

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: DECEMBER 2015

This document is published by Practical Law and can be found at: uk.practicallaw.com/3-621-1288
Request a free trial and demonstration at: uk.practicallaw.com/about/freetrial

James Ross, Ruth Bala, Thomas Samuels and Lee Finch are all specialist consumer credit counsel at Gough Square Chambers. On a regular basis, they will share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the December column, Thomas Samuels considers the impact of the Mortgage Credit Directive (2014/17/EU) (MCD) for consumer credit firms.

Thomas Samuels, Gough Square Chambers

RESOURCE INFORMATION

RESOURCE ID

3-621-1288

RESOURCE TYPE

Article

PUBLISHED DATE

17 December 2015

JURISDICTION

United Kingdom

IMPACT OF THE MORTGAGE CREDIT DIRECTIVE FOR CONSUMER CREDIT FIRMS

Many consumer credit firms are now beginning to consider implementation of EU Directive 2014/17/EU on credit agreements for consumers relating to immovable property, better known as the Mortgage Credit Directive (MCD).

The MCD represents a large-scale overhaul of secured consumer lending, uniting the law relating to first and second charge mortgages. Primarily, this means that the current separation between FCA-regulated first charge mortgages and second charge mortgages that are regulated under the Consumer Credit Act 1974 (CCA) will cease to exist. Rather, from 21 March 2016, both categories of secured loan will be dealt with by amendments inserted into the Mortgages and Home Finance Conduct of Business sourcebook (MCOB) in the FCA Handbook.

This column will provide an overview of the primary process changes introduced by the MCD regime. For the avoidance of doubt, it does not consider the new law surrounding "consumer buy-to-let (CBTL) mortgages" which are, at least partly, dealt with by the Mortgage Credit Directive Order 2015 (SI 2015/910). For an overview of the CBTL regime, see [Practice note, FCA consumer buy-to-let mortgage regime \(www.practicallaw.com/1-614-6246\)](http://www.practicallaw.com/1-614-6246).

SCOPE OF THE MCD AND PERMISSION

By way of implementation of the MCD, chapters 2A, 3A, 3B, 5A, 6A, 7A, 7B, 8A, 10A, 11A and 14 will be inserted into MCOB, effective from the implementation date.

These apply only in relation to "MCD regulated mortgage contracts", which are defined by the Handbook Glossary as "regulated mortgage contract[s], entered into on or after 21 March 2016, under which the borrower is a consumer and which is not an exempt MCD regulated mortgage contract."

For the purposes of the MCD regime, a "regulated mortgage contract" is simply any credit agreement secured on a loan, at least 40% of which is or is intended to be used as or in connection with a dwelling. Moreover, an "exempt MCD regulated mortgage contract" is a regulated mortgage contract, which is an exempt bridging loan, credit union loan, overdraft or lifetime mortgage. Accordingly the vast majority of ordinary consumer mortgages will now fall within its scope.

Most importantly, what this means is that firms will need to apply for the relevant mortgage permissions before lending under the MCD regime. It is very likely that those who already hold consumer credit authorisation and intend to continue lending on second charge security will already have begun this process, the application period having opened on 20 April 2015. In any event, failure to obtain the necessary permissions prior to 21 March 2016 will result in the commission of a criminal offence.

For an overview of the FCA's second charge mortgage regime, see [Practice note, FCA second charge mortgage regime \(www.practicallaw.com/6-575-0677\)](http://www.practicallaw.com/6-575-0677).



SUMMARY OF MAIN CHANGES

Although there are a myriad of new rules to consider and implement, the primary procedural changes for consumer credit lenders will surround the provision to customers of the new European Standard Information Sheet (referred to as the ESIS under MCOB 5A), and the concept of the “binding offer letter” (under MCOB 6A).

In addition, there are new rules about staff training, underwriting, responsible lending and financial difficulties, although such concepts are likely to be familiar from the rules in the Consumer Credit sourcebook (CONC).

ESIS

For many consumer credit lenders, the ESIS will appear to be a familiar document since it operates in a very similar fashion to and appears to mirror the format of a SECCI (that is, the standard European consumer credit information form).

The purpose of the ESIS is informational; to ensure that the customer is given information about the product and to have “the opportunity to satisfy themselves that it is suitable for them” (MCOB 5A.2.2G). As with a SECCI, it must be provided in a “durable medium”, with a clear statement (orally or written) about the importance of carefully considering its contents.

The timing requirements for the ESIS are somewhat unusual in that it must be provided before any formal application is made for the product in question (MCOB 5A.4.1(1)R). An ESIS must be provided whenever any of the following occur:

- A particular consumer is advised to enter into an MCD regulated mortgage contract.
- If the consumer specifically requests an ESIS.
- In certain circumstances during the course of the sale of an “execution-only” mortgage (as defined within the FCA Handbook Glossary).

However, generally speaking the ESIS must be provided “without undue delay” once the consumer has given the necessary information about his needs, financial situation and preferences at the stage of the affordability assessment or, in any event, in good time before the consumer becomes bound by an offer or contract (MCOB 5A.4.1R).

Where an ESIS is not provided, the consumer may not proceed to make a formal application for the MCD regulated mortgage contract.

The format of an ESIS is as per the template in Annex 1 to MCOB 5A, and extensive guidance is provided in Annex 2. In addition, there are various rules as to format and content in MCOB 5A.5 which, in particular, provides that the ESIS must contain “only the material prescribed... and no other material” and must be in “a separate document” from any other materials provided by the firm (MCOB 5A.5.5R).

The reality is that, although it will appear to be a familiar type of pre-contract document for consumer credit lenders, the rules surrounding the provision of the ESIS are considerably more prescribed and complex than those relating to a SECCI. However, there are several helpful examples of ESIS documents in the FCA's *policy statement* (www.practicallaw.com/6-606-7345) on implementing the MCD and its proposed regime for second charge mortgages (PS15/9), which illustrate how to complete the template in various scenarios, including broker-arranged mortgage contracts, bridging loans and foreign currency loans.

BINDING OFFER LETTER

Following the provision of the ESIS and the consumer's application, the firm must then provide a so-called “binding offer letter” whenever an offer is made with a view to entering into an MCD regulated mortgage contract or varying the terms of a previous offer (MCOB 6A.1.2R).

The purpose of this requirement is also information, albeit at a different stage; to ensure that the consumer is “able to check the features and price of the MCD regulated mortgage contract before they enter into it” (MCOB 6A.1.3G). For obvious reasons, as with the ESIS, the offer letter must be provided in a durable medium.

The content of the binding offer letter will be dealt with by MCOB 6A.3. Most notably it must match up to the content of the ESIS previously provided and, if it does not, a new ESIS must be provided at the same time that the offer letter is issued.

Although referred to as a binding offer letter, that is not strictly true since it can be made subject to certain specified conditions. Namely, there being no subsequent “material change” to the facts and circumstances relating to the offer, and/or that the consumer has not knowingly provided “incomplete or inaccurate information” within their

application. A material change includes anything relating to the condition, value or title to the property to be secured, or anything relating to the borrower's circumstances such as loss of employment (MCOB 6A.3.3G).

The real purpose of the binding offer letter is, following the ESIS and the application process, to give the consumer a final seven day period to consider the proposed terms of the deal and to decide whether to proceed. This will be referred to as the "reflection period" during which time the lender is bound by the offer and the consumer may accept the offer at any time. The reflection period exists to provide the consumer with "sufficient time to compare offers, assess their implications and make an informed decision" (MCOB 6A.3.5G).

The formal contents of the binding offer letter are not nearly as prescribed as those which exist relating to the ESIS. The only strict requirements are those set out in MCOB 6A.3.9R. The binding offer letter must include, among other matters, "a prominent statement" explaining the period of the offer, when any interest rate change might take effect, the consequences of not entering into the agreement (including non-reimbursable fees and charges) and state that, once the offer is accepted, there is no withdrawal period. Moreover, the binding offer must be accompanied by a draft credit agreement, details of how to complain about the firm and a tariff of charges that could be incurred.

Although there is no specific format for a binding offer letter it would seem sensible to include all the various warnings and explanations required within the body of a letter, accompanied by a document setting out all the terms of the agreement which, taken together, would constitute the binding offer letter.

LIKELY IMPACT OF THE MCD

The MCD aims to ensure (as the Directive itself notes) a standard of responsible secured lending across member states of the EU. It is noteworthy that, in particular, it includes specific rules and disclose obligations relating to loans made in foreign currencies (perhaps in an attempt to avoid the difficulties which arose in *Kasler v OTP Jelzálogbank Zrt* [2014] Bus LR 664 (for more information, see [Legal update, ECJ preliminary ruling on interpretation of Articles 4\(2\) and 6\(1\) of the Unfair Terms in Consumer Contracts Directive \(www.practicallaw.com/3-566-5647\)](http://www.practicallaw.com/3-566-5647))).

No doubt, it will result in a generally higher standard of protection for consumers thanks to the provision of far greater information about the contract to be entered into and the more stringent affordability and staff training requirements. However, in the same breath, certain protections are being lost. For example, the FCA have confirmed that, despite certain objections, primarily for the sake of consistency and ease of implementation, second charge consumer lending will no longer be within scope of the time order or unfair relationship provisions at sections 129 and 140A respectively of the CCA.

Overall lenders must obviously be careful to implement their new documents and procedures correctly, as well as ensuring that they have all necessary permissions to continue secured lending to consumers. As to the overall purpose of the MCD, however, its utility – beyond creating yet another layer of regulation – remains to be seen.