider may be relevant in this context? Please explain and be as specific as you can.
14. What factors do you consider to be the most important? Please explain why and be as specific as you can.

### Examples of the regulatory framework being unable to address unfairness

- 4.17** In this chapter, we have considered our current regulatory framework by applying it to some case studies to determine what factors should be taken into account when assessing the fairness of a change to a regulated mortgage contract.

#### Question 15:

Can you think of any examples where you believe that the current regulatory framework has not been sufficient to address potential unfairness? Please explain why you think this is the case.

- 4.18** In our final chapter, we will explore the options open to us for changing the regulatory framework if we are persuaded that it does not provide an appropriate degree of protection to consumers.

## 5. Options

---

### Introduction

---

- 5.1** This discussion is intended to increase transparency around our current rules and how these may apply in practice, as well as opening up the debate about fairness in this context. To make the discussion as comprehensive as possible, we want to consider the potential for changes to be made to the current regulatory framework.
- 5.2** Below we outline some options the discussion may lead to, including options for potential changes to the current regulatory framework. These options are not necessarily mutually exclusive.

---

### Option 1: No further action

---

- 5.3** Following this discussion, we may conclude that no further action is required other than issuing a feedback statement. That statement may set out the factors we consider that may be relevant in determining whether a change to the terms of a regulated mortgage contract is fair (after taking into account responses to this discussion paper). We are planning further engagement with both firms and consumers during the discussion period and we plan to publish a feedback statement in due course. It may be that this discussion alone is enough to provide clarity and transparency about the factors that we consider when we apply the regulatory framework in practice.

---

### Option 2: Make no changes to the current regulatory framework, but provide guidance on aspects of it

---

- 5.4** In the previous chapter, we set out, for discussion purposes, a list of the factors that could potentially be relevant to an assessment of fairness of a lender's change to a regulated mortgage contract under Principles 6 and 7. We set out some fictional case studies in order to put the consideration of these factors into context.

#### Guidance on Principles 6 and 7

- 5.5** One option as an outcome to this discussion may be for us to issue further guidance on our existing rules and Principles. In particular, we could look at Principles 6 and 7, in relation to our interpretation of 'fairness' in the context of changes to regulated mortgage contracts.
- 5.6** We do not think that it is possible to set out an exhaustive list of all the factors that lenders would need to consider when making changes to their regulated mortgage contracts. We assess fairness on a case-by-case basis, so any guidance that is issued will need to be considered

in this context. The Principles are flexible tools, designed to apply to a variety of scenarios. We would not want to curtail this flexibility by issuing guidance that limits the factors that we are able to take into account.

**Question 16:**

**If this is your preferred option, please explain what you would welcome further guidance on.**

**Guidance on MCOB or other handbook provisions**

- 5.7** Another option is to provide further guidance on the application of MCOB and our other Handbook rules. The mortgage market has been subject to significant change in recent years, most notably the implementation of the Mortgage Market Review (MMR) on 26 April 2014. Therefore, it may be preferable to allow these new provisions to ‘bed down’ before further guidance is issued, although we would welcome your views on whether further guidance would be helpful.

**Question 17:**

**If this is your preferred option, please explain what you would welcome further guidance on.**

**Option 3: Introduce new rules**

- 5.8** As stated under option 2, we note that the mortgage market has been subject to significant change over recent years. Further changes are expected with the implementation of EU Directives such as the Mortgage Credit Directive.<sup>30</sup> However, it is open to us to consider further changes to the regulatory framework, if it is concluded that there is a need for us to do so.

- 5.9** Possible options open to us are:

- **Introducing new rules.** For example, rules about the information that firms must provide to a consumer. However, it should be noted that there may be directive constraints on our ability to do this in relation to mortgages in the future.
- **Restricting, either entirely or in part, the changes that a lender can make to its regulated mortgage contracts.** Such restrictions could apply to all types of mortgage contracts or, alternatively, specific types of mortgage contracts.
- Although not mortgage specific, we could consider **introducing further safeguards to protect the most vulnerable categories of consumers.** For example, where consumers are identified by a firm as being vulnerable, should firms be required to take additional steps to protect those consumers?<sup>31</sup>

<sup>30</sup> See glossary on pages 50-51.

<sup>31</sup> The FCA has begun work to address the needs of consumers in vulnerable circumstances. We intend to publish an occasional paper that will explore the concept further, supported by qualitative research. The paper will outline the impact on consumers of bad practice by industry and set expectations for the future, based on what good looks like in this area.

- 5.10** Implementing any changes to our rules is likely to require us to consult and carry out a cost benefit analysis. Significant further research may also be required before any changes could be proposed.

**Question 18:**

**Which, if any, of these options would you favour and why? Are there any other options that you think we should consider? Please state them and explain why.**

## 6. Conclusion

- 6.1** This paper discusses the factors that may be relevant to an assessment of the fairness of a change to a regulated mortgage contract, with a particular focus on Principles 6 and 7. We are interested in hearing about your experiences of changes to regulated mortgage contracts and hearing your views on the points that we have raised in this paper.
- 6.2** Based on our experience to date in applying the regulatory framework to regulated mortgage contracts, it is our view that the Principles in particular have provided us with the flexibility we need to appropriately consider the fairness of a change to a regulated mortgage contract. In our view, the current regulatory framework has been sufficient to provide us with the necessary tools to address actual and potential unfairness. We are not always able, however, to disclose how we have reached a view in an individual case.
- 6.3** One of the key aims of this discussion paper is to promote more transparency around the factors that may be relevant in assessing the fairness of a change to a regulated mortgage contract, and to provide further clarity to firms and consumers about the approach that we take. As such, it may be that this discussion paper (and any lender and consumer engagement during the discussion period and the feedback statement) is sufficient as a stand-alone piece of work to provide this transparency and clarity. However, we want to open up this discussion to hear your views and have not ruled out the possibility that further work may be required.
- 6.4** We intend to engage in discussions with our readers during the discussion period by running some events for the industry and focus groups for consumers. We intend these discussions to complement, and not replace, any written feedback that we receive from readers.
- 6.5** We look forward to receiving your responses to this discussion paper. Our contact details are set out on page 2.
- 6.6** We will use your responses to inform our knowledge of the industry and the issues that are important to both firms and consumers. We will collate the feedback and aim to publish a feedback statement in due course.
- 6.7** Thank you for taking the time to participate in this discussion.

# Annex 1

## List of questions

### Q1: Your experiences

- Has your mortgage contract been changed at any time?
- What change was made?
- Did you think the change was fair or unfair? Please explain why. Think about how the firm has treated you, how they communicated the change to you, and if you think they considered your needs or situation.

### Q2: Change to a standard variable rate (SVR)

Imagine you have a mortgage contract where the interest rate is the lender's standard variable rate (SVR).<sup>32</sup> This is a rate set by the lender which can be increased or decreased. The lender should set out the reasons why the interest rate may be changed in the mortgage contract.

- What do you think are fair reasons for a lender to increase the SVR?
- Is there anything that the lender could do to make sure the increase is fair? For example, does the lender give you notice of the change; do they clearly set out their intention to increase the SVR; do they set out your options if you do not like the change?

See page 27 for a case study on SVR increases.

### Q3: Change to a fixed-rate contract before the end of the fixed term

Imagine you have a mortgage contract with an interest rate that is fixed for five years.

- Would you expect the interest rate to be changed before the end of the five-year period? If so, in what circumstances do you think this could be fair?

See page 29 for a case study based on an increase to the interest rate of a product that is stated to be fixed.

<sup>32</sup> See Glossary, on pages 50-51.

**Q4: The removal of a feature from a mortgage contract**

Imagine there is a term in your mortgage contract allowing you to rent the property out to someone else. There is also a term in the contract allowing the lender to withdraw your right to rent out the property at any time.

- Do you think that it is fair for the lender to be able to withdraw your right to rent the property out during the term of the contract? Please explain your reasons.

See page 31 for a case study about the withdrawal of a feature in a mortgage contract.

**Q5: The removal of a feature from a mortgage contract**

Imagine you have a mortgage that has a bank current account linked to it. The mortgage agreement allows you to borrow money from the current account, up to an agreed limit. This loan is repaid as part of your mortgage repayments.

- If you took out a mortgage that had this facility, would you expect that there may be a term in the contract that allows the lender to withdraw it?
- Do you think that it is fair for the lender to be able to withdraw this feature? Please explain your reasons.

See page 32 for a case study on the withdrawal of a loan facility in a mortgage contract.

**Q6: A variation caused by your mortgage provider changing**

Imagine that your mortgage is taken over by another provider, perhaps because two mortgage lenders have merged to become one company.

- Would you expect your mortgage terms to remain the same for the duration of your mortgage?
- Do you think it is fair for the new provider, who has taken over your existing lender, to be able to change your contract? Please explain why.
- Do you think that it is fair for the lender to be able to withdraw a feature? Please explain your reasons.

See page 35 for a case study on a lender taking over another lender's mortgages.

**Q7-11: Case studies**

Do you agree that the factors we have listed are the most relevant in this case study?

Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.

Do you agree with our view about the likely fairness of the change in this case?

How would your view on fairness change with different facts?

**Q12:** Do you think that the factors listed on pages 24-25 are relevant when assessing whether a change to a regulated mortgage contract is fair?

**Q13:** Are there any other factors that you consider may be relevant in this context? Please explain and be as specific as you can.

**Q14:** What factors do you consider to be the most important? Please explain why and be as specific as you can.

**Q15:** Can you think of any examples where you believe that the current regulatory framework has not been sufficient to address potential unfairness? Please explain why you think this is the case.

**Q16-17: Options**

If this is your preferred option, please explain what you would welcome further guidance on.

**Q18:** Which, if any, of these options would you favour and why? Are there any other options that you think we should consider? Please state them and explain why.

# Appendix 1

## Summary of key handbook provisions relevant to considering the fairness of changes to regulated mortgage contracts and other relevant considerations

### **FCA Handbook (for regulated mortgage contracts entered into after 31 October 2004)**

---

The Handbook provisions that we consider in this appendix are not intended to be exhaustive. Individual cases may require additional Handbook rules or guidance to be taken into account, depending on the facts. However, in order to facilitate a meaningful dialogue, this paper is limiting the discussion to a consideration of some of the most common Handbook provisions that we consider when looking at how lenders treat their customers.

#### **Summary of Handbook provisions that this appendix considers**

- MCOB 11.8.1E
- MCOB 2.2.6R and 3.6.3R
- DISP
- The Unfair Contract Terms Regulatory Guide (UNFCOG): UTCCRs

Principles 6 and 7 of the Principles for Businesses are set out in Chapter 2.

For ease of reference we have split our consideration of these Handbook provisions into three broad categories:

1. Treating customers fairly
2. Communication with consumers
3. Changes to contracts.

#### ***Treating Customers Fairly***

##### **MCOB 11.8.1E**

MCOB sets out the requirements applying to firms with mortgage customers. The rules in MCOB relate to lenders' standards of business conduct, advising and selling standards and disclosure (before, during and after the point of sale) among other rules. MCOB also sets out requirements that are relevant to lenders when making changes to their regulated mortgage contracts.

The evidential provision contained in MCOB 11.8.1E is based on the requirement for lenders to treat their customers fairly, as set out in Principle 6. It came into effect on 26 October 2012 as part of the MMR.

MCOB 11.8.1E provides that:

“Where a customer is unable to:

- enter into a new regulated mortgage contract or home purchase plan or vary the terms of an existing regulated mortgage contract or home purchase plan with the existing mortgage lender or home purchase provider; or
- enter into a new regulated mortgage contract or home purchase plan with a new mortgage lender or home purchase provider,

the existing mortgage lender or home purchase provider should not (for example, by offering less favourable interest rates or other terms) take advantage of the customer’s situation or treat the customer any less favourably than it would treat other customers with similar characteristics. To do so may be relied on as tending to show contravention of Principle 6 (Customers’ interests).”

As stated in the FSA’s Policy Statement 12/16<sup>33</sup>, this is a new evidential provision aimed at protecting those borrowers who find themselves ‘trapped’ with their current lender. This provision was given immediate effect as it is aimed at protecting not only those borrowers who may find themselves trapped in future following the implementation of the MMR, but also those borrowers who find themselves trapped today because they do not meet current tightened lending criteria.

This provision is relevant when considering changes a lender makes to its regulated mortgage contract, when the change is likely to cause detriment to ‘trapped’ borrowers. For instance, where customers are unhappy with a change to their mortgage contract, they may decide to leave their lender and seek a new mortgage with a different lender. However, ‘trapped’ borrowers are less likely to be able to take such an approach (for example, because of high loan to value ratios in their current mortgages, or because of their credit history). Therefore, their ability to respond to changes in mortgage contracts is reduced when compared with customers with similar characteristics. Firms should be able to demonstrate how they have complied with Principle 6 in their treatment of such ‘trapped’ borrowers.

### ***Communications with customers***

#### **MCOB 2.2.6R and 3.6.3R**

MCOB 2.2.6R is based on the requirement for lenders to communicate with customers in a way that is clear, fair and not misleading, as set out in Principle 7. MCOB 2.2.6R provides “When a firm communicates information to a customer, it must take reasonable steps to communicate in a way that is clear, fair and not misleading.”

Similarly, MCOB 3.6.3R is based on the requirement for firms to use financial promotions in a way that is consistent with Principle 7. It provides “A firm must be able to show that it has taken reasonable steps to ensure that a non-real time financial promotion is clear, fair and not misleading.”

<sup>33</sup> [www.fsa.gov.uk/static/pubs/policy/ps12-16.pdf](http://www.fsa.gov.uk/static/pubs/policy/ps12-16.pdf)

## DISP

DISP sets out rules and guidance on how firms should deal promptly and fairly with complaints. Although FCA rules do not generally apply to mortgage contracts entered into before 31 October 2004, FCA rules in relation to complaint handling apply to mortgage contracts entered into before that date but after FSMA came into force on 1 December 2001. For mortgage contracts sold before that date, the position is more complex. In the case of banks and building societies, such complaints will generally be subject to our rules on complaints handling on the basis of the lender's membership of the former Banking Ombudsman Scheme or Building Societies Ombudsman Scheme. In addition, borrowers may be able to refer their complaints to the FOS. However, in determining such complaints, the FOS must take into account what determination might have been expected under the former scheme.<sup>34</sup>

## Changes to contracts

### UTCCRs

The UTCCRs came into force on 1 July 1995 and apply to mortgage contracts. They are designed to protect consumers from unfair terms in standard-form contracts – terms that have not been individually negotiated and cause a significant imbalance in the parties' rights and obligations to the detriment of the consumer, contrary to the requirement of good faith.<sup>35</sup>

The FCA has powers in relation to unfair contract terms under the UTCCRs and cooperates with the Competition and Markets Authority (CMA)<sup>36</sup> (and prior to the existence of the CMA, co-operated with the Office of Fair Trading (OFT)) to ensure the effective and consistent delivery of consumer protection in this area. Ultimately, only a court can determine the fairness of a contract term.

The UTCCRs consider the fairness of contract terms in the way they are written and do not consider how a lender applies those terms in practice. They do, nevertheless, take into account factors such as all the circumstances attending the conclusion of the contract and the nature of the goods and services involved. A lender's practices when applying a contract term could be considered under FCA Principles and other rules.

In order to make a change to their mortgage contracts, lenders need to rely on their contractual rights, i.e. the contract needs to allow for that change to take place. Terms which allow lenders to unilaterally change the contract (often referred to as 'variation terms') reserve a significant power for the lender. Unilateral variation terms have the potential to change the bargain the consumer entered into without the consumer's explicit consent.<sup>37</sup>

Therefore, when including variation terms in their mortgage contracts, lenders need to choose the wording carefully. If a contract is found to be unfair, it is not binding on a consumer<sup>38</sup>, and therefore the lender is unable to enforce it.<sup>39</sup> In addition, lenders are required to ensure that contract are written in plain, intelligible language.<sup>40</sup>

When a lender has a potentially fair variation term (under the UTCCRs) in its mortgage contract, they must still ensure that it meets its obligations under Principle 6, 7 and MCOB.

<sup>34</sup> Similar transitional arrangements were put in place in October 2004 in relation to other mortgage lenders who were subject to the Mortgage Code Arbitration Scheme.

<sup>35</sup> Regulation 5(1)

<sup>36</sup> From 1 April 2014, the CMA took over from the OFT as the lead enforcer of the UTCCRs. The FCA and the CMA have a concordat that sets out the nature of their cooperation.

<sup>37</sup> [www.fca.org.uk/static/pubs/guidance/fg12\\_02.pdf](http://www.fca.org.uk/static/pubs/guidance/fg12_02.pdf)

<sup>38</sup> Regulation 8(1): "An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer."

<sup>39</sup> [www.fca.org.uk/static/pubs/guidance/fg12\\_02.pdf](http://www.fca.org.uk/static/pubs/guidance/fg12_02.pdf)

<sup>40</sup> Regulation 7(1): "A seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language."

The UNFCOG explains how the FCA will use its powers under the UTCCRs.

### **Consumer Rights Bill**

The Consumer Rights Bill, which is currently making its way through Parliament, aims to bring together and update consumer law.

The Bill covers a number of different areas of consumer law. If the Bill becomes law, the UTCCRs will be revoked and the Unfair Terms in Consumer Contracts Directive will be re-implemented. While the Bill does propose some changes to the current wording of the UTCCRs, the approach to assessing the fairness of unilateral variation terms is the same as that currently stated in the UTCCRs.

## **Consumer responsibility and our regulatory approach**

### **Consumer responsibility**

We acknowledge that consumers need to take some responsibility for protecting their own interests when buying financial products. In December 2008, the FSA published a Discussion Paper entitled 'Consumer responsibility'.<sup>41</sup> This aimed to contribute to the ongoing debate about the rights and responsibilities of firms and consumers in the retail market for financial services. We also hoped to provoke a debate about how to help and encourage consumers to consider their own interests more effectively in their decision making, the consequences of them failing to do so, and the drivers and obstructions to achieving a 'better' world for the retail market for financial services.

In its feedback document published in September 2009<sup>42</sup>, the FSA concluded that it was unlikely that there could be any general consensus about the appropriate balance of responsibilities between consumers and firms, and that there appeared to be little prospect of any significant shift in these views in the foreseeable future.

We therefore do not propose to reopen a full discussion about consumers' responsibilities at this stage. However, we have set out some elements we are likely to take into account when considering consumer responsibility in the context of lenders changing their mortgage contracts<sup>43</sup>:

### **Regulatory approach**

Under FSMA one of our operational objectives is securing an appropriate degree of protection for consumers. FSMA accordingly establishes the protection provided should be 'appropriate' rather than absolute or all encompassing. FSMA requires that, in deciding what might be the appropriate level of protection for consumers, we must have regard to the 'general principle that consumers should take responsibility for their decisions'.<sup>44</sup>

<sup>41</sup> [www.fs-cp.org.uk/publications/pdf/dp08\\_05.pdf](http://www.fs-cp.org.uk/publications/pdf/dp08_05.pdf)

<sup>42</sup> [www.fsa.gov.uk/pubs/discussion/fs09\\_02.pdf](http://www.fsa.gov.uk/pubs/discussion/fs09_02.pdf)

<sup>43</sup> Please also see the work on Consumer Responsibility done by the Practitioner Panel and published last year [www.fs-pp.org.uk/documents/fca\\_practitioner\\_panel\\_consumer\\_responsibility\\_report\\_september\\_2013.pdf](http://www.fs-pp.org.uk/documents/fca_practitioner_panel_consumer_responsibility_report_september_2013.pdf). In particular this found that there were barriers to consumers acting responsibly and that one of those was "Clearer, briefer and more standardised information written in terms that consumers can understand and a better fit between the information contained in marketing material"

<sup>44</sup> FSMA s1C(2)(d)

**Common law approach**

As a matter of common law, consumers' responsibilities in a mortgage contract can be summarised as follows:

Consumers should:

- act reasonably
- act in good faith
- make a reasonable effort to understand the mortgage product they are entering into, based on the information provided to them by the lender or their agent
- disclose information that is requested about their needs, desired outcome and risk appetite, along with any particular information about their circumstances which they reasonably ought to realise is relevant
- act properly and in good time to protect their own interests.

# Glossary

## Definitions used in this document

### **Buy-to-let mortgages**

Buy-to-let mortgages are taken out by those who are looking to invest in the property market. The purpose of purchasing or entering into a buy-to let mortgage is to purchase a property to earn an income by renting out the property to someone else. The rent may be used to help meet the mortgage repayments. The property will remain as an investment for the landlord and it is not intended that the landlord will live in the property.

### **Competition duty<sup>45</sup>**

In addition to our strategic and operational objectives, we have a further responsibility known as the competition duty. This duty requires us to promote effective competition in the interests of consumers when meeting our consumer protection and integrity objectives. We must look to achieve our desired outcomes using solutions that promote competition, regardless of which objective we are pursuing. As a matter of policy we will normally choose the most pro-competitive measure open to us, provided that is compatible with our duties as a whole. Consideration of how to apply this in practice will be made on a case-by-case basis.

### **Mortgage Credit Directive**

The Mortgage Credit Directive applies to certain agreements entered into by individuals acting outside their trade, business or profession. For the purposes of this discussion paper, the Directive applies to credit agreements secured by first or second charges on residential property. Member States have the option of disapplying the provisions of the Directive to certain mortgages, such as buy-to-let mortgages. The Directive is to be implemented in national law by 21 March 2016.

### **Mortgage intermediary**

Mortgage intermediaries act as the “middle man” between the lender and the borrower. Their role is to match borrowers with lenders who offer suitable products, as they are typically associated with a range of lenders.

### **Mortgage lender**

The lender is the financial institution that provides the actual credit to the borrower. Some lenders deal directly with borrowers, and others use mortgage intermediaries.

### **Mortgage Market Review**

In 2009 a Discussion Paper initiated a review of the mortgage market. This ultimately resulted in a Policy Statement and final rules in October 2012, most of which came into effect on 26 April 2014. The purpose of the Mortgage Market Review was to reform the mortgage market so that it works better for consumers, and to prevent poor practices whilst ensuring the majority of customers who can afford it can still access mortgages.

<sup>45</sup> See [www.fca.org.uk/static/documents/fca-approach-advancing-objectives.pdf](http://www.fca.org.uk/static/documents/fca-approach-advancing-objectives.pdf).

### **Principles for Businesses – ‘the Principles’**

The Principles are a general statement of the fundamental obligations of firms under the regulatory system. This discussion paper primarily focuses on Principle 6 and 7; Principle 6 requires a firm to ‘pay due regard to the interests of its customers and treat them fairly’ and Principle 7 requires a firm to ‘pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading’.

### **Regulated mortgage contract**

A regulated mortgage contract is a credit agreement that was taken out by an individual (or trustees) on or after 31 October 2004, on the security of a first legal mortgage on land in the United Kingdom, of which at least 40% is used in connection with a dwelling by the borrower.

The Glossary within the FCA Handbook provides a detailed definition of this term:

<http://fshandbook.info/FS/html/FCA/Glossary/R>

For the purposes of this discussion paper, we consider a regulated mortgage contract to be a first charge, residential mortgage contract taken out on or after 31 October 2004.

### **‘Treating customers fairly – towards fair outcomes for consumers’**

Published in July 2006, this paper delivered the Treating Customers Fairly initiative through identifying 6 improved outcomes for retail consumers. This paper importantly highlighted that this requirement on firms was not new, and was already prevalent in the regulatory framework due to the Principles.

### **Types of regulated mortgages**

This list is not intended to be exhaustive, but sets out types of regulated mortgages that may feature in this paper.

#### ***Fixed Rate:***

With this type of mortgage the interest rate is set for a specific period, usually somewhere between 2 and 5 years. This type of mortgage allows borrowers to make the same repayments until the end of the term of the fixed term mortgage.

#### ***Offset mortgage:***

This is where the mortgage is linked to a current account or a savings balance and helps reduce the amount of interest that is to be repaid to the lender. The more money that is deposited in the linked account, the less the mortgage balance is for the purpose of calculating interest.

#### ***Mortgage redraw facility:***

A mortgage redraw facility is a secured overdraft facility on a current account, where the consumer borrows against the equity in their home. It allows borrowers to draw down money from their agreed available limit.

#### ***Standard Variable Rate:***

A type of variable rate mortgage, the standard variable rate is any one lender’s set rate. It is not connected to a pre-determined rate and there are not typically any discounts attached.

Financial Conduct Authority



**PUB REF: 004898**

© Financial Conduct Authority 2014  
25 The North Colonnade Canary Wharf  
London E14 5HS  
Telephone: +44 (0)20 7066 1000  
Website: [www.fca.org.uk](http://www.fca.org.uk)  
All rights reserved