

HM Treasury Consultation: Implementation of the EU Mortgage Credit Directive

Following the passing of the EU Mortgage Credit Directive in February, the Government is now in the process of implementing this into UK mortgage regulation, and HM Treasury has just published a consultation paper to do this: <https://www.gov.uk/government/consultations/implementation-of-the-eu-mortgage-credit-directive/implementation-of-the-eu-mortgage-credit-directive>

While the UK normally “copies out” EU legislation into UK regulation, a more selective approach has been adopted this time in the light of the recent introduction of the Mortgage Market Review which has introduced several protections that the Directive aims to cover.

Introducing the Directive will require changes, both to specific FCA rules but also through secondary legislation in some cases. Most notable amendments include:

- **Definition of regulated mortgage contracts:** to bring the regulation of second charge mortgage lending into line with first charge mortgage lending. This will require legislative change;
- **Buy-to-let:** introducing a new set of regulations for buy-to-let lending, where the lending is to consumers rather than for business purposes. This has been controversial and has invited significant concern from trade associations representing both lenders and landlords;
- **Lending and buying residential property:** the Government needs to make provision in the FCA rules to comply with this, and will treat unsecured lending for residential property as consumer credit for legislative purposes.

Next steps: the consultation closes on 30 October 2014. the UK has until 21 March 2016 to implement the Mortgage Credit Directive. In order to fulfil this timeline for implementation the Government is aiming to lay this final legislation in Parliament in early 2015.

Background: the European Mortgage Credit Directive

A directive covering residential mortgage credit, more commonly referred to as the Mortgage Credit Directive (MCD) was published in February 2014. This followed a consultative process that dates back to 2005 and a proposal tabled by the European Commission in 2011. The finalised text is here: http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage/index_en.htm.

Most of the MCD provisions are concerned with setting the minimum regulatory requirements that member states are required to meet in order to protect consumers taking out credit agreements relating to residential property. This captures residential mortgages secured against the borrower’s home and also any other lending where the purpose is to acquire or retain property rights.

The MCD also imposes maximum standards on member states in a few areas, in particular the provision of pre-contractual information in a standardised format. The key areas in which the MCD places requirements on member states aim to ensure that:

- mortgage firms act fairly and professionally, and that their staff have an appropriate level of knowledge and competence;
- advertising of products is fair and not misleading, with certain standard information included where specific rates are being quoted;
- certain information is provided to the consumer ahead of a contract being concluded;
- lenders conduct an affordability test, looking at customers' income and expenditure, to determine whether they can afford the mortgage loan;
- minimum standards are followed where advice is provided to consumers;
- lenders put in place additional consumer safeguards where loans are in a foreign currency, to protect the customer against exchange rate risk;
- consumers are given a right to be able to exit a mortgage before it reaches the end of the term; and
- lenders exercise reasonable forbearance to customers in payment difficulties before initiating repossession proceedings.

These changes are broadly designed to ensure that the tail of irresponsible lending practices that occurred before the financial crisis cannot re-emerge. However, many of the above protections and provisions are already in place in the UK under the Mortgage Market Review (MMR) which came into force in June.

Required changes from existing regime

The government does not believe that the European directive offers much benefit in removing cross-border barriers in practice because it does not address the primary obstacles for such a market. From a lender's perspective, these include the relative difficulty in understanding credit risk in unfamiliar markets and the complexity in enforcing loans under foreign legal systems. For consumers, the scale and nature of a mortgage commitment drives a preference for dealing with well established, or local, brands.

The UK has until 21 March 2016 to implement the MCD, Implementing the MCD in the UK will involve various changes, mainly to FCA rules, but also where necessary existing legislation.

Definition of regulated mortgage contracts:

- This is not completely aligned with the definition of a mortgage under the MCD. In order for the FCA to have the necessary authority to write and enforce rules across the full scope required by the MCD, the Government will need to make a number of legislative amendments to adjust the FCA's remit.
- This could also draw previously unregulated introducers under MMR into the new aligned regulatory umbrella, even if they refer clients to a regulated adviser.
- Also, any individuals undertaking mortgage-related activities without receiving remuneration, in the course of acting as a trustee or personal representative may also need to be regulated.

Buy-to-let lending:

- The MCD requires an appropriate framework to protect consumers engaged in buy-to-let mortgage borrowing. This is currently only regulated by the FCA when the loan is secured on the borrower's own home (or the borrower intends to occupy at least 40% of the rented property).

- This change is not expected to affect the vast majority of buy-to-let lending which is done for business purposes and is therefore not subject to the directive.
- This will give rise to “accidental landlords” those who have not actively purchased a property with a view to letting it falling under the scope of the directive as the Government feels it would be non-complicit to exclude such borrowers, despite significant lobbying efforts to exclude the sector.
- These changes have proved highly controversial with both lender and landlord groups reacting sharply. The UK’s existing position on buy-to-let was mainly due to combination of industry lobbying during the time the FSA mortgage rules were being developed, and government policy to encourage a vibrant private-rented residential sector. Although they were strengthened slightly under the MMR in response to the financial crisis, the Government still supported a relatively light-touch approach to regulation.

All lending for buying residential property:

- The MCD covers all lending for the purpose of buying or retaining rights on residential property. While existing FCA rules now cover all *secured* lending for this purpose, the Government needs to make provision in the FCA rules to comply with this, and will treat unsecured lending for residential property as consumer credit for legislative purposes.

Equitable mortgages and timeshares:

- Equitable mortgages are used when the formalities to create a legal mortgage have not been completed, and so are secured without title deeds.
- These are currently only offered in the UK by just two providers but will have to become regulated under the new regime in order to comply with EU rules.
- Timeshares are also currently quite rare in the UK and are unregulated with respect to mortgages and come under unsecured lending, will also have to be gathered into the mortgage regulation.

Government lending:

- Currently any mortgage lending undertaken by the government (including local government and housing authorities) is exempt from the scope of FCA regulation, but this too will have to be amended and the FCA will have to scrutinise this further.

Other changes:

- Implementing some of the changes will require secondary legislation. These include amendments to the grounds for varying or cancelling a mortgage broker’s permission; the provisions for cross-border activities within the EEA; the regulatory regime for appointed representatives carrying out mortgage-related activities; and removing the UK-only restriction for the location of the property.

Amendments to the Financial Services and Markets Act (FSMA)

There are a number of legislative changes required to the FSMA, most significantly the following two:

- **National intermediary and appointed representative registers:** to give the FCA the powers to vary or cancel a mortgage intermediary’s permission under certain circumstances and to provide the necessary regulatory infrastructure for credit intermediaries to passport in and out of the UK.
- **Passporting into and out of the UK market:** the MCD’s “passporting” provisions are designed to support more cross-border activity, to facilitate UK credit intermediaries with an FCA permission to operate in other EU member states. Legislative changes are needed to set out how credit intermediaries can passport into and out of the UK, and to give the FCA the appropriate authority to supervise them effectively.

Comments from stakeholders

Council of Mortgage Lenders: welcomed the consultation but is very disappointed with what amounts to a U-turn on buy-to-let. It is hopeful that most of the impact will be modest, as much of it was anticipated and helpfully built in to the new MMR rules in the first place. It is frustrating though that, despite earlier assurances, the buy-to-let position turns out not to have been adequately resolved, resulting in a new proposal for regulating part of the buy to let mortgage market. “The regulatory regime now being proposed is based not on any evidence of a need for additional consumer protection, but purely on ensuring that the European legal requirements are met.”

Building Societies Association: again welcomed the Government’s selected approach to implementing the Directive to minimise costs, however is concerned that it will add cost and complexity to the mortgage process, with no discernible consumer benefit. They “cannot get away from the potential for further disruption and consumer confusion so soon after the MMR implementation and well before its impact has been fully analysed.”

National Landlords Association: was less complimentary and described the proposals published as part of the consultation as “infantile, arbitrary, confusing and ultimately contradictory”. They imply that a lender should be subject to different regulations depending on whether their client has taken a conscious decision to become a landlord, or opted to become a landlord in reaction to a change in circumstance such as inheriting a property. “All private landlords are held to the same legal standards when letting property. They should have access to the same range of financial products and lending criteria. In practice this framework is likely to exclude new landlords and those requiring the most flexibility from the buy to let market.”

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