

MORTGAGE CREDIT DIRECTIVE **FULL GUIDE**



Overview

The Mortgage Credit Directive (MCD) - an EU-wide framework of legislation and conduct for mortgage activity - is due to be implemented into UK law by March 2016.

The aim of the MCD is to create a single market for mortgages, ensuring that responsible lending becomes the norm across Europe and to provide better information and greater protection for the consumer by stress-testing their ability to repay a mortgage in changing economic circumstances.

With strict mortgage practices already in place in the UK following the launch of the Mortgage Market Review (MMR) in April 2014, the government do not believe that the MCD will have a significant impact on the UK market over and above the existing regulatory framework.

However it will mean a certain level of change to the rules currently set by the Financial Conduct Authority (FCA) which will require UK lenders and brokers to adapt their current processes and systems.

What are the main changes to look out for?

The key changes to mortgage lending as a result of the MCD are as follows:

- Some buy-to-let mortgages will become regulated by the FCA
- There will be a move to a Europe-wide standardised set of disclosure information for consumers
- Changes to the requirements for foreign currency loans
- Review of lender's sales processes and documentation

Mortgage Credit Directive Changes - In Detail

European Standardised Information Sheet

The European Standardised Information Sheet (ESIS) will replace the current Key Facts Illustration (KFI). Lenders have three years to implement this change, and must begin using the ESIS by 21st March 2019. Until then lenders can continue to issue a KFI, however additional disclosures will be required in order to meet the same level of information as the ESIS.

First and Second Charge Lending

Whereas the MMR only covered first charge mortgages the MCD requires that all first and second charge mortgages be treated equally.

At present first charges are regulated under the FCA regime, and second charge mortgages by the OFT and Consumer Credit Act. The new ruling means that all consumer mortgages, whether first or

second charge will be regulated by the FCA.

Any lender or broker currently advising on second charge mortgages will be required to adopt the MCD rules by 21st March 2016. In order to carry out any second charge mortgage business a firm must be authorised by the FCA and hold the correct permissions. There is currently no KFI equivalent for second charge mortgages but the ESIS must be adopted by 21st March 2019.

Annual Percentage Rate of Charge (APRC) and Second APRC

Lenders currently use an Annual Percentage Rate (APR) which allows the consumer to compare the overall cost of a mortgage. In accordance with the MCD, this will now be known as an Annual Percentage Rate of Charge (APRC).

The APRC is calculated in a similar way to an APR; however it follows the rules of the MCD. There is also the requirement of a second APRC for any loans which have a variable rate of interest (i.e. Standard Variable Rate and Tracker mortgages).

The second APRC will be an illustrative example of the cost of the mortgage using a 20 year high interest rate - based on a relevant external rate or the benchmark rate set by the FCA.

Consumer Buy-to-Let Mortgages

The MCD introduces a new category of buy-to-let mortgages known as Consumer Buy-to-Let (CBTL). This covers any buy-to-let mortgage that is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower'.

The CBTL mortgages will come under the supervision of the FCA - where previously they weren't regulated - however there will be no requirement of advice in the same way as with a standard residential mortgage.

Any lender wishing to offer a CBTL loan must hold the relevant FCA permissions. Intermediaries will be required to determine whether an application is a CBTL or BTL as typically no further checks will be done by the lender to determine the status of the mortgage.

What is the difference between CBTL and BTL?

If a customer is applying for a buy-to-let mortgage solely for the purposes of renting out the property with no intentions of living in it, this will be considered a business proposition and would be classed as a BTL. However, if the customer has previously resided in the property and is applying for a buy-to-let mortgage this will be treated as a CBTL mortgage.

An applicant with a portfolio of properties will typically be thought to be applying for a BTL.

Foreign Currency Loans

The MCD classes a foreign currency loan as either:

'A loan in a different currency from that in which the customer receives the income or holds the assets from which the credit is to be repaid; or a loan in a different currency from that of the country in which the customer is resident'.

For example, a customer may be resident in the UK but work overseas and be paid in dollars, therefore requiring a foreign currency loan.

Under the ruling of the MCD, any firms dealing with foreign currency loans are required to disclose any potential impact of fluctuations in the exchange rate. Customers must be notified if there is an adverse 20% exchange rate movement and extra measures should be put in place to offer consumers protection against any risks, such as being able to revert to an alternative currency.

Due to the low demand for foreign currency loans, many lenders do not offer this option, stating that only sterling income will be assessed for mortgage affordability.

Early Repayment of loans

The MCD requires that it be a general right of the consumer to be able to pay their mortgage off early if they so wish and that the lender must clearly state the implications of this i.e. providing them with clear and transparent information on early redemption charges.

Lenders Sales Processes

Due to the strict affordability checks and consumer protection brought in by the MMR, the MCD shouldn't bring too much change however lenders will be expected to tighten up their sales processes and remain compliant with the new regulations.

Alternative Finance Options

Lenders must now inform customers who are wishing to increase borrowing secured on their home i.e. remortgaging to release equity or alternative options. In certain circumstances an unsecured loan or a second charge mortgage may be more appropriate for them, rather than increasing the borrowing on their original mortgage.

If a lender does not offer the alternative finance options, then they are not required to advise on the suitability of these services.

Binding Offer

The MCD requires that when approving a borrower for a loan, the lender must offer the customer a 'binding offer' which will be subject to lawful conditions. Currently a lender will typically offer a conditional offer, which is subject to further checks.

A conditional or indicative offer is still permissible under the terms of the MCD, providing that a legally binding offer is made at a later stage.

A binding offer may still contain certain conditions, as this is required to counteract fraud etc.

Alongside the binding offer, the lender must also offer the customer a seven-day 'reflection' period. The binding offer cannot be withdrawn by the lender during this period.

The reflection period is designed to give the customer time to review the offer, and assess the implications of taking on a mortgage, however if they wish to accept the offer before the seven-days has passed, they can do so.

Staff Competency

All firms dealing with mortgage business are under a duty to act fairly and professionally to their consumers and they must ensure that all members of staff have the appropriate level of knowledge, training and qualifications. This also applies to those offering second charge mortgages – these firms will now face the same level of requirement as those dealing with first charge mortgages.

Specific Changes for Intermediaries

Intermediary Disclosure

If requested to do so, intermediaries must let the customer know which lenders they work with. For intermediaries that are paid commission, they must provide details of this also. Disclosures to the customer must be made in writing (email correspondence is acceptable).

Adequate Information

Before an offer is given to the consumer, they must be provided with an 'adequate explanation'. This requires the broker to provide the essential characteristics of the product on offer, the impact that this particular product could have on the customer (such as what would happen if they were to default) and disclosure regarding any ancillary products or services that may be bundled with the main product being sold.

Independent Advice

The MCD puts restrictions on brokers and advisers who call themselves independent. Under new rulings a firm can no longer call themselves independent unless they offer advice and recommend products from the whole of the secured lending market. This also includes second charge mortgages where these are offered.

Passporting

Once authorised under the terms and conditions of the MCD, an intermediary will be able to operate in another EU country, without the need to for any additional authorisation.

Qualifications

All brokers will need to hold a Level 3 qualification from 21 September 2018 (e.g. CeMAP)

What are the next steps?

The majority of information regarding the MCD and the changes involved has been available from the FCA since September 2015, some firms have already begun to adopt the new regime, however all firms will need to have done so by 21st March 2016 - with a further three year grace period to adopt the European Standardised Information Sheet.

All firms dealing with mortgage business will need to familiarise themselves with the new regime under the MCD, however if already compliant with the rules of the MMR, the changes shouldn't bring too much of an impact.

For those dealing with second charge mortgages, there will be much more change involved - now having to be authorised under the FCA.

If not already done so, it is imperative to start putting arrangements into place in order to gain authorisation from the FCA. The process can often be lengthy so in some cases plenty of time should be allowed for the application to be processed and approved.

Communication with lenders

It's important for brokers to have a continual line of communication open with lenders in order to establish when they are adopting the new rules, particularly in the case of the ESIS as they have until 21st March 2019 to bring in the changes to the KFI.

This could affect ongoing applications as in some cases brokers may be required to send out different disclosure documents depending on which lender they are dealing with.

