



Association of Finance Brokers response to HM Treasury's consultation paper on Mortgage Regulation

Introduction

The Association of Finance Brokers (AFB) is the trade association that represents intermediaries operating in the secured loan (second charge mortgages over residential properties) industry. The AFB represents brokers who are responsible for approximately 75% by volume and value of secured loans in the intermediary channel. Membership of the AFB is voluntary and on a corporate or individual basis.

AFB was established to promote the views of secured loans brokers operating in the UK and focuses on lobbying delegates in the Treasury, the Office of Fair Trading (OFT), as well as the FSA, the government and EU policymakers. In doing so, it aims to promote the interests of the industry in a constructive way that connects regulators and lawmakers with the "front line" of the secured loans market.

AFB welcomes the opportunity to respond to HM Treasury's consultation paper on Mortgage Regulation.

This paper only addresses the issues that are relevant to AFB members, those set out in chapters two on the regulation of second charge mortgages, which is of direct interest to our members.

Second-charge lending

Introduction

The consideration by HM Treasury to bring the second charge lending under the scope of the same regulator as first charge lending is welcomed, in principle, by AFB. AFB has supported second charge lending coming under the same regulator as first charge lending since its inception in 2006.

Proposals

The government paper *'A Better Deal for Consumers'* set out proposals to strengthen the UK's consumer credit regime by tackling consumer protection issues in particular parts of the consumer credit market; raising standards in decision-making across all regulated consumer credit products and making the regulatory regime for consumer credit effective for all consumers.

We do not believe that OFT regulation has been shown to be insufficient in delivering appropriate regulation of second charge lending. Increasing FSA's scope to include second charge lending would however impose an additional level of regulation through FSA's prudential requirements and conduct of business rules.

Closer working between OFT and FSA may result in some objectives being achieved. However, moving second charge lending under FSA's remit would allow the regulatory practices that are already applied to first charge mortgage firms, such as around prudential requirements and conduct of business rules, being applied to second charge lending.

We would raise concern over the levels of likely savings in compliance costs for firms that would otherwise be subject to both the FSMA and CCA regimes. Even if second charge lending regulation is moved to FSA most intermediaries will still be required to hold a consumer credit licence, and bear the cost of doing so. This is because of the requirement to hold a Category E credit licence to cover discussions of outstanding debts. Firms that are involved in discussions with clients regarding outstanding debt commitments, regardless of whether a fee is charged for the advice or not, are required to hold this category of licence. As this paper acknowledges, in recent years borrower demand has increased for second-charge mortgages used to consolidate existing credit, in particular by borrowers with impaired credit records. As such, given that consolidation is recognised as a key driver for consumers choosing to take out second charge borrowing, it is likely that the cost of complying with the OFT's consumer credit licence is unlikely to be reduced.

We would support the Government's view of not considering making any fundamental changes to the wider framework of consumer credit regulation until after the Consumer Credit Directive has been implemented.

The European Commission has carried out work in its Mortgage White Paper and its review on Credit intermediaries. It is currently looking at responsible lending and borrowing in the EU. The current European Commission's thinking does not draw a distinction between first and second charge lending and we are unaware of any EU member state that segments its regulation in the same way that the UK currently does. As such, we believe that it is a logical step that a single UK body regulates both first and second charge lending.

However, whilst this may be a logical step and the European Commission may not draw a distinction between first and second charge lending, first and second

mortgage are clearly used for different purposes by UK consumers. First charge lending will often be linked to a property purchase or a full remortgage of the mortgage debt, often to raise additional fund or to achieve a better interest rate.

A second charge loan may be appropriate for a variety of circumstances. Often a consumer will be tied into a long-term mortgage product with a complete rate and, therefore, will not want to remortgage. However, if they want to raise additional borrowing, without changing their first charge mortgage, a second charge loan can be of benefit to them. Raising a second charge loan on a property can provide substantially lower rates than unsecured borrowing offers. The loan could potentially be used for any purpose such as making improvements to property through to the consolidation of existing, more expensive debts.

Any changes to the regulation of second charge lending will need to acknowledge the differences in use between the two forms of borrowing and the comparative risks they present.

Regulation of second-charge mortgages – consultation questions

Question 1: Do you agree with the analysis of the second-charge mortgage market?

Yes.

Question 2: Do you agree that extending the scope of FSA mortgage regulation to include the second-charge mortgage market would achieve the Government's objective of ensuring a fair, stable and efficient market for second-charge mortgages?

It is very difficult to conclude whether extending the scope of FSA mortgage regulation to include second charge mortgage will achieve the Government's objectives of ensuring a fair, stable and efficient market for second charge mortgages, without being fully aware of how FSA will implement the regulation.

If we can assume that second charge mortgages will be incorporated into the MCOB regime, then this is likely to increase the regulatory controls imposed on second charge mortgage firms. However, some firms may already be subject to FSA regulation as some will already be involved in the first charge mortgage market.

Many of our members have been calling for FSA regulation of the second charge market since AFB's inception in 2006. We believe that, in principle, second charge regulation could achieve the Government's objectives in this sector. However, any actual outcomes would not only be dependent on the rules that the

regulator applies to the second charge lending market but also on competent implementation and supervision of those rules.

Consideration will need to be given to whether FSA's remit will result in second charge lending being brought directly under FSA's MCOB rules or if second charge lending will come under a subsection of MCOB, similar to that of equity release and sale and rent back. Alternatively, regulations could be carried out under FSA's scope but the current CCA rules could still be applied.

If CCA rules are not carried across to FSA then consideration will need to be given to what the new format for second charge loan agreements should be. Removing CCA agreements and applying a mortgage style KFI document would result in substantial additional cost for the second charge loan industry.

Given the work being carried out in Europe on the introduction of European Standard Information Sheet, it could be more appropriate to wait for its adoption before changing the format of second charge lending documentation.

Question 3: Do you consider that any further action would be necessary in order to ensure that any transfer of responsibility for regulating second-charge mortgages from the OFT to the FSA would not result in a loss of consumer protection?

We believe that moving second charge mortgages to the FSA should enhance consumer protection, that is not to say that OFT protection has not been effective but simply that FSA will impose an additional level of regulation through its prudential requirements and conduct of business rules. Furthermore, consumers will also benefit from having the additional protection offered by FSCS.

However, the current OFT's regulatory regime does apply some forms of consumer protection which are not applied under FSA's rules. FSA does not currently apply a consideration period under MCOB, although it could be argued that by the nature of most mortgage contracts a period where a consumer can withdraw already exists.

Currently most of the fees associated with taking out a second charge loan are rolled up into the borrowing and generally the valuation fee is paid by the broker prior to the loan completing. The cumulative effect of second charge lending coming under FSA's scope and the proposals made in FSA's mortgage market review paper surrounding the banning of fees being rolled up into the loan, could result in restricting consumers access to this product.

FSA's mortgage market review's raised concerns about borrowing being used for consolidation purposes and proposes restrictions on levels of equity withdrawal. If access to second charge lending were to be restricted then this could drive

consumers away from proactively trying to manage their debts through consolidation and towards IVAs or bankruptcy as their options become limited.

Question 4: Do you believe there are any other ways to mitigate the potential future risks posed by second-charge mortgage markets?

We believe that FSA regulation of second charge mortgages is the most appropriate way to mitigate any potential future risks in the second-charge mortgage markets.

Question 5: Do you agree with the costs and benefits of the options under consideration in relation to second-charge mortgages, as set out in the Impact Assessment?

Yes.

Question 6: Do you agree that FSA regulation of second-charge mortgages should be limited to lending to individuals and trustees?

We do not believe that limited companies and/or business-to-business lending should be included within FSA's scope to regulate of the second charge mortgage market.

One of FSA's prime objective is to "help retail consumers achieve a fair deal". It is not the objective of the FSA to regulate business-to-business lending or commercial borrowing, nor is it within its remit to do so. FSA does not currently regulate business-to-business lending as part of its regulation of first charge mortgages. We would not support any proposal for FSA's to regulate commercial transactions of this type.

Question 7: Do you agree that the proposed new definition of a regulated mortgage contract would include second-charge mortgages and continue to include first-charge residential mortgages in its scope?

Yes.

Question 8: Do you agree that the regulated activities in relation to regulated mortgage contracts should apply to second-charge mortgages?

Yes

Question 9: Do you agree that the exemptions and exclusions that apply in relation to regulated mortgage contracts are appropriate for second-charge mortgages?

Yes.

Question 10: Do you agree with the proposed arrangements for dealing with second-charge mortgages entered into before the date specified in the draft order?

We agree with the draft proposals that the definition would not have retrospective force.

AFB

10 February 2010