PARADIGM

THE FUTURE OF INTERMEDIARIES

TARGET TARGET TARGET TARGET

WELCOME TO TARGET…

Welcome to this special edition of Target. In this edition, we focus solely on the FSA's recent Mortgage Market Review (MMR) which has significant impact for firms who provide mortgage advice.

The MMR brings into force some of the most important changes seen to mortgage regulation since 'M-Day' in October 2004; changes which will have a major impact on the market generally but perhaps more importantly will see firms having to implement critical change into their business.

Arguably one of the most important changes being introduced will see mortgage advisers requiring approved persons status from the regulator, falling under the same requirements as advisers who provide financial advice. Clearly this will result in firms having to assess how this will affect their business both in terms of cost and their compliance framework and for some this may initially appear somewhat daunting. Paradigm however can help and ahead of our Autumn road-show we hope this issue of Target assists you in understanding the anticipated changes resulting from the MMR and highlighting how we can help you manage this major change.

CONTENTS

FSA MORTGAGE MARKET REVIEW

Background

The FSA's Mortgage Market Review (MMR) has been undertaken against a background of what many in the industry have seen as irresponsible lending and increasing mortgage fraud and malpractice.

The changes which will be implemented as a result of the review aim to reduce the risk of irresponsible lending, prevent unsuitable individuals from operating within the industry and to make those that do accountable for their actions. These new rules will allow the FSA to sanction, where appropriate, those that fail to meet the regulator's requirements.

In relation to the required approval of all mortgage advisers, it is hoped that these changes will contribute to a reduction in the amount of fraud in the mortgage market by either deterring rogue individuals from entering the home finance market or from continuing to operate in it. It will also lead to increased transparency enabling consumers to identify individuals who have been approved by the regulator.

Not all rules are yet finalised (a further policy paper was due to be issued in September 2010 containing final rules however this is now expected in November 2010) but the FSA felt it appropriate to release the near-final rules surrounding approved persons now in order that firms have as much notice as possible to help prepare for implementation (at present the FSA are working towards a date of 31st March 2011) of the new requirements.

Please Read On...

MORTGAGE ADVISERS TO BE APPROVED PERSONS UNDER FSA

Perhaps the most significant change for mortgage firms resulting from the MMR is the requirement for all mortgage advisers to be approved persons under the FSA.

A new controlled function (CF31) will be introduced for mortgage advisers together with a requirement for the person responsible for compliance in relation to home finance activity to be registered as CF10 (this is the current FSA controlled function for a firm's compliance officer).

One of the key changes in relation to the above is that the regulator can now impose a penalty on those persons who act without holding the appropriate approved person status or who act outside of their existing approved person status. The regulator can also take disciplinary action against any individual who acts without the correct authorisation – previously there were no powers for the FSA to do this.

Implementation – What do I need to do?

There are different stages to registering as an approved person depending on an adviser's existing competence and/or authorisation…

Individuals Requiring Approval for the first time

A complete application will need to be submitted to FSA. This consists of:

- An up to date and true Criminal Records Disclosure – A true record is one which is no more than 2 months old at the time of application to the FSA

- A fully completed FSA Individual Approved Persons Application (Form A) – The FSA are currently producing revised versions of the existing individual approved persons forms and these should be available on the FSA website in Q4 2010

IT IS ABSOLUTELY VITAL THAT ALL APPLICATIONS CONTAIN ALL THE REQUIRED INFORMATION AND CONTAIN FULL AND FRANK DISCLOSURE IN RELATION TO ALL AREAS AS APPROPRIATE. THE FSA TAKE A VERY DIM VIEW OF NON-DISCLOSURE AND COULD DECLINE AN APPLICATION WHERE THEY BELIEVE THIS HAS OCCURRED.

Criminal Records Disclosure

CRB checks are to be obtained and submitted to FSA in relation to all applications. There are two different types of checks as follows:

- Sole Traders and directors of single director firms will be required to submit a **standard disclosure** from the Criminal Records Bureau (CRB) due to the perceived higher risk of a sole individual seeking their own authorisation. This will show all spent and unspent convictions

This process will require sole traders / single director firms to register with an umbrella body via which the CRB check can be obtained – further details will be released on this later in 2010 although at this stage the end to end process of registration is estimated at 8 weeks so sole traders and single director firms are encouraged to register with an umbrella body at the earliest opportunity

- All other persons requiring FSA approval will be required to submit a **basic disclosure** from Disclosure Scotland which will show all unspent convictions

This is an automated online process – Umbrella body registration is not required and the process is estimated at 14 days between application and receiving back the disclosure certificate

Individuals Already Approved for One or More Controlled Functions

For individuals already approved for a controlled function, the FSA will already have undertaken relevant checks (including possible CRB checks as per their current process) and therefore the submission of a simple electronic notification form to FSA is all that will be required. The information requested on this form will be sufficient for the FSA to identify the firm and the approved person. Firms will receive an automatic acknowledgment that the notification has been received and the FSA Register will also be updated.

This process also applies to current trainee advisers

Individuals, who already hold CF10 and are responsible for home finance activities as part of this, will not be required to take any action as their existing FSA authorisation will continue to apply.

Transitional Arrangements

Further to the above high level overview of the new requirements, depending on an individual's current competence and approved person status, certain transitional arrangements will apply and are mapped out in the table below.

PLEASE NOTE: Failure to apply within the required timescales will result in advisers having to cease home finance activities.

Illustrative dates	FSA Message / Event	Desired Action by	Essential Action by Firms
November 2010	FSA hope to publish final rules and launch the MMR approved persons webpage so firms and individuals can track the development and updates of implementation and approval process.	Firms to note	
Quarter 4 - 2010	(Modified) Application forms for individual approval available for viewing on FSA website.		
Nov / Dec 2010		Sole trader and directors of single director firms to register with umbrella body.	
Jan / Feb 2011			Sole traders and directors of single Director firms submit their CRB forms to their umbrella bodies. Remaining CF31/CF10 applicants apply to Disclosure Scotland.
31 Mar 2011 (start date) – 30 Jun 2011 (end date)	The date FSA aim to start accepting 'complete' applications from firms for individuals (not currently approved) seeking approval for		All firms who have individuals seeking CF31/CF10 (and not currently an approved person) must submit completed applications, including criminal record check.

Illustrative dates	FSA Message / Event	Desired Action by	Essential Action by Firms
1 Jul 2011			Any firm seeking approval for any individual, in this first group, who is not currently an approved person, and has not submitted a complete application, must cease their customer function activities or compliance oversight activities and their pipeline business passed to an approved person in the firm.
1 Jul 2011 (start date) – 30 Sep 2011 (end date)	FSA accept notifications from Firms for individuals who are approved for one or more controlled functions and require the CF31. FSA accept from firms applications for individuals who are approved for another controlled function and require a CF10.		All firms seeking approval for individuals as a CF31 (and who are already approved for one or more controlled functions) must submit their notifications.
1 Oct 2011			Any firm seeking approval for any individual, currently an approved person, who hasn't submitted a notification, must cease their customer function activities with regard to home finance business. Firms with any individuals currently approved for a control function other than CF10, who has not submitted a complete application, must cease their compliance oversight activities.

NEW STANDARDS FOR RESPONSIBLE LENDING TO PROTECT CONSUMERS

As part of the Mortgage Market Review, the FSA has proposed tough new standards for responsible lending that will affect mortgage applications and provide extra protection for vulnerable consumers.

The proposals mean that mortgage applicants' incomes would have to be verified in all cases and their monthly expenses estimated to test affordability. Charges for borrowers in arrears will also be made clearer (please see separate arrears article later in this edition)

The changes would include:

- **requiring all mortgage applicants to verify their income, to help prevent mortgage fraud and ensure consumers do not overstate their earnings;**
- **imposing affordability tests for all mortgage applications, and making lenders responsible for assessing a borrower's ability to pay; and**
- **Extra measures to protect vulnerable mortgage customers with an impaired credit history.**

The proposals are based on a detailed analysis of the mortgage market, including the causes of arrears and repossessions since 2005.

Income verification

The regulator has found that borrowers with a self-certified mortgage are more likely to be in arrears or face repossession than those who verify their income. Despite this, between 2007 and the first quarter of 2010, almost half of all new mortgages were provided without a customer having to verify their earnings.

When looking at consumer finances between 2005 and 2008, the FSA also found that 46% of households either had no money left or had a shortfall after mortgage payments and living costs were deducted from their income. This is clearly something that cannot continue.

Lesley Titcomb, FSA mortgage market director, said:

"There is a clear link between financial overstretch and mortgage arrears and repossessions, and we are determined to protect vulnerable consumers by making sure that everyone who takes on a mortgage can afford to pay it back.   While it is clear the mortgage market has worked well for many, we need to build a strong new framework to protect mortgage customers and to ensure that the problems we have seen in the past do not happen again, particularly as the mortgage market recovers."

Interest Only Loans

As part of the moves by the regulator, and further to the issues around income verification highlighted above, there is also clear evidence that lenders are now clamping down on interest only mortgages and the indications are that the issue will only get tighter with recent commentary suggesting that the FSA's stance (and requirements placed on lenders) will effectively kill off interest only loans . Already there are several lenders, led initially by Lloyds Banking Group, refusing to accept interest only cases above £500,000 and differentiating in price between capital and interest loans (C&I) and interest only. Also, it is apparent that where they are willing to accept interest only mortgages they will want to see proof of how the borrower intends to repay the loan. No longer will an applicant be able to tick a box indicating that an inheritance or sale of the property is the chosen method. The lenders are signifying that they will be checking both advisers and networks to ensure the new guidelines are being followed. You may have already found that some of your '*Fast Track'* mortgages have been audited as part of the tighter controls lenders are now implementing.

One reason as to the popularity of interest only mortgages has been the cost which is considerably cheaper than C&I. For example, £150,000 at 4% comes to £500pm on interest only and £791pm on C&I – an increase of 58%. **However, cost will no longer be an acceptable argument for recommending an interest only mortgage. More and more lenders are basing affordability upon C&I payments and as such Paradigm believes it is the correct approach for firms to consider implementing systems and controls which address this issue now in order to be 'ahead of the curve' and to avoid any potential situations where lenders refuse to provide special deals or exclusives to firms due to their 'backwards' approach to change or where the regulator questions the rationale behind a recommendation where there is not a robust method of repayment in place.**

Please be clear however, there is still a place in the market for interest only mortgages, e.g. BTL and those with large bonuses and sophisticated borrowers. For now, most lenders will accept interest only BTL loans, albeit with more restrictions than previously and there are some specialised lenders that will consider interest only for the more sophisticated borrower who has unusual income with large bonuses . One thing that is clear is that an adviser will have to document how the borrower intends to repay the loan and be able to evidence this should they be asked to by the lender or the regulator. Lenders will no longer accept £25 per month into an ISA when the loan is for £200,000 Lenders may be required to evidence a clear exit and repayment strategy and the adviser must be able to evidence this.

ARREARS HANDLING

As another part to the Mortgage Market Review, the Financial Services Authority has also recently set out the rules which will ensure there are proper protections in place for vulnerable customers in arrears on their mortgages or entering sale and rent back (SRB) agreements.

The announcement demonstrates the FSA's commitment to intensive and intrusive supervision to ensure firms treat their customers fairly and forms part of crucial next steps following the FSA's Mortgage Market Review.

It defines the standards firms must follow on arrears handling and contains details of the full sale and rent back regime aimed at providing customers with greater protection.

Arrears

Customers in arrears must be treated fairly by firms and the following key areas have been confirmed;

- **Firms must not apply a monthly arrears charge where an agreement is already in place to repay the arrears;**
- **Payments by customers in financial difficulties must first be allocated to clearing the missed monthly payments, rather than to arrears charges, which can be repaid later; and**
- **Firms must consider all options for borrowers. Repossessions should always be the last resort.**

A new rule has also been introduced requiring firms to record all arrears handling telephone calls and to keep the records for three years.

Sale and Rent Back

Following the implementation of new rules on 30 June 2010, sale and rent back customers are now better shielded from firms using aggressive or unfair methods. Some of the full protections include:

- **Banning of exploitative advertising and high-pressure sales techniques and prohibiting the use of emotive terms like 'fast sale', 'mortgage rescue' and 'cash quickly' in promotional literature;**
- **A 14-day cooling-off period to give consumers more time to make decisions on sale and rent back;**
- **Banning of cold calling and prohibiting firms from dropping promotional leaflets through letter boxes;**
- **Security of tenure for customers for a minimum of five years;**
- **Measures to ensure all risks are clearly signposted to the customer, via FSA literature and during the sales process.**

Lesley Titcomb, FSA director responsible for the mortgage sector, said:

"With cases of vulnerable homeowners evicted from their homes after 6-12 months after selling to unscrupulous sale and rent back companies, tighter controls were vital. Sale and rent back is often used by those who want to sell in a hurry to stay in their home, and so it is vital that they are better protected during what is usually a difficult period financially.

We also think it is wrong that arrears charges should be taken from customers already in difficult circumstances and trying to get their finances back on track. The new rules make absolutely clear the standards we expect of firms, and we have already taken tough action against some of the worst offenders."

The new measures will also require that all firms active in the sale and rent back market must be authorised or face potential fines. The FSA is proactively monitoring the SRB market for unauthorised activity, and have made it clear that they will take action if necessary citing the fact that not being treated fairly or having all the facts can be a source of real distress for people in already difficult circumstances.

HOW CAN PARADIGM HELP YOU?

As we mentioned at the outset of this special edition, the Mortgage Market Review brings into force, or proposes, some of the most important changes seen to mortgage regulation since 'M-Day' in October 2004; changes which will have a major impact on the market generally but perhaps more importantly will see firms having to implement critical change into their business.

If you are now starting to think about how these changes could be implemented but are wondering "where do I start?" or "How will I know if I am acting in line with the FSA's requirements?" then we can help.

Paradigm has quickly built an enviable reputation for regulatory consultancy support with a commercial edge, i.e. we help you meet your regulatory requirements but in a way which grows your business. We pride ourselves on providing a bespoke service to the firms we support as we believe that no two firms are the same and therefore providing "off the shelf" solutions provides little value and may actually compromise the firm's ability to meet their regulatory obligations.

Our team of experienced consultants are able to work with firms to understand the regulatory risks affecting their business and to design bespoke programmes to resolve these. Areas that our consultants can assist with include:

- Risk assessments and mitigation plans
- Monitoring plan design and audit
- Provision of Training Courses
- FSA applications and authorisation
- Capital adequacy issues
- Due diligence exercise
- Section 166 - Skilled Persons Report

This is not an exhaustive list but highlights the wide area of expertise that is available at Paradigm.

Our field based consultants are complemented by our Head Office based Technical Servcies Team. Both of these teams come from varied compliance backgrounds and offer a wealth of experience to our members, building bespoke compliance support plans to suit individual needs.

Technical Services also provides a comprehensive financial promotion review service with detailed guidance and bespoke advice provided in relation to FSA and all other relevant legislation.

Other services provided by Technical Services include:

- Remote File Reviews
- RMAR/GABRIEL completion
- FSA Application assistance
- Complaints Guidance
- Guidance on policy issued by FSA and other industry bodies

If you haven't considered regulatory support previously but now feel that a helping hand is required, then you need look no further. MMR and its' implications mean that now more than ever all mortgage brokers require guidance and support from a professional source. Paradigm can provide bespoke support at an affordable cost. For those of you already using our services, the above may highlight some areas that you may not be currently taking advantage of.

For more information, please contact suecaughtry@paradigmmortgages.com

PARADIGM
THE FUTURE OF INTERMEDIARIES
TARGET TARGET TARGET TARGET