

MORTGAGE REGULATION CONSULTATION

Main issues arising from the consultation

Arranging

i) Introducers

What the consultation document says

Introducing falls under the definition of ‘arranging’. The position in the consultation document is that where a firm introduces a borrower to an authorised person, or an appointed representative of an authorised person, and the introduction is made with a view to the provision of independent advice to the prospective borrower, the introduction is excluded from the regulated activity of ‘arranging’.

What respondents said

A number of respondents wanted to exclude introducers that introduce a customer to any authorised firm. They said there are large numbers of firms such as estate agents and house builders who introduce customers to authorised firms that do not offer independent advice. Moreover, this reflects the current position under the Mortgage Code and to go down the route in the consultation document (and regulate introducers that introduce customers to firms that are not independent, but still authorised) would have a significant impact on the structure of the market. It would also affect thousands of firms that currently carry on mortgage-related introductions. They said that consumers who use introducers would be adequately protected by the fact that the authorised firms to which they are introduced are subject to FSA rules.

They questioned whether the proposed regulatory response was proportionate given the limited potential for consumer detriment, and the relatively low numbers of consumer complaints currently made in respect of introducers. One possible area of concern related to introducing in the sub-prime market where potential borrowers are likely to be vulnerable. But any suggestion that a loan has been sold inappropriately would be a matter for the FSA as regulator to pursue with the lender direct.

One respondent wanted all introducers to be excluded from carrying on a regulated activity, whether they refer a potential borrower to an adviser whether independent or not. This is because it seemed inconsistent to provide that a builder is not carrying on a regulated activity if he refers a borrower to an appointed representative of a life company for mortgage advice purposes, but is carrying on a regulated activity if he refers that borrower to one who is not independent.

On the other hand, two respondents supported the proposals in the consultation document because introducers could, in effect, be performing an advisory function.

HMT Decision

As no respondent disagreed with the proposed exclusion of introductions made with a view to the provision of independent advice, this exclusion is retained.

As to other views, the Treasury has concluded that there are sufficient safeguards built in later in the lending process (with lenders, advisors and arrangers all having to be authorised and comply with FSA rules) such that there is little consumer detriment involved in an introduction to an authorised person. The Treasury has, therefore, decided that introductions to any authorised firm, whether independent or otherwise, should be exempted from regulation. Similarly, the Treasury has concluded that introductions to appointed representatives should also be exempted, as the same protections will be in place.

The Treasury has, however, set some conditions: that the introducer must not handle any money paid by the client in connection with any transaction that the client enters into with the authorised person as a result of the introduction (other than money that is legitimately due to the introducer for any services rendered to the client); and that before making the introduction, the introducer must disclose if he is a member of the same group as the authorised person to whom the introduction is made, together with any financial interest that he has in making the introduction.

ii) Packagers

What the consultation document said

There was no mention of packagers in the consultation document.

What respondents said

A number of broad categories of packagers were identified: Mortgage clubs – providing information services for intermediaries; Mortgage packaging companies – providing services to the benefit of lenders; Broker packagers – offering intermediaries a complete outsourcing service; and correspondent lenders providing front-end administration services for lenders.

Respondents were concerned that the terms of the Regulated Activities Order (RAO) as drafted caught ‘packager’ firms that merely act as an administrative business-to-business conduit between the intermediary and lender. These do not deal with the prospective consumer, nor do they influence product choice. They said that this went against the policy intention that mortgage regulation is intended to cover any firm directly involved in helping the consumer to choose the particular product with a particular lender.

HM Treasury decision

The Treasury takes the view that, as the proposed legislation is drafted, the first two categories of firm mentioned above (mortgage clubs and mortgage packaging companies) would not carry on the regulated activity of arranging, while the others (broker packagers and correspondent lenders) may or would be and could therefore be subject to regulation. The Treasury has concluded that no further amendment is required to the legislation to take account of packager firms.

Advising

i) General

What the consultation document says

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). In practice, this would mean advising a borrower to take out a specific mortgage with a specific lender. Strategic or generic advice would not be regulated. This follows the format for investment advice.

What respondents have said

Some respondents thought that there should be room in the FSA regime for execution-only products. Regulation of advice should not stop consumers from exercising the choice to buy products off-the-shelf. In addition, they wanted clarity between advice and information. It is apparent that most lenders and intermediaries claim to have given advice to a consumer when they have merely matched the consumer's preferences and expectations to the products available to them. Matching is not advice. It is merely aiding the consumer to select their preferred product.

One respondent asked whether mortgage advice should be regulated in the same way as investment advice.

Finally, one respondent thought that the scope of the activity was too narrow and that it should extend to advice on the merits of obtaining a particular type of mortgage, or to approach a particular lender for a mortgage. This was based on the recognition that generic advice may influence the consumer's decisions and ultimately leads to the consumer entering into a particular regulated mortgage contract.

HM Treasury decision

It was never the Treasury's intention to rule out execution-only and indeed that still exists. As to respondents' concerns in relation to matching, the Treasury believes that this is 'arranging' mortgages and is caught by those provisions. The Treasury concluded that the definition of advising should follow that for investment business as in the consultation document. There is, therefore, no need to alter the definition of advice in the consultation draft of the Regulated Activities Order (RAO).

ii) By way of business

What the consultation document said

That advice and arranging on an un-commercial basis by Citizens' Advice Bureaux (CABx) and charities, personal loans to friends and families, and so on, would not fall within the regulated mortgage regime as they were not carried on 'by way of business'.

What respondents have said

Most respondents agreed with the principle that money advice agencies should not be regulated for advising on regulated mortgage contracts but wanted clarity by means of a specific exclusion or exemption in the legislation. This was because there was some disagreement whether money advice agencies actually were not run as a business in its broadest sense. They thought there was a probability that consumer advice agencies such as CABx will be carrying on the regulated activity of advising on regulated mortgage contracts. One option could be to design an explicit exemption or exclusion for CABx and other agencies that offer counselling and advice.

One respondent suggested that there was an anomaly in the legislation. This was that one-off business transactions would be caught under the current 'by-way-of business' definition. This was in contrast to the definition on investment business where a firm had to be 'carrying on the business' of the activity.

One respondent said that the definition of advising included the activities of commercial debt counselling. They supported this by pointing to the fact that such counsellors give borrowers advice in relation to their existing mortgage commitments and other loans that may lead to changes to their mortgage arrangements.

On the other hand, another respondent questioned the appropriateness of any exclusion or exemption for CABx and other community groups engaged in the welfare of their client base, and also questioned whether it was appropriate that such agencies should escape regulation as a result of the 'business test'. Whilst it was clear that such firms are not commercial in nature and so are not acting 'by way of business', it is important that consumers receive advice from competent advisers. Consumers that use these organisations are often vulnerable and the advice they receive may be crucial to their

future financial security. As such, regulation of such agencies is equally important as it is for commercial organisations.

HM Treasury decision

The Treasury cannot say categorically that all money advice centres, CABx, charities and so on are not carrying on the activity by way of business as this will depend on the circumstances in each individual case. Ultimately, the test is set by the Business Order, but the sort of factors that are likely to be taken into account will vary from case to case but could include: whether a person provides a service without any expectation of reward or payment of any kind; whether clients pay for the advice; whether the individuals giving it are paid; the frequency with which the activity is carried on; whether the body advertises its services; and so on. In the Treasury's view, this points to CABx and others not being caught even without a separate exclusion.

But the Treasury has noted that there appears to be an anomaly between the definition of by-way-of-business under investment business and that for mortgages and has decided that the definition should be the same for both. The business tests for advising and arranging regulated mortgage contracts have, therefore, been harmonised with the equivalent investment business activities.

Polarisation (see also appointed representatives)

What the consultation document says

There was no mention of polarisation in the mortgage consultation document.

What respondents have said

A number of bodies responded with comments on polarisation seeing a read-across with the FSA's consultation paper – CP 121. Some were concerned that the FSA proposals on depolarisation should not be dealt with in isolation from the HMT consultation document. Finalising the RAO before decisions are taken on CP 121 is unhelpful timing. Whilst CP121 is concerned with investment business, market failures highlighted in that consultation could similarly occur in the mortgage market. Some commentators consider that the number of independent mortgage advisers will fall as many consumers will not be prepared to pay a fee for advice and advisers will not generate enough income to stay in business.

HM Treasury decision

These were matters to be taken into account by the FSA as part of its consideration of the responses to CP 121. The FSA will consider the links between CP121 and mortgages in developing its proposals for mortgage regulation.

Appointed representatives

What the consultation document says

The Government intends to extend the appointed representatives regime to the new regulated activities of advising and arranging regulated mortgage contracts.

What respondents have said

Respondents' concerns stemmed from the position that, under FSMA 2000, a person cannot be both an authorised person and an appointed representative of an authorised firm. This being the case, they thought that the regime might have the effect of restricting consumer choice in the market place. Many independent mortgage advisers have access to the whole range of mortgage products, but are also appointed representatives for a particular life insurance company. Such independent mortgage brokers would need to make a choice between being authorised and giving up appointed representative status for life products, or becoming an appointed representative of a mortgage lender. Respondents thought that appointed representative firms could only have one principal.

HM Treasury decision

No respondent had a fundamental objection to extending the appointed representative regime to mortgages. Rather they were concerned with the detailed rules that may surround the regime. These matters are for the FSA who will be consulting on the issues in due course.

Answers to specific questions

1) Any other activities to be included?

Respondents suggested that Buy-to-let mortgages, Home Reversion Schemes, and debt collection be regulated activities.

HM Treasury decision

The Treasury believes that the definition of a mortgage is the right one, and that there should be no changes.

2) Exemptions from the Financial Promotions Order?

What the consultation document says

The financial promotion regime for mortgage lending and administration would be extended to advising and arranging qualifying credit. Normally a communication will need to be issued by an authorised person or the contents approved by an authorised

person. Exemptions will include: communications by central government and LAs; communications between companies within the same group; and communications to high net worth companies or sophisticated investors.

What respondents have said

Most agreed with HMT's approach, but cautioned that Consumer Credit Act (CCA) and FSA regulated adverts should be harmonised as much as possible. Some questioned the exemption for high net worth or sophisticated individuals.

One respondent was concerned about the advertisements that cover CCA and FSA regulated credit, the treatment of adverts for brokers' services, and the treatment of composite adverts.

Others said that it is likely a significant number of credit brokers will be carrying on both ancillary credit business (within the meaning of the CCA) and the regulated activities of arranging (and possibly advising) in relation to regulated mortgage contracts. It was thought that they would be subject to dual regulation - that is, they will need to be both FSA authorised (or appointed representatives), and have a CCA license.

In the interests of removing the potential for dual regulation of advertising a number of suggestions were made, including placing all consumer credit advertising under the FSA. Alternatively, it was suggested that all advertisements that advertise the services of credit brokers (whether or not they offer to arrange credit by way of a regulated mortgage contract) should be covered by the CCA advertising rules only.

One respondent commented on an apparent anomaly. Whilst the Financial Promotion Order exempted communications by local authorities, there did not appear to be an equivalent exemption for communications issued by registered social landlords and the Housing Corporation. This was seen to be inconsistent with the fact that local authorities, registered social landlords and the Housing Corporation are all exempt in relation to the regulated activities of mortgage lending, arranging and advice by reason of paragraphs 47 and 48 of the Schedule to the Exemption Order.

On the other hand, one respondent considered that there should be no exemptions, so LAs and high net worth individuals should be covered by the Financial Promotion rules.

HM Treasury decision

The Treasury favoured the financial promotion regime as set out in the consultation document.

3) *The Consumer Credit Act (CCA) £5 limit and s.155 CCA*

What the consultation document says

Section 155 of the CCA restricts the brokerage fee to a limit of £5 in relation to transactions that do not lead to the client entering into a contract. The amendments made to this provision (in the draft RAO amendment Order) dis-apply s.155 in relation to fees charged by credit brokers in connection with services that consist of introducing a potential borrower to a regulated mortgage lender with a view to the potential borrower obtaining credit under a regulated mortgage contract. We believed that dis-applying this provision is justified because there may well be occasions when the appropriate advice is not to take out a mortgage.

What respondents have said

Respondents said that the consultation document mis-describes the effect of s.155. In fact s.155 applies only where there has been an introduction to a lender or another broker that does not result in a contract.

Having explained that, there was a broad range of views. Some wanted the £5 limit to remain for consumer protection reasons, others wanted it increased because it did not cover the amount of work that a broker puts in, some wanted it to be removed altogether, and others wanted it to be removed if similar provision was included in FSA rules.

HM Treasury decision

If s.155 were not amended in the way proposed, the £5 cap, as applied to mortgage intermediaries regulated under FSMA, would only cover introductions that do not result in the borrower entering into a regulated mortgage contract. There would be no statutory mechanism of redress, requiring the refunding of fees, for other consumers. If s.155 is dis-applied, the FSA will be able to make rules that confer in a wider range of circumstances the kind of protection that is afforded by s.155 in a more limited range of circumstances. The Treasury, therefore, decided not to change the policy in the consultation document and will be carving-out s.155 of the CCA.

4) *Securitisation*

What the consultation document said

HMT's general policy is to ensure that where regulated mortgage contracts have been securitised and are being administered by an authorised person pursuant to an administration agreement, the special purpose vehicle or a trustee associated with it, is not to be treated as carrying on regulated activities in relation to those securitised contracts. Respondents were asked to consider whether the extension of FSA regulation to advice and arranging affected that policy and/or if the RAO needed amending to give effect to that policy in relation to the new regulated activities..

What respondents have said

Whilst most respondents did not think the extension of regulated activities to include arranging and advising impacted adversely on the securitisation market, others thought otherwise. The main concern was that an administration agreement could be construed as constituting the making of ‘arrangements’ by the special purpose vehicle/and or trustee with an originator or administrator to enter into new regulated mortgage contracts with borrowers and that entering into that administration agreement could therefore be a regulated activity. These respondents wanted certainty and suggested some technical drafting changes that could clarify the position. The respondents who expressed concerns also suggested that there was a risk that, where the administrator carried on the regulated activities of arranging or advising in relation to securitised regulated mortgage contracts pursuant to the terms of the administration agreement, the SPV or trustees might be treated as also carrying on those regulated activities.

HM Treasury decision

The Treasury has agreed to make certain technical amendment to take account of respondents’ concerns. These consist of the new exclusions to be inserted into the RAO as articles 29A and 54A.

5) *Part XX Professionals*

What the consultation document says

That the Part XX regime should apply to the activities of mortgage advice and arranging in the same way as it currently applies to the activities of investment advice and arranging. Therefore professionals will be able to carry on both of the proposed activities without being authorised persons, subject to the restriction that the Part XX regime will not apply, for the purposes of the new activity of advising, where they recommend a particular regulated mortgage contract with a particular lender. Professionals will need authorisation or appointed representative status if they recommend a particular product.

What respondents have said

Most respondents supported HMT’s approach in respect of professionals. They said that solicitors undertaking conveyancing should not be required to be authorised merely because they offer general advice to the borrower. But where the solicitor is making a positive recommendation of the products of a particular lender, they should require authorisation.

Other respondents were not convinced that mortgage advice should be treated in the same way as investment advice. The proposed amendments to the Non-Exempt Activities Order (NEAO) would prevent solicitors from recommending particular mortgages under Part XX of FSMA. Mortgage advice did not require the same level of knowledge and competence as investment advice and should be treated differently. Moreover a

mortgage does not necessarily attract the same risks to clients as selecting some forms of investments. HMT's proposals would restrict the market and consumers may well lose a source of objective advice from professional advisers. In addition, they would appear to restrict professional firms from providing advice in conjunction with a Power of Attorney.

On the other hand, other respondents rejected the proposal that professionals should be exempted from authorisation. They are unlikely to have received any training in the wide range of retail financial products and services and may give inappropriate advice. Given the general move to improve standards in the intermediary sector, this was considered to be contradictory.

HM Treasury decision

The Treasury could see the arguments on both sides, but believe that the right balance has been struck between the ability of professionals to advise their clients without fear of contravening FSA rules, and the appropriate level consumer protection. There should be no change to the policy set out in the consultation document.

6) *Trustees*

What the consultation document said

In the case of investment business, there is an exclusion for trustees, nominees, and personal representatives who carry on investment advice and arranging provided eg the trustee is only remunerated in his capacity as trustee. The government will apply this exclusion for trustees who advise on or arrange mortgages.

What respondents have said

Most respondents supported HMT proposals.

One anomaly was identified in respect of trustees who 'by way of business' enter into regulated mortgage contracts. It has been suggested that article 66 of the RAO be amended to include entering into and administering (as well as advice on) regulated mortgage contracts so that all mortgage activities are on an equal footing.

HM Treasury decision

The Treasury has decided to extend the exclusion for trustees, nominees and personal representatives so that it now also applies to the regulated activities of entering into (as lender), and administering a regulated mortgage contract. New paragraph (6A) to be inserted into article 66 of the RAO makes that extension.

7) *The rationale for regulation and the Regulatory Impact Assessment*

What respondents have said

Most respondents generally agreed with the rationale provided the approach taken by the FSA is light touch and proportionate, but say that it is not possible to state categorically that the costs of changing from one system to another will be relatively modest. For example, one respondent said that, in principle, the introduction of a single regulatory contact should help lenders and borrowers alike, but they remain to be convinced that the compliance costs arising from the proposals will be low.

HM Treasury decision

The Treasury has noted the comments.

8) *Other points*

i) Business lending

What respondents have said

A couple of respondents made representations in respect of the impact on the small business banking market of the definition of a regulated mortgage contract. They say that there are two separate banking markets: personal customers and businesses. Business borrowers may be choosing between different types of security as well as different lending products (for example leasing or factoring) and not just different mortgage loan products secured on a residential property. Businesses do not adopt the same decision making processes as individuals. The Treasury's measures pose a real threat of increasing cost and reducing the availability of credit in the small business market. They urge HMT to work closely with the FSA to ensure a separate and proportionate regime is established for the business lending market, and that this recognises the fundamental differences between this and the quite separate personal market.

HM Treasury decision

The Treasury has decided that there should be no change to the definition of a regulated mortgage contract. However, the FSA are able to use their different tools in different ways and will consider and consult on whether some accommodation could be made in this area.

ii) Definition of a regulated mortgage contract

What respondents have said

A couple of respondents reiterate their view that the definition of a regulated mortgage contract will not protect everyone. They want the FSA to regulate all loans secured on

property including second charges, and loans for properties outside the UK. They also want HMT to revisit the 40% residential threshold.

HM Treasury decision

No change to the definition.

iii) variations

What respondents have said

A number of bodies suggested regulation in this area should be proportionate to the risk. In addition, some suggested additional examples of variations to mortgages. These were:

- increases in charges for redemption and de-coupling rates from BoE rate or LIBOR; and
- release from, or addition of property to, the security.

HM Treasury decision

HM Treasury has noted the views.

iv) Home Improvement Agencies

What respondents have said

One respondent suggested that Home Improvement Agencies should be exempted from regulation. HIAs facilitate loans for home repairs and adaptations. They provide services to individual clients (the elderly and disabled) but do not do so 'by way of business'.

HM Treasury decision

No specific exclusion. But if the HIA is not carrying on the activity by way of business – see above for changed definition – they have no need to fear regulation.

v) Local authorities, registered social landlords (RSLs)

What respondents have said

Few respondents commented on this. One respondent supported the extension of the exemptions in respect of local authorities and social housing because: they are already subject to separate regulation and government scrutiny; DTLR has committed itself to providing guidance to LAs to mirror FSA requirements; and the mortgage activity is different in character to that undertaken by commercial lenders.

On the other hand, a couple of respondents were concerned because LA staff are unlikely to have expert knowledge about loan products, and for them to be able to advise customers about potentially highly complex products without being authorised persons appeared to contradict the Government's policy of regulating mortgage advice. It was suggested that LA staff should act as introducers, rather than advisers, to avoid the need for authorisation. Appropriate protections should be provided to customers that seek advice on equity release and home improvement loans via local authorities and housing associations. The FSA regime should be extended or a similarly robust regime put in place.

One respondent sought an exemption for Community Development Finance Initiatives that have a social aim. Alternatively, they ask for an exemption for mortgages under £10 – 15,000 on the basis that they meet CCA requirements.

HM Treasury decision

No change.

vi) Home reversion schemes

What respondents have said

Home reversion schemes are equity release schemes that involve the sale of the property by the 'borrower' to the person providing the finance. Mortgage-based equity release schemes are covered under the FSA regulation, but home reversion schemes are not. Respondents said that these schemes were interchangeable but the risks are greater in a home reversion.

HM Treasury decision

The Treasury does not consider that it has the power to give FSA responsibility for regulating home reversion schemes. These are not financial services products, but are sale and purchase arrangements in relation to real property.

vii) Debt collection

What respondents have said

That debt collecting in relation to regulated mortgage contracts should be regulated.

HM Treasury decision

The regulated activity of 'administering' a regulated mortgage contract expressly includes 'taking any necessary steps for the purposes of collecting or recovering payments due under the contract from the borrower'. Where debt collecting involves

these activities, a firm will need to be authorised unless it can take advantage of a relevant exemption.

**HM TREASURY
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