

## Mortgage Credit Directive – summary of final rules

This communication is addressed to all members of AMI and AFB.

Following our member presentations and our discussions with the FCA, we have set out below a summary of the new rules that will apply to brokers from next year as a result of the Mortgage Credit Directive. This communication should be read in conjunction with the updated presentation slides.

The summary does not provide an exhaustive list of the changes and we would recommend firms still read the [full final rules](#). Alternatively firms can forward date the FCA's handbook to view the new rules.

The FCA has produced factsheets on the Directive for both [first charge](#) and [second charge](#) intermediaries and a dedicated [section on their website](#).

### Introduction

The European Mortgage Credit Directive comes into effect from 21 March 2016 and the FCA has now confirmed how it will implement the Directive into its rules.

The Directive applies to all first and second charge brokers and lenders, who will all follow the same regulatory regime from next March (i.e. the FCA's Mortgages and Home Finance Conduct of Business sourcebook). References to 'brokers' in this summary therefore apply to both first and second charge intermediaries.

Firms (both lenders and brokers) can choose to adopt the new rules early, from 21 September 2015. Some rules have transition periods so they can be implemented later than 21 March 2016.

Brokers will need to have continual dialogue with lenders to ascertain when they decide to adopt the new rules, as this will affect any ongoing applications.

Any pipeline applications which have not had the new rules applied by 21 March 2016 will have to be restarted, but brokers should monitor lender communications and websites and if required speak to lenders about specific cases. The option for brokers to adopt the rules earlier than this date should help avoid this.

### **Additional information for second charge**

Seconds firms can now apply for regulated mortgage permissions. More information on applying for authorisation can be found in [this flowchart](#) and [on the FCA website](#).

Current second charge brokers should also be aware of the additional changes that will apply as a result of the change in regime from consumer credit to MCOB. These additional changes are not listed in this document, but key ones have been included in our presentation slides. In addition, firms should read the FCA's [thematic report on MMR Advice and Distribution](#) published in July 2015.

For consumer buy to let (CBTL), firms with consumer credit interim permission should apply when making an application for consumer credit authorisation. The consumer credit application form has been amended to include a CBTL question and firms who have already made an application should send a request for CBTL registration to their case officer.

## Summary of rules

### Disclosure

Most of these rules require brokers to disclose information using a 'durable medium', which broadly means by handing over a document or sending an email or letter. This includes, but is not limited to, the scope of your service, the lenders you deal with and how your firm is remunerated. Different information will have to be provided within different timescales. There will be few instances when you can rely on only giving information to a customer orally.

Brokers will have to provide customers with:

- the number of lenders whose products you consider (i.e. who you have on panel) and that the customer has a right to request a list of these lenders
- the basis of your remuneration (i.e. commission and/or fees), including if any commission will be offset against any fees
- the levels of commission paid by each lender (only if the customer requests this) and that the customer has the right to request this. If more than one level of commission is paid by a lender, the range can be given rather than specifying each rate (in the case of different levels being paid depending on through whom the product is placed). The commission levels would however have to be split to show the type of product (new or product transfer). This commission information can be provided in a separate schedule and the FCA has confirmed that this schedule can be updated periodically (e.g. biannually).
- 'adequate explanations' before an offer is issued. This includes:
  - the European Standardised Information Sheet and other pre-contractual information
  - the essential characteristics of the product(s) proposed
  - the specific effects that these products may have on the customer, including the consequences of defaulting
  - if any ancillary services are bundled, whether each component can be terminated separately and the implications for the customer of doing so

The ESIS is likely to become known as the Mortgage Illustration.

The FCA has [provided a document](#) summarising the timing of the new disclosure requirements, which should be read in conjunction with the relevant sections of its Handbook. The FCA has stated that it is designed to provide an overview of its rules but not to be used as a substitute for reading and understanding the rules.

Under the new rules brokers will have to disclose to customers the availability of alternative finance options, where the customer is looking to increase borrowing. This will mean telling the customers that the following alternative finance options may be available and more appropriate:

- a further advance from the existing lender, unless you know the existing lender will not do this
- a second charge mortgage (if you are a first charge broker)
- a new first charge mortgage (if you are a second charge broker)
- unsecured lending

You will not have to comment on the suitability of these options unless they are within your scope.

## Scope of services

With both first and second charge brokers being authorised by the same mortgage permission, brokers will have to consider what will fall under their scope of services. Will this be firsts only, seconds only, or both?

If you have commercial arrangements with other firms for any part of the advice the customer receives, you will need to decide how these arrangements set out the responsibilities for advice and remuneration. You will need to also consider what the customer journey looks like with multiple firms involved. All firms will have to ensure that the customer is clear about who is giving any advice and the scope or limitations of their service. Where customers are moved between firms this will have to be explicit.

The FCA has provided further clarity on how introductions impact scope of service. Where a first broker, for example, has clearly disclosed that seconds are beyond the range on which they offer advice, they can, where a first or remortgage is not suitable, introduce a customer to a seconds broker (who would be wholly responsible for their advice) without seconds needing to be included in their scope of services. The FCA has reiterated that it needs to be clear to the customer who is advising on what. Firms might want to still undertake due diligence on and have contractual relationships with the seconds provider, to make clear where the liability for advice sits.

The FCA is currently contacting first charge firms to find out which will carry out seconds business from 2016.

Intermediaries advising on either firsts only or seconds only will not be able to call themselves “independent” (or “whole of market”) as firms will only be “offering products from one part of a relevant market”. The FCA has confirmed the relevant market will be all regulated mortgage contracts, which from 21 March 2016 will include both first and second charge.

Therefore only intermediaries who themselves advise on both first and second charge mortgages and look at a sufficiently broad range of both markets will be able to:

- Describe their services as unlimited
- Describe themselves as independent – including as part of their company or trading name

Firms who do not meet the above criteria will not be able to use the terms “unlimited” or “independent”.

First charge firms who exclude second charges from their scope of service can still “introduce” to a second charge firm, where they consider that a re-mortgage is not in the customer’s best interests. However the second charge firm will be wholly responsible for disclosure and advice on the second charge loan. The same rule applies for second charge firms introducing to a first charge broker.

However in making such an “introduction” rather than a recommendation, firms who introduce customers to a broker who looks at the other part of the market, cannot call themselves independent, whole of market or describe their scope as unlimited.

If firms advise on both firsts and seconds but do not consider the majority of lenders of both markets, they cannot use the term “independent” to describe their services.

## The European Standardised Information Sheet (ESIS)

This new prescribed document will have to be provided to customers at specific times in the application process. Brokers will be responsible for meeting the timing requirements, but you can decide whether you issue the lender's ESIS or your own. You will have to ensure that any ESIS you issue is accurate. The content of the ESIS cannot be changed but you can give customers supplementary information, which is likely to be needed.

The ESIS includes information such as the main features of the product, interest rates (up to five may be included depending on the type of product) and early repayment.

The following events trigger when an ESIS must be given to a customer:

- once details on affordability have been provided
- at the point of advice
- when they have paid any fee
- before the application is submitted to the lender
- at their request

The ESIS needs to only be provided on the first trigger event, and in a durable medium. The ESIS does not need to be provided again unless there is a material change in its content.

We do not believe that the introduction of the ESIS presents much difference to the processes today in ensuring that the document provided at point of recommendation should reflect the advice, which of course could be varied by the final offer provided by the lender.

### **Transition for first charge**

The ESIS replaces the Key Facts Illustration (KFI) in the current first charge process.

The rules give a transitional period for firms to use the ESIS. Until 21 March 2019 firms can choose to issue a 'KFI plus' document instead, which is based on the KFI but includes some additional information.

We believe that during this period different lenders will be using different documents, so this is an example where brokers' additional explanation will be key.

## Offers

Lenders can issue draft / indicative offers which are non-binding, but the final offer issued by a lender must be binding. A lender can only withdraw a binding offer if:

- there has been material change (defined in the FCA's rules) to the facts and circumstances upon relating to the binding offer which occurs after the date on which the binding offer is made, or
- the customer has knowingly provided incomplete or inaccurate information for the purpose of the assessment of affordability, and has knowingly falsified or withheld the information provided for the purpose of that assessment

A lender cannot use the above conditions as a means of avoiding the requirement to undertake a proper affordability assessment before the binding offer is made.

The binding offer must be based on an ESIS, which will have either been previously issued to the customer, or is being issued alongside the binding offer if it differs to information contained in a previously issued ESIS.

Customers will have a 'reflection period' of at least seven days from when the binding offer is issued. Customers can choose to accept the offer at any time during the period. If the customer decides to waive the reflection period and accept the offer earlier, this needs to be recorded.

## Other changes

### **Professional indemnity insurance**

All brokers will have to hold a minimum level of professional indemnity insurance: EUR 460,000 for each individual claim and in aggregate EUR 750,000 per calendar year for all claims.

### **Capital resources**

In the calculation of the capital resources of a firm, any income from second charge mortgages does not need to be included. If a firm only carries out home finance mediation activity or administration in respect of second charge contracts then these requirements do not apply.

### **Training and competence**

All brokers will need to hold a Level 3 qualification from 21 September 2018 (e.g. CeMAP). Supervisors will need to be fully competent from 21 March 2016. For more information on transitional provisions for seconds firms, see the AFB accompanying slides.

### **Financial promotions**

The FCA has made changes to the rules on financial promotions. Whilst the requirement for intermediaries to detail their fees has been removed, firms must still ensure the promotions are fair, clear and not misleading. Firms can continue to disclose their fees under the new rules without this constituting as relating to the cost of credit.

### **Early Repayment Charges**

We expect that lenders will move to more graduated ERCs, particularly on longer fix products. The FCA do not consider that the MCD requires a rule change, but expects lenders to move to a new structure as they have not been applying the existing rules appropriately. The MCD wording makes this clear.

### **Lifetime mortgages**

The FCA has created two definitions of lifetime mortgages – those that fall under these new rules and those that are exempt. The new definition applies to mortgages which require repayment of capital during the contract.

### **Foreign currency mortgages**

There will be extra requirements that apply to foreign currency mortgages, defined as being denominated in a different currency to the customer's income or residence. Some lenders may choose to mitigate the exposure to exchange rate risk by giving customers the right to convert the mortgage into an alternative currency in certain circumstances. Others may instead however choose to deliver a product using swap contract protections or to provide a risk warning instead, where there would be no need to track exchange rates.

### **Bridging loans**

Most bridging loans will be exempt from the MCD rules and will either continue to be unregulated or regulated under MCOB. For more information see the separate guidance.

**Removal of Mortgage Market Review transitional arrangement**

From 21 March 2016, the FCA is removing the exemption to apply an affordability assessment where consumers are remortgaging with a different lender and there is no additional borrowing and no other changes to terms likely to be material to affordability.

**Fee disclosure**

The rules and guidance around the ESIS indicate that firms may exclude income paid away to third parties. AMI considers that following the judgements in legal cases such as Hurstanger, Plevin and McWilliam, brokers need to fully disclose all income they might be receiving from all products linked to the transaction to avoid risk of sanction by FOS or the courts.