Equity Release

Quick reference Guide Chapter 2

By the end of this guide you will understand the regulation of lifetime mortgages including the main sources of reference and product disclosure requirements.

Regulation of Lifetime Mortgages

2.0 Definitions

Here are some terms that you need to be familiar with in relation to this chapter:

Term	Definition
FCA handbook	A definitive reference for all regulated firms.
High level standards	The generic standards which apply to all regulated firms and with which all providers are expected to comply.
FCA sourcebooks	These are intended to amplify the requirements of the higher level principles and lay down specific and detailed rules for certain activities.
Risk based approach	The shift by the FCA away from prescriptive rules and towards a requirement for regulated firms to make their own risk assessments in relation to compliance and then create appropriate controls.
Lifetime mortgage	The generic term that applies to a wide range of products targeted at elderly borrowers such as home income plans, cash plans, capital drawdown schemes and open-ended mortgages.
Shared appreciation mortgage	A plan that enables the customer to raise capital and make no payments. The lender foregoes interest completely but takes its income (profit) from a share in the increase in the property value that has occurred redemption date.

There are also a number of abbreviations used as follows:

IDD	• Initial Disclosure Document
FSCS	• Financial Services Compensation Scheme
FOS	• Financial Ombudsman Service
HMRC	• Her Majesty's Revenue and Customs
ERC	• Equity Release Council
T&C	• Training and Competence
KFI	• Key Facts Illustration

2.A The FCA Handbook

The FCA Handbook is the definitive reference for all regulated firms, but not all parts apply to all firms.

High Level Standards apply to all regulated firms and set down generic standards with which all providers are expected to comply. The Principles are:

1. Integrity

2. Skill, care and diligence

3. Management and control

4. Financial prudence

5. Market conduct

6. Customers' interests

7. Communications with clients

8. Conflicts of interest

9. Customers: relationship of trust

10. Clients' assets

11. Relations with regulators

Each of these Principles has an obligation associated with it which outlines what is expected of the firm under each Principle.

2.A.1 FCA sourcebooks

FCA sourcebooks are intended to amplify requirements of the higher level principles and lay down specific and detailed rules for certain activities.

These include:

- The **Conduct of Business (COBS) rules**, relevant to providers of regulated investments;
- The **Insurance: Conduct of Business (ICOBS) rules**, relevant to providers of general insurance products and some life assurance products;
- The **Mortgages and Home Finance: Conduct of Business (MCOB) rules**, relevant to providers of regulated mortgage contracts, lifetime mortgages and home reversion plans; and
- The **Training and Competence (T & C) rules**, relevant to all persons engaged in regulated activities.

A **risk-based approach** is the shift by FCA away from prescriptive rules and towards requirement for regulated firms to make own risk assessments in relation to compliance and create appropriate controls.

2.A.2 Regulated mortgage contracts

The FCA regulates most types of residential mortgage. Home reversion plans are not mortgages so fell outside the original MCOB regulations but became regulated from **6 April 2007** within the **Mortgages: Conduct of Business Sourcebook (Home Reversion and Home Purchase Activities) Instrument 2006.**

As a result, all equity release products provided by UK firms are now regulated.

Equity release is the generic term that applies to wide range of products targeted at older borrowers such as lifetime mortgages, home income plans, cash plans, capital drawdown schemes and open-ended mortgages.

Equity release is also the generic term for home reversion plans. However, a home reversion plan is not a mortgage contract. It involves a sale of all or part of the property with no mortgage element.

2.B Mortgages and Home Finance: Conduct of Business (MCOB) rules

The **MCOB** regulations were enacted by the FCA under the powers conferred on it by the **Financial Services and Markets Act 2000 (FSMA).**

MCOB only applies to 'regulated mortgage contracts' granted by **first legal charge** on land of which **at least 40%** used for residential purposes by:

- the borrower
- the beneficiary of a trust
- a relation of the borrower.

The term ‘relation’ applies to:

- a spouse/civil partner
- a partner whose relationship with the borrower resembles that of a spouse, whether of the same or the opposite sex
- parent or grandparent
- child or grandchild
- brother or sister (which includes step-brother and step-sister).

Some mortgages are **not** regulated mortgage contracts such as:

- second and subsequent legal charges over land e.g. secured loans and second mortgages (technically called puisne mortgages)
- commercial mortgages entirely for business purposes including buy to let
- equitable mortgages (mortgages secured by simple deposit and written record - rarely used for residential borrowing).

There are two sections in MCOB of specific relevance to regulation of lifetime mortgages:

- **Section 8** – lifetime mortgages: advising and selling standards
- **Section 9** – lifetime mortgages: product disclosure

2.B.1 Scope of MCOB

Regulations apply to the following types of firm:

- mortgage lenders
- mortgage advisers
- mortgage arrangers
- mortgage administrators

2.B.2 Lifetime mortgage definition

Key elements are:

- borrowers above a specified age
- there may or may not be a specified mortgage term
- repayment will not be sought until specified occurrence
- continued occupation of the property
- potential to defer capital repayments and interest payments

2.C Advising and Selling Standards

Equity release is considered 'high risk' and is subject to greater degree of scrutiny by the FCA.

Standards apply if a firm:

- makes or anticipates making a recommendation in relation to a lifetime mortgage
- gives or anticipates giving personalised information on a lifetime mortgage or
- where the customer is entering into a lifetime mortgage or varying the terms of a lifetime mortgage.

Varying the terms occurs when a name is added or removed, when a further advance is taken out or when the customer switches from one type of interest rate to another.

The purpose of this section is to amplify higher level FCA Principles:

Principle 6 - pay due regard to interests of customers;

Principle 7 - communications with clients must be **clear, fair and not misleading**;

Principle 9 - customers: relationships of trust.

2.C.1 Services and Costs Disclosure Document

An SCDD must be provided by the adviser when first contact is made with a potential customer once it is known that there is a possibility of doing business with the customer.

Section 1 – simple statement that the FCA is the independent watchdog that regulates financial services and that the SCDD is an FCA requirement (amplified in section 6 of SCDD).

Section 2 – sets out **range of products** offered. A Provider may:

- offer products from whole market
- offer products from limited number of companies
- offer products from single provider

Section 3 – **level of service** indicated here which may be:

- **Advice and a recommendation**, after needs of the customer have been assessed or
- **Provision of information**, where the customer must make their own choice

Sections 4 & 5 – disclose **fees** that must be paid by customer, when these will be incurred and details of any refunds that may be repaid.

Section 6 – amplification of Section 1 which states that the provider or appointed representative (AR) is regulated by the FCA and also gives the firm's FCA register number and name and registered address of provider or AR.

Sections 7 & 8 set out information on how to **complain** and the cover provided by the FSCS.

Financial Ombudsman Service

FOS may deal with complaints that cannot be resolved through internal channels**.** Decisions of FOS are binding on the firm but not on the customer, who has recourse to the courts if dissatisfied.

Borrowers with loans not regulated under MCOB rules but fall within the scope of the **Consumer Credit Act 1974** are able to take complaints to FOS since 2008.

Financial Services Compensation Scheme

FSCS ensures customers have a statutory minimum level of cover if the firm becomes insolvent, subject to certain conditions.

There is more on FOS and FCSC in a later Learning Outcome.

2.C.2 Suitability

Establishing the suitability of a product for a customer is a key part of the role of a Financial Adviser. A contract will be suitable if, having regard to facts provided by the customer and any other relevant facts of which the firm/adviser is aware, it can be concluded that:

- benefits to the customer outweigh adverse effects on customer's entitlement to means tested benefits and customer's tax position
- alternative methods of raising finance, such as a home reversion plan or local authority or other grant are less suitable
- if payments are to be made to the mortgage lender, that the customer can afford to enter into the contract
- contract is appropriate to needs, objectives and circumstances of customer
- contract is the most suitable from range offered by provider within the stated level of service

If no regulated contract suitable, **no recommendation can be made**.

Section C2 of Chapter 2 of the ER1 study text is extensive and must be read and understood in its entirety as this is a key issue.

2.C.3 Record keeping

Records must be retained of:

- customer information, including that relating to needs and circumstances
- rationale for recommendations (effectively the ‘reasons why’ recommendation given) based upon suitability assessment

Must be kept for a minimum of **3 years** from the date of the personal recommendation.

2.C.4 Non-advised sales

Non-advised sales occurred when the firm did not give advice or make a recommendation. A Firm would ask questions to narrow down options available and customers could then make a choice based on information provided.

Questions must be scripted in advance and should cover:

- eligibility
- customer’s preferences for their estate
- health and life expectancy
- future plans and needs

Compilers of scripted questions and those overseeing non-advised sales were subject to T & C requirements prescribed by the FCA.

However, under the new Mortgages and Home Finance Conduct of Business sourcebook (MCOB) rules, which came into effect on 26 April 2014, ‘non-advised sales’ will no longer be allowed.

2.C.5 Client money rules

Money received from, or on behalf of, the client must be held in a separate client account and banked within **one day** of receipt. Interest belongs to the customer unless agreed otherwise.

2.D Product Disclosure Requirements

It is an FCA requirement to provide a **Key Facts Illustration (KFI)** to the customer.

Pre-application disclosure regulations apply if a firm:

- makes a personal recommendation
- provides information specific to amount required on a specific type of mortgage contract (general information may therefore be provided)
- provides the means for customer to make an application

If on-screen quotation accessed, specific warning must be prominently displayed.

KFI must be provided without delay, but delay permitted in certain circumstances.

2.D.1 Illustration – basic requirements

The key thing here is that the format of the Illustration is prescribed and all Providers' KFI documents will, by definition, be very similar.

- Must be in the format prescribed in MCOB.
- All 16 sections to be included.
- Standard terminology required.
- Must be **clear, fair and not misleading.**

Permitted tolerances:

- charges must be no more than 1% or £1, whichever is greater, below the actual figure
- APR to be not more than 0.1% understated and rounded to one decimal place

It is permissible to provide estimates of conveyancing fees and insurance premiums.

The content may be varied to reflect different features of the product – usually under section 14.

It is necessary to **personalise** the KFI and include customer specific illustrations covering, **for example**, the specific contract, the amount of the loan and the value of the property being used as security.

To ensure consistency, **Mortality Tables** produced by the Institute and Faculty of Actuaries must be used.

For joint mortgages, “longest life” expectancy should be used or customer may choose a term.

Specific information must be included at head of KFI. This includes the customer’s name, the date of issue of the KFI and how long the illustration is valid for.

2.D.2 Content of the illustration

- **Sections 1 to 3 set out essential information for customer**
- **Section 4 – What you have told us**
- **Section 5 – Description of this mortgage**
- **Section 6 – Benefits**
- **Section 7 – Risks – important things you should consider**
- **Section 8 – What you will owe and when**
- **Section 9 – Will the interest rate change?**
- **Section 10 – How the value of your home could change**
- **Section 11 – What fees must you pay?**
- **Section 12 – Insurance**
- **Section 13 – What happens if you do not want this mortgage anymore?**
- **Section 14 – Additional features**
- **Section 15 – Overall cost of this mortgage**
- **Section 16 – Using a mortgage intermediary**
- **Contact details**

ER1 Chapter 2, Section D2 of the study text is extensive and must be read and understood in its entirety as this is a key issue.

2.D.3 Foreign currency mortgages

Foreign currency mortgages are in currency other than sterling so exchange rate risks apply. MCOB includes special pre-application disclosure rules.

2.D.4 Shared Appreciation Mortgages

As above, **Shared Appreciation Mortgages** require special pre-application disclosure rules as special risks apply.

2.D.5 Disclosure at offer stage

Disclosure at offer stage may require statement relating to **Consumer Credit Act 2006** if borrowing facility is so regulated.

2.D.6 Disclosure at the start of the contract

Where interest payments are required, a number of **disclosures at the start of the contract are** required.

Similarly for **rolled up** interest and **drawdown mortgages.**

2.D.7 Disclosure after sale

Disclosure after sale must be provided by way of an **annual statement**, which must include a specific amount of information **detailing all payments and charges etc.**

2.E Event driven information

Customers must be given reasonable notice of:

- any changes in payments
- firm's right to enter property to carry out essential repairs and maintenance and the costs etc
- material changes in terms and conditions that may be varied by the firm

2.E.1 Further advances

If a customer takes out a **further advance,** KFI must be based on the further advance only and the amount must be described as 'additional borrowing'.

2.E.2 Addition or removal of a party to the mortgage

Addition or removal of a party to a mortgage is regarded as a variation of contract under MCOB rules, which triggers disclosure requirements. The exception is where a joint borrower dies and the contract converts to the survivor's sole name.

2.E.3 Changes to mortgage payments, amounts drawn down and amount owed

These rules require the firm to advise the customer **for example**, of the original amounts/rates **and** the new figures. **Similar rules apply to** drawdown mortgages and rolled-up interest mortgages.

2.F Equity Release Council

Safe Home Income Plans (SHIP) was established in 1991 by a small group of product providers to establish minimum standards of service and product design. In 2012, SHIP was incorporated into the newly formed **Equity Release Council** which has adopted the **SHIP Code of Conduct. The ERC** has a much expanded network of members which includes solicitors, property valuers and other specialists who operate in the equity release market.

2.G Reform of the regulatory system

The new regulatory structure has been in place since April 2013.

The **Financial Policy Committee** (FPC) has executive power over financial supervision at the Bank of England and will be chaired by the Governor of the Bank of England. It can refer any serious issues to the **Prudential Regulatory Authority** (PRA).

The **PRA** is the body established for the regulation of financial firms. It is a subsidiary of the Bank of England.

The **Financial Conduct Authority (FCA)** is responsible mainly for promoting consumer confidence and has four key objectives around choice, protection, integrity and promoting competition (in line with its other strategic objectives).

The FCA will report to the Treasury in the event of a regulatory failure.

Equity Release Chapter 2 (ER02) – End of Module Test

Multiple Choice Questions

Question	**Answer**	
1 - All regulated lifetime mortgages and home reversion plans are covered by the…	A.	COB rules
	B.	ICOB rules
	C.	MCOB rules
	D.	T & C rules

2 - MCOB rules to apply to mortgage contracts	A.	granted by second legal charges over land
	B.	granted by first legal charges over land
	C.	such as commercial mortgages
	D.	equitable mortgages

3 - The initial disclosure document does not indicate the…	A.	risks of the product
	B.	range of products offered
	C.	level of service
	D.	cover provided by the FSCS

4 - Records of customer information must be kept for a minimum of how many years from the date of the personal recommendation?	A.	3 years
	B.	4 years
	C.	5 years
	D.	6 years

5 - The key facts illustration does NOT set out…	A.	the benefits of the product
	B.	the overall cost of the mortgage
	C.	what fees must be paid
	D.	the information on how to complain

6 - Disclosure after sale must be provided by way of…	A.	an initial disclosure document
	B.	a key facts illustration
	C.	a key features illustration
	D.	an annual statement

7 - In respect of illustrations issued by intermediaries, the permitted tolerances are:	A.	1% or £10 whichever is lower
	B.	1% or £10 whichever is greater
	C.	11% or £1 whichever is greater
	D.	1% or £1 whichever is greater

8 - Which of the following is not regarded as a variation of the contract under MCOB rules?	A.	The addition of a name
	B.	The death of a joint borrower
	C.	The removal of a name
	D.	A transfer of equity

9 - Under the Equity Release Council Code of Conduct, which of the following guarantees is not provided?	A.	To allow customers to remain in their property for life
	B.	To provide customers with fair, simple and complete presentations
	C.	The customer must use a Solicitor chosen by the product provider
	D.	All plans must carry a no negative equity guarantee

- End of Questions -

Answers

Question	**Answer**	
1 - All regulated lifetime mortgages and home reversion plans are covered by the…	C	MCOB rules
2 - MCOB rules to apply to mortgage contracts	B	granted by first legal charges over land
3 - The initial disclosure document does not indicate the…	A	risks of the product
4 - Records of customer information must be kept for a minimum of how many years from the date of the personal recommendation?	A	3 Years
5 - The key facts illustration does NOT set out…	D	the information on how to complain
6 - Disclosure after sale must be provided by way of…	D	an annual statement
7 - In respect of illustrations issued by intermediaries, the permitted tolerances are:	D	1% or £1 whichever is greater
8 - Which of the following is not regarded as a variation of the contract under MCOB rules?	B	The death of a joint borrower
9 - Under the Equity Release Council Code of Conduct, which of the following guarantees is not provided?	C	The customer must use a Solicitor chosen by the product provider