

## REGULATING MORTGAGES

In December 2001, the Economic Secretary to the Treasury announced that the Financial Services Authority (FSA) would have responsibility for regulating mortgage business, including mortgage advice, whether carried on by intermediaries or lenders. This represented an extension of the FSA's remit, which had previously not included the power to regulate advice or intermediaries in relation to mortgages. To bring this about, legislation in the shape of orders under the Financial Services and Markets Act 2000 (FSMA) will specify what the FSA's responsibilities are to be. Through this document, the Treasury is consulting about the orders required to bring these decisions into effect, the likely date for which is now envisaged to be in the second quarter of 2004, and not 1<sup>st</sup> September 2002 as previously envisaged.

2. The Treasury would welcome feedback on the proposals explained here. Please write to:

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3. It would be helpful to receive your response by **30<sup>th</sup> April 2002**. Please explain in your reply if you represent an organisation, and if so, its membership and coverage. Your answer may be made public unless you say you want it kept confidential.

## **the Government's approach**

4. This consultation is the third on the subject of mortgage regulation.<sup>1</sup> The feedback from these formal consultations, as well as representations from a wide range of opinion, persuaded the Government that mortgage borrowers essentially needed two things. Firstly, they needed good quality, clear and comparable information about the mortgages on offer in the market place to help them make informed choices. And secondly, there was a recognition that a mortgage is one of the biggest financial decisions most people are likely to make and that high quality, understandable advice is crucial to many when making that decision. In the rare and unfortunate cases when things go wrong, this can have very serious implications and for this reason there was a need to ensure a high standard of advice is available across the board.
  
5. Ministers are tackling this situation in two stages:
  - ?? defining **CAT** standards for mortgages as reference points to help borrowers understand mortgages on offer and recognise loans likely to offer fair deals. These voluntary standards were published in April 2000, with immediate effect.
  - ?? giving the FSA power to regulate residential mortgage lending, including the advice process. Entering into a regulated mortgage contract as lender, and administering such a contract, are already specified as regulated activities under the Financial Services and Markets Act 2000 (FSMA)

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<sup>1</sup> See *Regulation of Mortgages*, HM Treasury July 1999, and *Regulating Mortgages* HM Treasury, October 2000.

by article 61 of the Regulated Activities Order (RAO)<sup>2</sup>. New provision will now be made to bring the activities of arranging and advising on such mortgages within the regulatory regime of the FSMA.

6. The existence of CAT standards - setting benchmarks for Charges, Access and Terms for straightforward mortgages - is already stimulating mortgage lenders toward delivering fair value to their customers. More lenders now calculate interest daily rather than annually, ensuring that overpayments reduce mortgage debts immediately; and still more plan to adopt this approach. And early repayment charges now often end when a period of fixed or capped interest payments closes.

### **next steps**

7. The principal steps required to implement the **new regulatory regime** are:
  - ?? amendments to the RAO which will specify the new regulated activities of arranging and advising in relation to regulated mortgage contracts, which are to be subject to regulation by the FSA;
  - ?? amendments to the Financial Promotion Order (FPO), to be made under s 21 of the FSMA, which will bring

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<sup>2</sup> *The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001*, SI 2001 No.544, as amended by SI 2001/3544

communications promoting the services of intermediaries who arrange or advise borrowers on regulated mortgage contracts within the financial promotion regime under FSMA, and specify relevant exemptions from that regime;

- ?? the FSA will then make rules for mortgage lenders and intermediaries, subject to the usual statutory requirements of consultation and cost-benefit analysis.
8. This document sets out for consultation the final pieces of legislation that will make effective the first two of these three steps. Some of the legal framework for regulating mortgages is already in place following earlier consultation and legislation. We do not propose to re-open this legislation or the policy direction approved by Parliament except where necessary to regulate the new activities of arranging and advice. The FSA will consult separately about the third step, its own rules.

**definition: mortgages**

9. The policy announced in December 2001 is designed to ensure that most retail residential mortgage loans granted to individuals will be protected by FSA regulation. The definition of a **regulated mortgage contract** remains unchanged from that approved by Parliament.
10. In essence, the mortgages to be covered by the FSA's regime will be those secured by first legal charges, on UK property, where at least 40% is residential accommodation to be occupied by the borrower or his or her immediate family.

**activities to be regulated**

11. The main significance of the December 2001 decision is that in addition to the activities of entering into or administering a regulated mortgage contract (as defined), firms or people engaged in **advising** on or **arranging** aspects of a regulated mortgage contract will, after the appointed day (envisaged to be in the second quarter of 2004), need to be authorised by the FSA, with specific permission to engage in such activities, unless they are entitled to carry on those activities as appointed representatives (see para 32 below).
  
12. The “threshold” conditions for FSA authorisation are set out in Schedule 6 to the Financial Services and Markets Act 2000. Authorised persons carrying on the new regulated activities will be subject to FSA rules, which could include rules regulating the conduct of that business. In drawing up these rules, the FSA are obliged under the FSMA to consult publicly on them, and this consultation must include a cost benefit analysis. The FSA’s rules must have regard to the principle of proportionality, so that where such rules impose a burden on a person or restrict the ways in which the activity may be carried on, that burden or restriction should be proportionate to the benefits, considered in general terms, which are expected to result from its imposition.
  
13. The FSA is obliged to adopt a “risk-based” approach to regulation, which means having regard to the varying degrees of risk involved in different kinds of transactions, to the differing degrees of experience and expertise possessed by different consumers in relation to different kinds of regulated activity, and to the general principle that consumers

should take responsibility for their decisions.

14. Arranging or advising on regulated mortgage contracts will constitute regulated activities only if carried on **by way of business** (s22 of the FSMA). The approach to regulation outlined in this document should mean that all key aspects of the transaction, including the arranging and related advice, for virtually all retail mortgages, would be subject to FSA regulation.
15. Hence activities that are not carried on by way of business will not be subject to FSA regulation. These might include:
  - ?? secured loans granted by certain charities, churches or educational institutions on deliberately uncommercial terms, eg permanently subsidised loans to borrowers in certain defined categories;
  - ?? one-off personal loans to friends or within families, whether at market interest rates or not.
  - ?? advice and arranging in relation to regulated mortgage contracts carried on on an uncommercial basis, by Citizens' Advice Bureaux and other community groups engaged in the welfare of their client base.
16. It is important to be aware though, that the *by way of business* criterion does not exclude the activities of persons who expect to make a loss with an initial offer but subsequently plan to make a profit. Such persons may still be carrying on the relevant activity by way of business, and will therefore need to be authorised or be the

appointed representative of an authorised person. Ultimately, in the event of a dispute, it will be for the courts to decide exactly how the business criterion is to be interpreted in relation to all regulated activities.

### **arranging**

17. The regulatory regime is designed to ensure that *all* activities which, in essence, lead to borrowers taking out mortgages, are subject to regulation. The Government's intention in specifying 'arranging' as well as 'advising' as a regulated activity is to regulate the activities of intermediaries when they arrange for customers to take out mortgages but do not give advice at the same time.
18. Where the arranging is simply “execution-only” in nature, where an intermediary or a lender is merely carrying out a borrower’s instructions, as opposed to giving him or her advice in connection with the choice of a mortgage, the likely risks to borrowers are less. In setting its rules, FSA’s risk based approach would take into account the range of risks associated with this and other mortgage related activities.
19. The activity of arranging has two limbs. The first consists of arranging for a person to enter into a regulated mortgage contract as borrower with another person, or arranging a variation in the terms of a regulated mortgage contract in such a way that will change the obligations of the borrower under that contract. This is aimed at brokers and intermediaries who introduce a client to a mortgage lender, and at persons who, as the whole or the part of their business,

arrange with a lender to vary a regulated mortgage contract. The second consists of making arrangements with a view to another person who takes part in those arrangements entering as a borrower into a regulated mortgage contract. This is aimed at persons, such as, say, a house builder or estate agent, who introduce a client to another person who will arrange for the client to enter into a mortgage.

20. However, the Treasury proposes to apply an exclusion to the second limb, so that a person will not be carrying on the regulated activity if he simply refers a potential borrower to an independent adviser who is authorised by the FSA, or who is the appointed representative of an authorised person. The exclusion will not apply to an introduction to a tied agent of a particular lender, since the Treasury takes the view that referring a potential borrower to a tied agent restricts in advance the range of options which might otherwise be available to that borrower.

### **advising**

21. Information or general guidance is not advice. Advice has a specific meaning in the regulatory context. The intention is to regulate only the giving of advice on the merits of taking out a particular mortgage (where that advice is given by way of business).

This means that:

~~///~~ Strategic or generic advice is not regulated. Thus, advice that a person should save for a deposit before taking out a mortgage is not a regulated activity. Equally, advising a person to “get a mortgage” is not a regulated activity. But advising a person to specifically take

out a fixed rate mortgage with the Lincsdale Bank – for example – would be a regulated activity;

~~As~~ As stated earlier, the advice must be given by way of business.

22. If a person is carrying on a regulated activity, he may be subject to FSA conduct of business rules. The FSA will consult separately on these.
23. Together with other financial services products, the regulation of mortgage arranging and advice is affected by the rules established by the E-Commerce Directive. This means that mortgages provided over the internet (or by text message) from a firm established in another EEA state will be subject to the regulatory regime established by that state and will be outside the scope of the new regime we are establishing.
24. Views are invited as to whether in the context of a regulated mortgage contract, there are any other activities that should be included in addition to (or instead of) those specified in paras 17 – 23.

### **variations to a mortgage**

25. Variations to a mortgage can often have implications for borrowers in that they may, for example, materially alter the terms originally envisaged by the borrower.
26. The FSA will be able to make conduct of business rules applying to

authorised persons who arrange, or advise on, a variation to the terms of a regulated mortgage contract which would lead to a change in the obligations of the borrower under that contract. As discussed earlier, the FSA is obliged to consult on such rules and to adhere to the principle of proportionality.

27. The sorts of variations which would be relevant might include, but are not confined to,
- a. changes to the repayment method (eg from interest – only to a repayment basis)
  - b. changes to the type of mortgage (eg from a fixed rate to a variable mortgage)
  - c. the addition or removal of a borrower
  - d. the capitalization of arrears or other charges
  - e. an increase in the loan amount
  - f. a variation to the duration of the loan

### **financial promotion**

28. In principle it seems reasonable for the FSMA financial promotion regime to deal with **promotion** of mortgage advice and arranging in a similar way to the current provisions relating to the promotion of mortgage lending and administration. This will mean that normally a communication about mortgage advice and arranging will have to be issued by an authorised person, or the contents of the communication will have to be approved by an authorised person prior to being issued. Authorised persons will be subject to FSA rules when issuing their own promotions and when approving the contents of a promotion issued by an unauthorised person.

29. Promotions relating to mortgage advice and arranging will only be able to be made by unauthorised persons where the promotions benefit from an exemption in either Part IV or Part VI of the Financial Promotion Order (FPO), **or where the contents of the promotions have been approved by an authorised person**. The government proposes that the exemptions which currently apply to mortgage lending will apply to mortgage arranging and advice.
30. These include exemptions for communications by central government and by local authorities; for communications between companies in the same group; and for communications to high net worth companies and sophisticated investors who do not need the same level of protection as other consumers. There are exemptions for communications by settlors, trustees and personal representatives to beneficiaries of trusts, wills and intestacy. And there is an exemption for certain communications by members of the professions who are within the FSMA Part XX regime (see paragraphs 48 to 51 of this consultation document for more details of the Part XX regime). There is also an exemption for certain communications made in the course of the supply of goods and services. For the full picture of exemptions currently applicable to mortgage lending and administration please consult the Financial Services and Markets Act 2000 ( Financial Promotion) Order 2001, SI 2001/1335 .
31. The Government proposes making one addition to the current exemptions applicable to mortgage lending and administration which it also intends applying to mortgage advice and arranging. Article 30 of the FPO provides for an exemption for solicited real time communications made by an overseas communicator from outside the United Kingdom for the purposes of his carrying on business of engaging in relevant investment activities outside the United Kingdom. This exemption currently does not apply to mortgage

lending and administration, but the Government thinks the exemption should now apply.

Views are invited on the government's proposed approach to financial promotion in relation to mortgage advice and arranging. In particular should any existing exemptions be removed, or any new categories of exemption be created?

### **appointed representatives**

32. In general terms only persons authorised by the FSA are able to carry on regulated activities by way of business. However s. 39 of FSMA creates an important exemption from that general rule for “appointed representatives”. “Appointed representatives” of authorised persons may carry on specified regulated activities without the appointed representatives themselves being authorised by the FSA provided the following conditions are met:

- a) the appointed representative is a party to a contract with an authorised person, referred to as the principal, which permits the appointed representative to carry on regulated activities;
- b) that contract must prohibit the appointed representative from representing persons other than the principal, or permit the principal to impose such a prohibition; and
- c) the principal has accepted responsibility in writing for the conduct of those regulated activities

The Government has the power to prescribe which regulated activities an appointed representative can carry on.

33. The advantage of the appointed representatives regime is that on the one hand the appointed representatives do not have to go through the process of FSA authorisation, but on the other hand consumers benefit from the protection that FSA regulation provides as the FSA will be regulating the principal.
34. Accordingly, the Government intends to extend the appointed representatives regime to the new regulated activities of arranging and advising on regulated mortgage contracts.
35. It should be noted however that under FSMA a person cannot be an appointed representative for one activity if he is authorised for another activity. Therefore an independent mortgage intermediary who becomes authorised in relation to the activities of mortgage arranging and advising could not continue to be an appointed representative for other activities.

### **related consumer lending**

36. Not all consumer lending is secured on residential property. Many retail loans are unsecured. Some unsecured loans, as well as loans that are on second charges on property are currently regulated under the Consumer Credit Act 1974 (CCA), and that will continue to be the case.
37. Feedback in the earlier consultation on regulation of mortgages brought out strongly that firms active in the mortgage market wanted to avoid dual regulation so far as possible. In particular, it was clear that it would be desirable for mortgages not to be treated as regulated consumer credit agreements under the CCA when lending under a regulated mortgage contract becomes a regulated activity in the second quarter of 2004. That objective was achieved in the

amendments to the CCA already made in the Regulated Activities Order.

38. The CCA also regulates persons who carry on ancillary consumer credit activities such as credit brokerage, debt adjustment and debt counselling. As those activities are currently defined in the CCA, they would overlap with the new regulated activities of arranging and advising on regulated mortgage contracts. In order to avoid as far as possible the dual regulation of intermediaries and advisers, we intend to exclude from the scope of such ancillary consumer credit activities those new regulated activities. This carve out is effected by the amendments to section 146 of the CCA in the draft provisions annexed to this document.

39. It should be noted the CCA and its licensing regime will still apply to credit brokers in respect of non-regulated mortgages and other loans, as well as to authorised persons or appointed representatives who carry on other ancillary credit activities *in addition* to a regulated activity of mortgage arranging or advice. Accordingly, mortgage intermediaries who are to be regulated under FSMA may need to retain their CCA licence.

40. The amendments made to the CCA also disapply section 155 of that Act in relation to fees charged by credit brokers in connection with services which consist of introducing a potential borrower to a regulated mortgage lender. That section restricts the brokerage fee to a limit of £5 in relation to transactions which do not lead to the client entering into a contract. The Treasury believes that disapplying this provision is justified in the mortgage context because there may well be occasions when the appropriate advice would be for a potential borrower **not** to take out a mortgage, perhaps because his or her circumstances were not suited to one.

Views are invited as to whether removal of this £5 limit would lead to

difficulties for would-be borrowers, and, if so, the evidence to support that view.

### **loans sold or transferred to other lenders**

41. HM Treasury's previous consultation (October 2000) drew attention to the specialist area of **securitisation**. This normally occurs where the original lenders which make the loans pass on legal ownership of the loan to a third party through sale or securitisation. The Government does not want to restrict any reasonable business disposals of this kind, provided that borrowers' rights under the FSA's mortgage regulation rules are not damaged.
42. In a straightforward **sale**, the original lender may sell a mortgage portfolio to another authorised lender, passing on all ongoing responsibility towards the borrowers in the process, either to the new owner of the mortgage book, or to another authorised lender. Then, so far as the borrowers are concerned, the new owner steps into the position of the originator. After the sale FSA's post-sale rules would apply to the purchaser of the mortgage portfolio.
43. But securitisation can be more complicated as there are different ways in which transfers can take place. The essence of any such transfer is that the originator sells the equitable interest in a mortgage portfolio to a special purpose vehicle (SPV), which raises finance to pay for the loan book by selling its own shares. The originator may (or may not) retain the first legal charges on the mortgages in the portfolio. There may (or may not) be other parties to the transaction, which operate and administer the loan book of the originator.
44. Whatever the exact terms of the securitisation, the essence of the approach reached was to avoid the regulatory responsibility for

regulated mortgages ever falling on an SPV or a trustee associated with it. Rather, either an authorised lender or an administrator assumed the regulatory responsibilities in regard to the customer.

45. Even if an SPV might on occasion need to exercise certain rights under a legal title to a mortgage, for example enforcement of a debt, it would also be always possible for institutions to so organize affairs that only a single authorised institution would have the ongoing regulatory interface with the borrower, for regulated mortgages at any one time. Though slightly cumbersome, it was agreed that this was a small price to pay for the overall achievement.
46. The addition of the new activities of arranging and advising in these proposals are not intended to disturb those arrangements. Views are invited on this point, particularly from those engaged in securitisation business.
47. The new regulatory arrangements for mortgages are designed to ensure that, at any one time, it would be possible for each mortgage to be linked to one and only one FSA authorised firm (with mortgage permission) to have the ongoing regulatory responsibility towards consumers. That firm will be subject to the appropriate FSA rules - for example for follow up to lending in the case of mortgage sales.

### **professionals and trustees**

48. The FSMA Part XX regime provides that a member of a professional body designated by the Government may carry on regulated activities without being authorised or an exempt person in relation to that activity, provided that these are “incidental to the provision by him of professional services” (s. 327(4) of FSMA). These “designated professional bodies” (DPBs) include the Law Society, the Institute of

### Chartered Accountants and others.

49. The Government does have the option in the FSMA Non-Exempt Activities Order (NEAO) to exclude certain regulated activities from this Part XX regime (i.e. the professionals may not carry on these 'non-exempt' activities at all without being authorised or an exempt person).
50. The Government proposes to apply the Part XX regime to the activities of mortgage advice and arranging in the same way as it currently applies to the activities of investment advice and arranging. This means that professionals will be able to carry on the new activity of mortgage arranging under the Part XX regime, and will also be able to carry on the new activity of mortgage advice subject to a partial carve out from the Part XX regime in the NEAO. That carve out will be similar to the carve out which applies in relation to investment advice.
51. Thus, the NEAO will provide that where professionals recommend a particular product the professionals cannot benefit from the Part XX regime. This is the sort of advice that should be regulated. However, advice given by professionals which falls short of this will fall within the Part XX regime. For example a professional would be able to advise that a regulated mortgage identified by a client may be unsuitable for that client, without the professional needing to be authorised to give such advice. One effect of this would be that advice and arranging in relation to regulated mortgage contracts given or undertaken in a way that is incidental to a solicitor's conveyancing services for a client would be exempt from FSA regulation, provided only that such advice did not amount to a recommendation to buy a particular product.

Views are invited on whether the Part XX regime should apply to the new regulated activities of mortgage advice and mortgage arranging as

described above?

### **trustees**

52. In relation to investment advice and arranging, the RAO provides an exemption from regulation for trustees, nominees, and personal representatives provided certain conditions are met. A key condition is that the trustee is only remunerated in his capacity as a trustee.
53. The government proposes applying this exemption for trustees to the activities of mortgage advice and arranging. Trustees are already bound by trust law to act in the interests of the beneficiaries.

Views are invited on whether trustees should benefit from the limited exclusion from regulation described above in relation to the activities of mortgage advice and arranging?

### **timetable**

54. The intention is that “N3”, the original “Appointed Day” that statutory mortgage regulation was to come into effect will now be sometime in the **second quarter of 2004**, rather than September 1<sup>st</sup> 2002 as previously envisaged. Consequential amendments to orders to reflect this change will be put in place.

### **regulatory impact**

55. These decisions will enable the FSA to develop a customer focussed way of regulating mortgages. They should empower borrowers, and help people looking for mortgages select deals that suit them. Bearing in mind that the industry already incurs a base level of costs in self-

regulation, the Government believes that the initial implementation, and subsequent recurring, costs of statutory regulation will be relatively modest, and that the new arrangements should not make mortgages cost appreciably more. Indeed, because there will be better and more comparable information in the marketplace, competition should be livelier and in the longer term, borrowers' costs could even fall. The accompanying Regulatory Impact Assessment at Annex B discusses some of these issues further.

### **feedback**

56. Comments are invited on the proposals in this document on *how* to implement the decision to regulate mortgage business. You may find it helpful to structure your reply using the questions in annex C - though comments on any of the questions raised in this document would be welcome, particularly if backed by evidence to support the comments made. The address for comments is given at the front of this document (para 2).

**H M Treasury**  
**February 2002**

## Annex A: The proposed Orders

*Order made by the Treasury, laid before Parliament under paragraph 26(2) to (5) of Schedule 2 to the Financial Services and Markets Act 2000, for approval by resolution of each House of Parliament within 28 days beginning with the day on which the Order was made (no account being taken of any time during which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than four days).*

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### STATUTORY INSTRUMENTS

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**2002 No.**

## FINANCIAL SERVICES AND MARKETS

### The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) [No.2] Order 2002

*Made* - - - - 2002

*Laid before Parliament* 2002

*Coming into force in accordance with article 1*

Whereas, in the opinion of the Treasury, one of the effects of the following Order is that activities which are not regulated activities (within the meaning of the Financial Services and Markets Act 2000<sup>(1)</sup>) will become regulated activities (within the meaning of that Act);

The Treasury, in exercise of the powers conferred on them by sections 22(1) and (5) and 428(3) of, and paragraph 25 of Schedule 2 to, that Act, hereby make the following Order:

#### Citation, commencement and interpretation

**1.**—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) [No.2] Order 2002, and comes into force [*date of commencement of mortgage regulation*].

(2) In this Order, “the Regulated Activities Order” means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001<sup>(2)</sup>.

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<sup>(1)</sup> 2000 c. 8.

<sup>(2)</sup> S.I. 2001/544, amended by S.I. 2001/3544 {\*\*\*}.

*Amendments to the Regulated Activities Order***Commencement of provisions relating to regulated mortgage contracts**

2. In article 2(2) of the Regulated Activities Order (commencement), for sub-paragraph (b) substitute -

“(b) for the purposes of articles 25A, 53A, 61 to 63, 88, 90 and 91 (regulated mortgage contracts) on [*date of commencement of mortgage regulation*].”.

**Arranging regulated mortgage contracts**

3. After article 25 of the Regulated Activities Order insert –

**“Arranging regulated mortgage contracts**

**25A.** – (1) Making arrangements –

(a) for another person to enter into a regulated mortgage contract as borrower; or

(b) for another person to vary the terms of a regulated mortgage contract entered into by him as borrower after the coming into force of article 61,

is a specified kind of activity.

(2) Making arrangements with a view to a person who participates in the arrangements entering into a regulated mortgage contract as borrower is also a specified kind of activity.

(3) In this article “borrower” has the meaning given by article 61(3)(a)(i).”.

**Exclusion of arrangements not causing a deal**

4. In article 26 of the Regulated Activities Order (arrangements not causing a deal), after “article 25(1)” insert “and article 25A(1)”.

**Exclusion where a person provides means of communication between parties**

5. In article 27 of the Regulated Activities Order (enabling parties to communicate), after “article 25(2)” insert “and article 25A(2)”.

**Exclusion where the arranger is a party to the transaction**

6. After article 28 of the Regulated Activities Order insert –

**“28A.** – (1) There are excluded from article 25A(1) any arrangements –

(a) for a contract into which the person making the arrangements enters or is to enter; or

(b) for a variation of a contract to which that person is (or is to become) a party.

(2) There are excluded from article 25A(2) any arrangements which a person makes with a view to contracts into which he enters or is to enter.”.

**Exclusion of arrangements where transaction is with or through an authorised person**

7. In article 29 of the Regulated Activities Order (arranging deals with or through authorised persons), in paragraph (1) –

(a) after “article 25(1) and (2)” insert “and article 25A(1) and (2)”; and

(b) in sub-paragraph (b), after “in his capacity as an investor” insert “or (as the case may be) a borrower under a regulated mortgage contract”.

### **Exclusion of arrangements which consist of introduction to an authorised person for independent advice**

**8.** In article 33 of the Regulated Activities Order (introducing) –

- (a) after “article 25(2)” insert “and article 25A(2)”;
- (b) in paragraph (b)(iii) –
  - (i) after “25,” insert “25A”, and
  - (ii) after “53” insert “53A”.

### **Other exclusions**

**9.** In article 36 (other exclusions) –

- (a) the current text is numbered paragraph (1);
- (b) after paragraph (1) insert –

“(2) Article 25A is also subject to the exclusions in articles 66 (trustees etc.) and 67 (profession or non-investment business).”.

### **Advising on regulated mortgage contracts**

**10.** After article 53 of the Regulated Activities Order insert –

#### **“Advising on regulated mortgage contracts**

**53A.** – (1) Advising a person is a specified kind of activity if the advice –

- (a) is given to the person in his capacity as a borrower or potential borrower; and
- (b) is advice on the merits of his doing any of the following -
  - (i) entering into a particular regulated mortgage contract, or
  - (ii) varying the terms of a regulated mortgage contract entered into by him after the coming into force of article 61.

(2) In this article, “borrower” has the meaning given by article 61(3)(a)(i).”.

### **Exclusion of advice given in print, electronic or broadcast media**

**11.**—(1) Article 54 of the Regulated Activities Order (advice given in newspapers etc.) is amended as follows.

(2) In paragraph (1), after “from article 53” insert “and article 53A”.

(3) In sub-paragraph (a) of that paragraph, after “in article 53” insert “or (as the case may be) article 53A”.

(4) For sub-paragraph (b) of that paragraph substitute -

“(b) that of leading or enabling persons –

- (i) to buy, sell, subscribe for or underwrite securities or contractually based investments, or (as the case may be)
- (ii) to enter as borrower into regulated mortgage contracts, or vary the terms of regulated mortgage contracts entered into by such persons as borrower.”.

(5) In paragraph (2), after “from article 53” insert “and article 53A”.

### **Other exclusions**

**12.** In article 55 of the Regulated Activities Order (other exclusions) –

- (a) the current text is numbered paragraph (1); and
- (b) after paragraph (1) insert –
  - “(2) Article 53A is also subject to the exclusions in articles 66 (trustees etc.) and 67 (profession or non-investment business).”.

### **Exclusion of trustees, nominees and personal representatives**

**13.** In article 66 of the Regulated Activities Order (trustees, nominees and personal representatives) –

- (a) in paragraph (2), after (article 25(1) and (2))” insert “25A(1) and (2)”; and
- (b) in paragraph (6), after “article 53” insert “article 53A(1)”.

### **Exclusion of activities carried on in the course of a profession or non-investment business.**

**14.** In paragraph (1) of article 67 of the Regulated Activities Order (activities carried on in the course of a profession or non-investment business) for “40 and 53” substitute “25A, 40, 53 and 53A”.

## *Amendments to the Consumer Credit Act 1974*

### **Exceptions from section 145**

**15.**—(1) In section 145 of the Consumer Credit Act 1974 (types of ancillary credit business)<sup>(3)</sup> –

- (a) in subsection (2), after “section 146(5)” insert “and (5A)”; and
- (b) in subsection (5), after “section 146(5)” insert “and (5B)”; and
- (c) in subsection (6), after “section 146(5)” insert “and (5C)”.

(2) In section 146 of that Act (exceptions from section 145), after subsection (5) insert –

“(5A) It is not credit-brokerage for a person to effect the introduction of an individual desiring to obtain credit if the introduction is made –

- (a) to an authorised person, within the meaning of the 2000 Act, who has permission under that Act to enter as lender into relevant agreements; and either
- (b) with a view to that individual entering into as borrower into a relevant agreement with that authorised person; or
- (c) with a view to that individual increasing the sum secured under an existing relevant agreement [between that individual as borrower and that authorised person as lender].

(5B) It is not debt-adjusting for a person to carry on an activity mentioned in paragraph (a), (b) or (c) of section 145(5) if –

- (a) the debt in question is due under a relevant agreement; and
- (b) that activity constitutes a regulated activity for the purposes of the 2000 Act.

(5C) It is not debt-counselling for a person to give advice to debtors if –

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<sup>(3)</sup> 1974 c. 39.

- (a) the debt in question is due under a relevant agreement; and
  - (b) giving that advice constitutes a regulated activity for the purposes of the 2000 Act.
- (5D) In this section –
- “the 2000 Act” means the Financial Services and Markets Act 2000;
  - “relevant agreement” means an agreement for the provision of credit secured on land, where entering into that agreement as lender is a regulated activity for the purposes of the 2000 Act,
- and subsections (5A) to (5C) must be read with –
- (a) section 22 of the Financial Services and Markets Act 2000 (regulated activities: power to specify classes of activity and categories of investment);
  - (b) any order for the time being in force under that section; and
  - (c) Schedule 2 to that Act.”.

### **Disapplication of section 155 in relation to authorised persons and appointed representatives**

- 16.**—(1) Section 155 (right to recover brokerage fees) is amended follows.
- (2) At the start of subsection (1), insert “Subject to subsection (2A),”.
- (3) After subsection (2) insert –
- “(2A) But subsection (1) does not apply where –
- (a) the fee or commission relates to the effecting of an introduction of a kind mentioned in section 146(5A); and
  - (b) the person charging that fee or commission is an authorised person or an appointed representative, within the meaning of the Financial Services and Markets Act 2000.”.

#### *Amendments to Other Instruments Made Under the Financial Services and Markets Act 2000*

### **Amendment to the Financial Services and Markets Act 2000 (Exemption) Order 2001**

- 17.**—(1) The Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001<sup>(4)</sup> is amended as follows.
- (a) In paragraph 47 (local authorities), for “article 61” substitute “articles 25A, 53A or 61”.
  - (b) In paragraph 48 (social housing)<sup>(5)</sup>, for “article 61” substitute “articles 25A, 53A or 61”.

### **Amendment to the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001**

- 18.**—(1) The Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001<sup>(6)</sup> are amended as follows.
- (2) In regulation 1 (citation, commencement and interpretation), in paragraph (2), after the definition of “the Regulated Activities Order” insert –
- ““regulated mortgage contract”, and “borrower” in relation to such a contract, have the meaning given in article 61(3) of the Regulated Activities Order;”.

<sup>(4)</sup> S.I. 2001/1201.

<sup>(5)</sup> Amendments not relevant to this article were made to paragraph 48 by S.I. 2001/3623.

<sup>(6)</sup> S.I. 2001/1217, as amended by S.I. 2001/2508.

- (3) In regulation 2 (descriptions of business for which appointed representatives are exempt) –
- (a) after paragraph (a) insert –  
“(aa) an activity of the kind specified by article 25A of the Regulated Activities Order (arranging regulated mortgage contracts) ;”;
  - (b) at the end of paragraph (c) omit “or”;
  - (c) after paragraph (c) insert –  
“(cc) an activity of the kind specified by article 53A of that Order (advising on regulated mortgage contracts); or”; and
  - (d) in paragraph (d), for “paragraph (a), (b) or (c)” substitute “any of paragraphs (a) to (cc)”.
- (4) In regulation 3 (requirements applying to contracts between authorised persons and appointed representatives), after paragraph (2) insert –
- “(3) A representative is also to be treated as representing other counterparties for the purposes of paragraph (1) where he –
- (a) makes arrangements (in circumstances constituting the carrying on of an activity of the kind specified by article 25A of that Order) –
    - (i) for persons to enter (or with a view to persons entering) as borrowers into regulated mortgage contracts with other counterparties, or
    - (ii) for a person to vary a regulated mortgage contract entered into by a person as borrower after the coming into force of article 61 of that Order with other counterparties; or
  - (b) gives advice (in circumstances constituting the carrying on of an activity of the kind specified by article 53A of that Order) on the merits of –
    - (i) persons entering as borrowers into regulated mortgage contracts with other counterparties, or
    - (ii) persons varying regulated mortgage contracts entered into by them as borrowers after the coming into force of article 61 of that Order with other counterparties.”.

#### **Amendment to the Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001**

**19.**—(1) The Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001<sup>(7)</sup> is amended as follows.

- (2) In paragraph (3) of article 1 (citation and commencement), for sub-paragraph (b) substitute –  
“(b) for the purposes of articles 6A and 6B on [*commencement of mortgage regulation*].”.
- (3) The existing article 6A<sup>(8)</sup> is renumbered as article 6B.
- (4) After article 6 insert –  
“**6A** – (1) An activity of the kind specified by article 53A of the Regulated Activities Order (advising on regulated mortgage contracts) where the advice in question falls within paragraph (2).  
(2) Subject to paragraph (3), advice falls within this paragraph in so far as –
  - (a) it consists of a recommendation to enter as borrower into a regulated mortgage contract with a particular person; and

<sup>(7)</sup> S.I. 2001/1227, as amended by S.I. 2001/3650.

<sup>(8)</sup> Article 6A was inserted by S.I. 2001/3650, article 3.

(b) in entering into a regulated mortgage contract that person would be carrying on an activity of the kind specified by article 61(1) of the Regulated Activities Order (regulated mortgage contracts).

(3) Advice does not fall within paragraph (2) if it endorses a corresponding recommendation given to the individual by an authorised person with permission to carry on an activity of the kind specified by article 53A of the Regulated Activities Order or a person who is an exempt person in relation to an activity of that kind.”.

**Amendment to the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2001**

**20.** In article 1 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2001<sup>(9)</sup> (citation and commencement), for paragraph (b) substitute -

“(b) for the purposes of article 8, on [*commencement of mortgage regulation*].”.

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<sup>(9)</sup> S.I. 2001/3544.

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 STATUTORY INSTRUMENTS
 

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2002 No.

**FINANCIAL SERVICES AND MARKETS**

**The Financial Services and Markets Act 2000 (Misleading Statements and Practices) (Amendment) Order 2002**

*Made* - - - - 2002

*Laid before Parliament* 2002

*Coming into force in accordance with article 1*

The Treasury, in exercise of the powers conferred on them by section 397(9) and (14) of the Financial Services and Markets Act 2000<sup>(1)</sup>, hereby make the following Order:

**Citation and commencement**

1. This Order may be cited as the Financial Services and Markets Act 2000 (Misleading Statements and Practices) (Amendment) Order 2002, and comes into force [*date of commencement of mortgage regulation*].

**Amendment of the Financial Services and Markets Act 2000 (Misleading Statements and Practices) Order 2001**

2.—(1) The Financial Services and Markets Act 2000 (Misleading Statements and Practices) Order 2001<sup>(2)</sup> is amended as follows.

(2) In paragraph (2) of article 1 (citation and commencement), for sub-paragraph (b) substitute -  
 “(b) for the purposes of articles 3(c), (ca) and (cb) and 4(c), on [*date of commencement of mortgage regulation*]”.

(3) In article 2 (interpretation), in the definition of “controlled activity”, for “paragraph 9 or 10” (in both places) substitute “paragraph 9, 10, 10A or 10B”.

(4) In article 3 (specified kinds of activity), after paragraph (c) insert -  
 “(ca) an activity which falls within paragraph 10A (arranging qualifying credit) of that Schedule, or agreeing to carry on such an activity;

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<sup>(1)</sup> 2000 c.8.

<sup>(2)</sup> S.I. 2001/3645.

(cb) an activity which falls within paragraph 10B (advising on qualifying credit) of that Schedule, or agreeing to carry on such an activity;”.

## STATUTORY INSTRUMENTS

2002 No.

**FINANCIAL SERVICES AND MARKETS****The Financial Services and Markets Act 2000 (Financial  
Promotion) (Amendment) Order 2002**

*Made* - - - - 2002  
*Laid before Parliament* 2002  
*Coming into force in accordance with article 1*

Whereas this Order adds activities to those that are controlled activities for the purposes of section 21 of the Financial Services and Markets Act 2000<sup>(1)</sup> and is therefore an Order to which section 429(4) of that Act applies;

Whereas a draft of this Order has been approved by resolution of both Houses of Parliament;

The Treasury in exercise of the powers conferred on them by section 21(9) and section 428(30) of the Financial Services and Markets Act 2000 hereby make the following Order:

**Citation and commencement**

1. This Order may be cited as the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2002, and comes into force on [*date of commencement of mortgage regulation*].

**Amendments to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001**

2.—(1) The Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 <sup>(2)</sup> is amended as follows.

(2) In paragraph (3) of article 1 (citation and commencement), for sub-paragraph (b) substitute -  
“(b) for the purposes of paragraphs 10, 10A, 10B and 26 of Schedule 1 (qualifying credit), on [*date of commencement of mortgage regulation*]”.

(3) In paragraph (2) of article 29 (communications required or authorised by enactments), for “paragraph 10” substitute “paragraphs 10, 10A or 10B”.

<sup>(1)</sup> 2000 c.8.

<sup>(2)</sup> S.I. 2001/1335.

(4) In paragraph (2) of article 30 (overseas communicators: solicited real time communications), in the definition of “relevant investment activities”, after “paragraphs 3 to 7” insert “or 10 to 10B”.

(5) In article 46 (qualifying credit to bodies corporate), for “paragraph 10” substitute “paragraph 10, 10A or 10B”.

(6) In Schedule 1, after paragraph 10 (providing qualifying credit) insert –

**“Arranging qualifying credit etc.**

**10A** Making arrangements –

(a) for another person to enter as borrower into an agreement for the provision of qualifying credit; or

(b) for a borrower under a regulated mortgage contract, within the meaning of article 61(3) of the Regulated Activities Order, entered into after the coming into force of that article, to vary the terms of that contract,

is a controlled activity.

**Advising on qualifying credit etc.**

**10B** Advising a person is a controlled activity if the advice is –

(a) given to the person in his capacity as a borrower or potential borrower; and

(b) advice on the merits of his doing any of the following -

(i) entering into an agreement for the provision of qualifying credit, or

(ii) varying the terms of a regulated mortgage contract entered into by him after the coming into force of article 61 of the Regulated Activities Order.”.

(7) In paragraph 11 (agreeing to carry on specified kinds of activity), for “paragraphs 3 to 10” substitute “paragraphs 3 to 10B”.

## **Annex B: Regulatory Impact Assessment**

### **the issues and objective**

1. **Issue:** The Treasury intends to give the Financial Services Authority (FSA) responsibility for regulating the selling of residential mortgages including the advice associated with the sales process. A separate consultation will follow later in the year to give the FSA similar powers to regulate general insurance intermediation. This paper concentrates mainly on mortgages except where inter related matters arise in the general insurance context.
2. **Objective**

The Treasury believes that mortgage regulation will:

- ?? Benefit millions of consumers by regularising standards and providing safeguards and minimum standards of mortgage advice
- ?? Simplify the regulatory landscape by introducing a single regulator for mortgage advice, general insurance and other retail investment business (eg pensions)

### **risk assessment**

3. The Julius group report<sup>1</sup> (para 3.17) recommended that only a statutory regulatory regime, covering mortgage advice, including that given by intermediaries, offered sufficient protection to

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<sup>1</sup> *Cracking the Codes for Customers*, Banking Services Consumer Codes Review Group May 2001

consumers, when it came to taking out the most significant financial transaction in their life.

4. Consumer groups too echoed these sentiments. The bulk of industry, including the Council of Mortgage Lenders, too called for statutory regulation.
5. The average mortgage is over £70,000, making it easily the largest single financial transaction most people are likely to make. There are over 4,500 mortgage products in the market place for potential borrowers to choose from at any at any one time, and over 1 million new loans (both for house purchase and re-mortgages) each year. Though the increase in choice is welcome, it brings in its wake increased complexity.
6. The consequences for borrowers making the wrong choice or getting the decision wrong is that:
  - a. consumers will either pay more than they would have done if there had been adequate straightforward, clear advice, and effective competition;
  - b. that they buy products they subsequently find they cannot afford or switch from; that lenders may find ways of picking and choosing which is the least onerous regulatory system (or avoid regulation altogether);
  - c. and that consumers may lose their homes through lenders pressing for repossession without giving consumers adequate opportunities for dealing with the situation.

### **benefits**

7. The present unregulated market leaves it to consumers to make the right choices for themselves in, probably, the most significant transaction in their lives. Well over half of people taking out mortgages turn to some form of advisor. Such advice as they

receive has no statutory rules governing either the competence of the advisor or the suitability of the advice he or she gives. Bad advice, leading to a wrong decision has the consequences described in para 6 above.

8. Regulation of the sales process, including such rules that the FSA would draw up governing disclosure and suitability of advice, is likely to avoid many of these problems for consumers, especially if coupled with other initiatives to raise consumer awareness in this area.
9. It could also help true competition to flourish in this area, because it would help correct the information asymmetry that presently exists against the customer, where the person selling the product understands the range of options available much better than the person buying it. On balance, regulation of advice can be expected further to help consumers to make informed decisions and contribute to effective competition – where consumers can exercise choice because there is a range of suppliers and they understand the product.
10. Businesses too would benefit. At present many firms, including at least 13,000 brokers have to comply with a wide array of requirements if they wish to offer a full range of services to their customers.
11. For example, a High Street broker typically offering personal pensions, general insurance and mortgages might at present have to comply with the requirements respectively of:
  - a. The FSA
  - b. The General Insurance Standards Council (GISC) and/ or the Institute of Insurance Brokers Regulatory Council
  - c. The Mortgage Code Compliance Board.

12. Their customers similarly would have to turn to the mechanisms laid down by each of these bodies in order to seek redress or compliance with standards.
13. Having to deal with the requirements of just one regulator, rather than several “quasi” regulators is likely to have benefits in costs for intermediaries, the majority of which are small businesses.
14. As a result the industry, including at least 13,000 small financial intermediary businesses, will now have a single set of rules (the FSA’s) to deal with, rather than a range of arrangements spanning voluntary codes, industry standard setting bodies as well as statutory regulators.
- 15.** The 1.1 million new mortgage (and re-mortgage) customers, and the vast majority of households who have general insurance policies (paying £ 20 billion in premiums each year) would benefit by having a single point of regulatory contact – the FSA – with standards which will be designed to safeguard the consumer interests in proportion to the risks they are likely to face.

### **compliance costs**

16. The benefits of the streamlined approach have been discussed above. The Financial Services and Markets Act (FSMA) 2000 places a statutory duty on the regulator – the FSA – to act proportionately and the regulator has already announced that “restrictions imposed on firms and markets should be in proportion to the expected benefits for consumers and the industry. In making judgements in this area, the FSA will take into account the costs incurred by firms and consumers”<sup>2</sup>. In addition, the Act obliges the FSA to consult on its proposed rules, to prepare a cost benefit analysis thereon and to have regard to

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<sup>2</sup> *A New Regulator for the New Millennium*, FSA January 2000

competition issues. The OFT keeps the regulating provisions (including rules) and practices of the FSA under review to establish whether they have significant adverse effects on competition.

17. In the context of cost, it is worth noting that the calls for regulation emanate from many parts of the industry itself, as well as consumer groups.
18. The industry is already committed to increasingly stringent forms of self-regulation through the Mortgage Code which effectively binds the preponderant majority of lenders and intermediaries in the sector. The costs associated with this self regulated regime are being incurred by the industry and will have increased as a result of additional Code requirements for training and competence standards, regardless of the decision to give FSA powers to regulate.
19. The incremental costs of imposing FSA regulation will in the final analysis depend on the precise nature of the rules that the FSA requires industry to follow. Under the FSMA, the proposed rules will themselves have to be the subject of consultation and a cost –benefit analysis, but in the last cost- benefit analysis<sup>3</sup> carried out by the FSA on a full blown statutory regime for mortgages, the indication was the extra costs to homeowners were likely to be in the order of recurring costs of £32 million and one-off costs of £36 million. To put this in some context, the estimated value of mortgage lending in 2001 was some £161.5 billion. For the avoidance of doubt, these costs represent the incremental cost over and above the cost of the planned level of voluntary regulation under the Mortgage Code . In other words, they do not take into account costs the industry already incurs, nor did they take into account the possibility of personalised

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<sup>3</sup> *A cost-benefit analysis of statutory regulation of mortgage advice*, FSA October 1999

disclosure, the costs associated with changes to financial promotion requirements or to post-sale disclosure, or the costs of capital for unauthorised mortgage lenders.

20. That costing is some two years old and will be revisited later in the year by the FSA. But it is probable that there will be benefits of synergy for a regime which regulates general insurance sales as well as mortgage advice, a scenario not envisaged in the previous analysis.

### **consultation**

21. The Treasury has consulted twice on mortgage regulation, in July 1999 and October 2000 respectively. Under those consultations, the Treasury proposed that the FSA regulate in a way which focussed on transparency of mortgage terms. There were no proposals to govern mortgage advice whether given by lenders or intermediaries.
22. It was partly as a feedback from these combined consultations, as well as the benefits of streamlining regulation for intermediaries providing a range of financial services, including general insurance, that persuaded the Treasury of the need to extend the scope of mortgage regulation to cover advice.
23. With this consultation, The Treasury is seeking views on the legal text to give effect to the policy it wishes to achieve. The FSA too will consult on its proposals for new rules to regulate under the new regime, and those rules will, by law, be subjected to a cost/ benefit analysis.

### **enforcement, sanctions, monitoring and review**

24. It will be for the FSA to enforce and monitor compliance by lenders. The FSA will have a number of sanctions available if lenders fail to comply including fines, and ultimately withdrawal of permission to carry on the business. But firms have the

safeguard of the right of appeal to an independent tribunal against decisions of the FSA.

25. The Treasury is committed as a result of its response to the Cruickshank Report<sup>4</sup> to reviewing the operation of the Financial Services and Markets Act after it comes into operation. And implicit in the FSA's approach to regulation is an assessment of the effectiveness of past regulatory rules that have been put in place. It's recent proposals on radically liberalising the existing rules on polarisation<sup>5</sup> is an example of this.

**HM Treasury**  
**February 2002**

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<sup>4</sup> *Competition in UK Banking, The Cruickshank Report- Government response*, HM Treasury, August 2000

<sup>5</sup> *Reforming Polarisation: Making the market work for consumers*, FSA Consultation Paper #121, Jan 2002

**Annex C: issues for feedback**

- 1** *Should any other regulated activities be included in addition to (or instead of) those listed? {paras 11-23}*
- 2** *Should any categories of exemption from the Financial Promotion Order be removed or created in the light of the new activities of advising and arranging? {paras 28-31}*
- 3** *Would disapplying the CCA s 155 £5 fee limit for transactions that do not go through, lead to difficulties for borrowers? What is the evidence? ? {paras 36 - 40}*
- 4** *Would the inclusion of the new activities of arranging and advising impact on securitisation of mortgage portfolios. If so, how, having regard to the approach adopted after the October 2000 consultation. {paras 41 -46}*
- 5** *Should the Part XX regime for professionals apply to the new regulated activities of mortgage advice and mortgage lending as described in {paras 48-51}?*
- 6.** *Should trustees benefit from the limited exclusion from regulation described above in relation to the activities of mortgage advice and arranging? {paras 52 -53}*
- 7** *Is the rationale for regulation as set out in the Regulatory Impact Assessment, reasonable? { Annex B }*
- 8** *Any other points?*