

# **The Mortgage Credit Directive**

## **Analysis of FCA policy statement and final rules**

**March 2016**

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# Background

## Timetable

- MCD adopted 4 Feb 2014
- Some of the MCD was implemented as part of MMR
- Effective 21 March 2016 – firms can choose to adopt from 21 Sep 2015
- Some rules have transition periods, can be up to 2019
- FCA will contact first charge firms 'late 2015 or early 2016' to find out if they will carry out seconds from 2016
- Treasury will carry out review of implementation by Sep 2018 to feed into European Commission review in 2019
- Seconds firms can now apply for regulated mortgage permission



# MCD – Final Rules

## High level principles

- Written disclosure
- KFI replaced by ESIS (or 'KFI plus')
- Removal of transitional provisions for remos from other lenders
- Alternative finance options and consideration of scope of service
- 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
- Minimum limits for PI cover
- Suitability letter remains not compulsory, but needs durable disclosure
- Remuneration cannot be contingent on sales targets
- Binding offers
- Reflection period
- Extra requirements on foreign currency mortgages



# MCD – Final Rules



## Consideration of scope – possible options

Scope	What your adviser does
Firsts only	Notify customer of alternative options but can only advise on remortgage.
Firsts and seconds	Compare costs of remortgage vs second themselves and make recommendation
Firsts and seconds – but outsourced	Compare costs of remortgage vs second (using seconds broker) and make recommendation themselves
Firsts only but refer onto seconds	Compare costs of remortgage and make recommendation, passing seconds advice onto seconds broker (who may execute or pass back for remortgage)

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 firsts only 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.



# MCD – Final Rules



## Disclosure

- U-turn on disclosure: disclosure has to be written (given by durable medium) – return of the IDD? Full oral disclosure still required
- Provide customers with list of lenders and confirm whether scope is firsts or both firsts and seconds
- 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
- Provide 'adequate explanations' before an offer is issued (can be oral)
- If customer is increasing borrowing, must notify them of the availability of alternative finance options (can be oral) – not obliged to comment on suitability unless service offered
- Make available to customers, on request, the levels of commission paid by different lenders



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## ESIS

- Different lenders likely to use different documents until 2019
- Has to be provided to customer before application (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)



# MCD – Final Rules



## 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)
- Self-build mortgages – offer can be for full amount or an initial amount, replaced by binding offer at each further stage



# MCD – Final Rules

## KFI plus vs ESIS

New information required	KFI plus	ESIS
For a variable interest-rate loan, the warning and additional APRC	✓	✓
For a foreign currency loan, the warning and illustrative example	✓	✓
The reflection period	✓	✓
The maximum LTV available in % and £, or the minimum value of the property required by the firm to lend the illustrated amount	✗	✓



# MCD – Final Rules

## Types of mortgages

Foreign currency mortgages – mortgage is denominated in a different currency to the customer's income or their residence

- If the currency fluctuates by 20% since outset, customer has right to convert mortgage to alternative currency
- Likely that some lenders will stop offering these mortgages – some have already

## Lifetime mortgages

- Now two definitions – one under MCD and one that's MCD exempt
- New MCD definition encompasses requirement to repay capital – not many out there which will fall under this
- KFI must be used for MCD exempt ones

## Shared equity credit agreements

- Cannot be execution only
- Can be interest roll-up
- Need to consider various factors when assessing their suitability



# MCD – Final Rules

## Bridging loans

- 'MCD exempt bridging loans' will not be subject to MCD rules
- Defined as 'a regulated mortgage contract or an article 3(1)(b) credit agreement either of no fixed duration or which is due to be repaid within 12 months, used by the consumer as a temporary financing solution while transitioning to another financial arrangement for the immovable property.'
- Bridging loans that don't constitute 'transitioning to another financial arrangement' will mean they are subject to MCD rules
- Firms need to continue to determine the purpose of a loan – whether for personal or business purposes
- Further considerations from 21 March – will a bridging loan be unregulated, regulated under MCOB or regulated under MCD?
- Factor that may affect this is on which property the loan is secured against



# 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 – conduct rules in MCD Order
- 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 instances such as BTL for consolidating debt)



# MCD – Final Rules



## 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 – any income from seconds not included in calculating annual income
- Reliable standards for property valuations
- Firms must have clear and effective policies to deal with vulnerable customers
- Tweaks to financial promotion rules – makes social media easier, removes requirement for intermediaries to disclose fees
- Passporting rights to other EEA member states (further details will be in FCA consultation Q3 2015)



# Consequences

- Extra explanation to consumers during KFI+/ESIS period
- Change to “Fair, clear and not misleading”
- Concerns over 6 month conversion window
- Increased need for diary management on pipeline
- Will we see lender tranche management in early 2016
- Consumer ignorance on BTL changes
- Responsibility still sits at firm level



## Remaining questions

- Lenders have told FCA they 'are largely confident' in providing an adequate explanation in an execution-only sale. FCA is relying on them to have appropriate arrangements in place, which may involve transferring the sale to an advised channel. Will lenders actually do this?



# Remaining questions now answered



- 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 which is likely to affect exams taken from 2017

