

The Mortgage Credit Directive

Analysis of FCA policy statement and final rules

March 2016



Background

Timetable

- MCD adopted 4 Feb 2014
- Some of the MCD was implemented as part of MMR on 26 April 2014
- Effective 21 March 2016 – firms can choose to adopt from 21 Sep 2015
- Some rules have transition periods, can be up to 2019
- Can apply for mortgage permission from 20 April 2015
- Treasury will carry out review of implementation by Sep 2018 to feed into European Commission review in 2019



New rules

High level principles

- Second charge regulated same as first charge
- Written disclosure of services, product and offer and at specific times
- Consideration of scope
- Remuneration cannot be contingent on sales targets
- Income verification and affordability checks in all cases
- No transitional period for pipeline cases – ‘agreements’ pre 21/03/16 will not be subject to MCD i.e. those at offer stage or later – but disclosure and charges rules will apply
- Capital resources for those who do not exclusively advise on seconds
- PI cover
- Binding offers and reflection period
- Right to repay loan early
- Every intermediary to hold mortgage qualification by 21/09/18
- FCA, FSCS and FOS fees



Authorisation

Permission held (and firm's activity)	Action
Mortgage and interim for seconds	None needed
Mortgage (only CC activity is seconds)	Contact FCA to request to move application period so don't have to apply for credit permission
Mortgage (seconds and other credit activities)	
No mortgage and interim for seconds and other credit activities	
No mortgage and interim (only CC activity is seconds)	Contact FCA to request to move application period and complete a financial services home finance application form

If you've already submitted a consumer credit application:

- If FCA determined your application before 20/04/15, apply to vary your firm's permissions on their website
- If FCA hadn't determined your application by 20/04/15, complete a supplementary application form and add this to your 'in-progress' application



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Disclosure

- Oral disclosure required – but must also be in writing (durable medium) as per MCOB 4.4A
- Provide customers with list of lenders and confirm whether scope is seconds or both seconds and firsts
- Cannot describe services as 'independent', 'unlimited' or 'whole of market' (or in firm name) unless advise on both firsts and seconds and majority of both markets considered
- Inform customers how you are remunerated
- Availability of alternative finance options (which can be oral) – remortgage, further advance – not obliged to comment on suitability unless service offered
- Provide 'adequate explanations' before an offer is issued (which can be orally)
- Make available to customers, on request, the levels of commission paid by different lenders
- Enhanced disclosure for debt consolidation



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ESIS

- Has to be provided to customer before submission to lender (except if customer refuses to disclose key info) – doesn't necessarily mean when application form completed, can mean payment of fee
- Plus trigger points if hasn't yet been issued – at point of advice (if by telephone then max 5 days after), at customer's request, once customer has provided affordability info
- Must not be issued to consumer who is clearly ineligible based on info obtained from consumer or from lending criteria
- Intermediary responsible for timing
- Up to 5 rates will be included – explanation may be needed
- Content of ESIS cannot be changed – supplementary info may be helpful
- Must be issued in a durable medium
- Also has to be issued when varying terms to contract (rate switch or adding/removing party)
- Includes right to repay loan early and cost – which has to be reasonable



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Consideration of scope – possible options

Scope	What your adviser does
Seconds only	Notify customer of alternative options but can only advise on second charge
Seconds and firsts	Compare costs of second vs remortgage themselves and make recommendation
Seconds and firsts – but outsourced	Compare costs of second vs remortgage (using first charge broker) and make recommendation
Seconds only but receives referral from first	Compare costs of second and make recommendation, passing first charge advice onto broker (who may execute or pass back for second)

Under all of the options:

- consider the customer journey
- decide how the commercial arrangement will set out remuneration and responsibility for advice

The FCA has confirmed that where a first broker introduces a customer to a seconds broker, if the first broker has clearly stated that they do not advise on seconds and this is passed over, they do not have to include seconds in their scope. Likewise seconds will not have to include firsts in their scope for receiving this referral.



Existing MCOB rules

Advising and selling

- All spoken or interactive dialogue to be advised – impact on non-advised sellers and telephone operations
- Execution-only – certain circumstances only (online/post applications, high net worth, mortgage professionals, business loans) – this does not exist in intermediary world
- A firm must not encourage a customer to opt out of receiving advice on a mortgage or to reject advice given
- **Broker suitability** - lender eligibility; term; stability of payment; capital repayment or IO; low start?; early repayment; credit history; fees, as a minimum
- Committed expenditure and **basic** essential and **basic** quality of living costs
- Brokers should only submit applications which meet a lender's published criteria – How to evidence?



Existing MCOB rules

Advising and selling

- Debt consolidation – will be advised
- Bridging captured – max 12 months – risks on unregulated
- Transitional arrangements
 - no new borrowing
 - it is in the customer's best interests
 - no need to assess affordability
- Fees and charges (brokers' and lenders') cannot be automatically rolled up into the loan – can only be rolled up where customer has made explicit choice
- MCOB rules on payment shortfall charges and excessive charges (12.4 and 12.5) will apply to all loans entered before 2016 in respect of charges from that date



Existing MCOB & final MCD rules



Stress tests

- Lenders will have to:
 - consider the expected interest rate environment for a future period of at least five years
 - not use their own forecasts of future interest rates, but have regard to market expectations and any prevailing FPC recommendation
 - assume a minimum interest rate increase of 1% over the five-year period, even where the market expects interest rates to fall, or rise by less than 1% over that period
- Lenders must consider impact of expected interest rate increases on existing higher priority mortgages as well as on the second charge mortgage - based on the new total loan repayments
- Lenders should assess this impact based on the outstanding balance of the first charge loan – can obtain details from credit reference agency
- Debt consolidation - lender to either take reasonable steps to ensure the debts to be consolidated are repaid, or include them in the affordability assessment as if they were not repaid



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T&C

Competency

- An individual cannot be assessed as competent unless the full qualification is achieved as a minimum (TC 2.1.1). All advisers need to be appropriately supervised (TC 2.1.2 – TC 2.1.3)
- Supervisors need to be fully competent from 21 March 2016.

Qualifications

- Advisers – can continue advising post 21 March 2016 as long as full qualification obtained by 21 September 2018. By 21 March 2017 latest individuals will need to obtain the regulatory module before being able to advise (TC TP 9.1 and TC 2.1.6). Any new starters after 21 March 2016 have 30 months to obtain the qualification but will again need to pass the regulatory module before being able to speak to customers (TC 2.2.A.1).
- Supervisors – rules don't say they need to be qualified but it would be difficult to demonstrate competence and technical knowledge otherwise (see TC 2.1.4)

Firms therefore have to have an appropriate T&C scheme in place from 21 March 2016.

We recommend that firms will need to take their own legal advice so that any actions are based on their own business models.



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Binding offers

- All offers are binding
- Offer has to reflect ESIS – which doesn't have to be issued again unless material change
- Binding offer has to be given to customer when entering a contract or varying the terms to a contract (adding/removing a party, making a further advance, switching interest rate)
- Minimum 7 day 'reflection' period after binding offer – customer can proceed before period ends (not clear in ESIS)
- Stepped loans – offer can be for full amount or an initial amount, replaced by binding offer at each further stage



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Other key changes

- Remuneration not dependent on sales targets – does not prevent remuneration packages based on sales volumes or different incentive levels for different types of mortgage
- PI cover must be minimum €460k per claim and aggregate €750k per calendar year for all claims (including ARs)
- Capital resources – if firm only carries out home finance mediation activity or administration of second charge contracts then these requirements do not apply. If they do apply, any income from seconds is not included in calculating annual income
 - e.g. if a firm carries out insurance mediation or home finance mediation activity (or both) but no other regulated activities and does not hold client money, the capital resources requirement is the higher of £5,000 and 2.5% of annual income in relation to these activities



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Other key changes

- Reliable standards for property valuations
- Firms must have clear and effective policies to deal with vulnerable customers
- Tweaks to financial promotion rules – eases use of social media
- Passporting rights to other EEA member states (further details will be in FCA consultation Q3 2015)
- FCA will review introducing prudential requirements to second charge market in 2017



Other MCD changes

Fees

- Second charge firms will come under the FSCS regime
- Two types of FSCS fee:
 - management expenses levy, which covers the costs of running the compensation scheme
 - compensation costs levy, which provides the funds to make valid compensation claims
- FSCS fees are generally based on the firm's activities and annual eligible income
- All second charge activities will come under FOS's compulsory jurisdiction for after March 2016
- FCA annual periodic fee, which recovers the costs of FCA regulation, will be due after March 2016



Other MCD changes

Consumer buy-to-let

- BTL which is not entered into wholly or predominantly for business purposes
- Not a consumer BTL if:
 - Borrower has previously had a BTL
 - Borrower has/had intention at time of purchase to let property out or for it to be occupied by them or relative
- Still not regulated at all if a relative occupies the property less than 40% of the time or less than 40% of land is used as dwelling
- Borrower will sign declaration to confirm they are not a consumer – not responsibility of intermediary or lender to verify unless reason to suspect
- Firms already authorised will need to register to be able to carry out CBTL activity from 21/03/16 – can do now via FCA Connect system
- Fee is £100 to register; £250 p.a. plus £100 annual FOS levy from 2016/17
- Final rules for CBTL were confirmed in June
- CBTL borrowers eligible for FOS but not FSCS
- Broking of unregulated buy-to-let will not require authorisation from 21/03/16 except in certain circumstances (e.g. debt con)



Consequences

- Gaining authorisation
- Being careful not to step outside scope and evidencing how you monitor this
- Fair, clear and not misleading
- Robust diary management on pipeline
- Responsibility sits with CF1 at firm level
- Consumer ignorance of these changes
- Managing your training and supervision procedures
- Who will own valuations?





Remaining questions now answered

- Authorisations – firms do not need to wait for the application period to apply for a mortgage permission, they can apply earlier without moving the application period. FCA is suggesting an application date of no later than September 2015 to increase the likelihood it will be determined by 21 March 2016.
- Disclosure of remuneration to customer – in the ESIS this must not include payment to third party (i.e. exclude commission to principal) but firms can include this in other documentation – we believe they should be doing this
- Early repayment charges – FCA has confirmed that the onus is on lenders to establish an appropriate early repayment charge and that brokers should continue as they are currently when taking into account the ERC as part of a product's suitability
- The FCA is working on updating the syllabus although unlikely this will be done by 2016

