

<b>Title:</b> <b>Financial Services Authority regulation of administering a regulated mortgage contract</b> <b>Lead department or agency:</b> HM Treasury <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>
	<b>IA No:</b>
	<b>Date:</b> 21/12/2010
	<b>Stage:</b> Final
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Secondary legislation
<b>Contact for enquiries:</b> public.enquiries@hmtreasury.gsi.gov.uk	

## Summary: Intervention and Options

### What is the problem under consideration? Why is government intervention necessary?

There is evidence that a growing number of mortgage lenders are selling their mortgage books, either to limit losses or raise funds, or because they want to exit the UK market. The buyers in these cases are often hedge funds and private equity firms, attracted by the chance to purchase assets at a significant discount. The Government has evidence that some borrowers may be treated unfairly because their mortgage has been sold on to an unregulated firm as part of a mortgage book sale, a decision over which they had no choice or control.

### What are the policy objectives and the intended effects?

The Government has identified in the market for the onward sale of mortgage books risks of negative externalities impacting on mortgage borrowers. The intention is to mitigate the risks of market failure in order to achieve a fair, stable and efficient market in mortgages.

This would be achieved by ensuring that the firm which interacts with the mortgage holder, for example by notifying them of changes in interest rates or payments due under the contract, must be regulated by the FSA. This could be either the purchaser of the mortgage book or a Third Party Administrator appointed by them.

### What policy options have been considered? Please justify preferred option (further details in Evidence Base)

The Government has considered the following options:

- Option 1: to maintain the existing framework;
- Option 2: to create a new regulated activity of 'purchasing' a regulated mortgage contract;
- Option 3: to create a new regulated activity of 'managing' a regulated mortgage contract; and
- Option 4: to expand the definition of the regulated activity of 'administering' a regulated mortgage contract.

The Government intends to proceed with Option 4. The first option risks significant consumer detriment. The second would not regulate ongoing activity under the contract and would risk consumer detriment. The third would jeopardise lenders' ability to securitise their mortgages to raise funds. Option 4 is the most effective way to ensure appropriate consumer protections for mortgage holders without affecting lenders' ability to securitise their mortgage loans.

**When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?**

It will be reviewed  
11/2013

**Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?**

Yes

**SELECT SIGNATORY Sign-off** For final proposal stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.***



Signed by the responsible Minister:

Date: 24/11/2010

# Summary: Analysis and Evidence

## Policy Option 1

### Description:

To expand the definition of the regulated activity of 'administering' a regulated mortgage contract.

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate: £0.25m

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	1	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	£250,000		negligible	£250,000

#### Description and scale of key monetised costs by 'main affected groups'

Cost to FSA (£250,000 one off, met within current resources, negligible ongoing).

Cost to purchasers of mortgage books (£0 one off, negligible ongoing).

Cost to Third Party Administrators (£0 one off, negligible ongoing).

#### Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	Optional
High	Optional		Optional	Optional
Best Estimate	N/A		N/A	N/A

#### Description and scale of key monetised benefits by 'main affected groups'

#### Other key non-monetised benefits by 'main affected groups'

Increased protection for consumers, including the benefits of remaining in their own homes rather than being repossessed. Reduced costs to Government of repossession.

Key assumptions/sensitivities/risks			Discount rate (%)

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB:	AB savings:	Net:	Policy cost savings:	Yes

## Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			01/01/2011		
Which organisation(s) will enforce the policy?			FSA		
What is the annual change in enforcement cost (£m)?			N/A		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			Traded: N/A		Non-traded: N/A
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs: N/A		Benefits: N/A
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro neg	< 20 neg	Small neg	Medium neg	Large neg
Are any of these organisations exempt?	No	No	No	No	No

## Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
<b>Statutory equality duties<sup>1</sup></b> <a href="#">Statutory Equality Duties Impact Test guidance</a>	No	
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	No	
Small firms <a href="#">Small Firms Impact Test guidance</a>	No	
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	No	
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	No	
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	No	
Human rights <a href="#">Human Rights Impact Test guidance</a>	No	
Justice system <a href="#">Justice Impact Test guidance</a>	No	
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	No	
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	No	

<sup>1</sup> Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

## Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

### References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	Mortgage Regulation: a consultation, <i>HM Treasury</i> , November 2009
2	Mortgage regulation: summary of responses, <i>HM Treasury</i> , March 2010
3	
4	

+ Add another row

### Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

#### Annual profile of monetised costs and benefits\* - (£m) constant prices

	Y <sub>0</sub>	Y <sub>1</sub>	Y <sub>2</sub>	Y <sub>3</sub>	Y <sub>4</sub>	Y <sub>5</sub>	Y <sub>6</sub>	Y <sub>7</sub>	Y <sub>8</sub>	Y <sub>9</sub>
Transition costs	0.250									
Annual recurring cost										
Total annual costs	0.250									
Transition benefits										
Annual recurring benefits										
Total annual benefits										

\* For non-monetised benefits please see summary pages and main evidence base section

# Evidence Base (for summary sheets)

## Mortgage Regulation

In 2004, the scope of Financial Services Authority (FSA) regulation was extended to include first-charge residential mortgages. The FSA's regime provides mortgage holders with important protections, including requirements that lenders treat customers fairly and only seek repossession as a last resort. A mortgage holder has recourse to the Financial Ombudsman Service if they do not believe that the mortgage lender is meeting these requirements.

FSA regulation applies to firms that engage in regulated activities. These activities are set out in legislation. At present, regulated activities in relation to mortgages include 'entering into' a mortgage contract and 'administering' a mortgage contract. Administering a mortgage contract is in turn defined as notifying the mortgage holder of changes of which they need to be aware, for example changes in interest rates, and collecting payments due under the contract.

This narrow definition of 'administering' does not capture the many activities which can cause consumer detriment, for example decisions on interest rates and charges, forbearance options or whether to repossess a property. A firm which engages in these activities but is not 'entering into' or 'administering' need not be regulated by the FSA, and so is not bound by the FSA's requirements, including the 'Treating Customers Fairly' regime. A mortgage holder does not have the right of recourse to the Financial Ombudsman Service if they are not happy with the actions of the unregulated owner of their mortgage contract with regard to these unregulated activities.

## Market failure analysis

There is evidence that a growing number of mortgage lenders are selling their mortgage books, either to limit losses or raise funds, or because they want to exit the UK market.

The buyers in these cases are often hedge funds and private equity firms, attracted by the chance to purchase assets at a significant discount. They may be looking to make a quick return on their purchase through liquidation (repossession). A firm which only engages in these activities may seek to maximise margins by raising interest rates and charges, potentially to levels that are unaffordable to borrowers, without following the forbearance strategies required under regulation.

The FSA has presented evidence that indicates unregulated firms had, by the second quarter of 2009, purchased 16,500 regulated mortgage contracts, to the value of about £1.7 billion. The FSA has also reported that the volume of activity is likely to increase.

In general, these firms neither have the systems nor the desire to manage mortgage contracts on a day to day basis, for example by collecting mortgage payments or notifying mortgage holders of changes to interest rates. The mortgage purchaser therefore appoints a third party administrator (TPA) to manage the mortgage contract on their behalf.

Such TPAs are already regulated by the FSA as they 'administer' mortgages under the current definition. In this scenario, the FSA requirement to 'Treat Customers Fairly', and the customer's right of recourse to the Financial Ombudsman Service, apply only to the administrator. Consumer protection for the unregulated activities of the new owner is provided by the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) and the Consumer Protection from Unfair Trading Regulations 2008 (CPRs). However both essentially relate to the initial terms of the contract when it is entered into. They do not provide the same levels of consumer protection as FSA rules and protections, which relate to actions undertaken on an ongoing basis.

A regulated mortgage contract can be sold to an unregulated firm, and the mortgage holder will lose the consumer protections given by FSA regulation. The mortgage holder has no choice about or control over the sale of their mortgage contract.

Some mortgage book sales may result in severe harm to borrowers, for example repossession without exploring forbearance options. As these borrowers are not agents in the market in which these mortgage books are sold, this harm may be seen as a negative externality of the market for the onward sale of mortgages.

## Securitisation

In considering what action to take to address this market failure, the Government has borne in mind mortgage originators' need to securitise mortgages. Securitisation plays an important role in mortgage funding. At present there is around £400 billion in outstanding UK residential mortgage securitisations.

Securitisation involves the transfer and legal sale of mortgages to a special purpose vehicle (SPV). The SPV sells claims on the interest and repayments generated by the pool of loans to investors. The SPV is a legal shell which owns the mortgages and manages the payments to investors, but the mortgages may be managed either by the originator or the originator may appoint a TPA.

## **Policy options**

The Government is concerned that borrowers may be treated unfairly because their mortgage has been sold on to an unregulated firm as part of a mortgage book sale, a decision over which they had no choice or control. The Government has considered four policy options:

- Option 1 - maintain the existing framework;
- Option 2 - to create a new regulated activity of 'purchasing' a regulated mortgage contract;
- Option 3 - to create a new regulated activity of 'managing' a regulated mortgage contract; and
- Option 4 - to expand the definition of the regulated activity of 'administering' a regulated mortgage contract.

Option 1 would leave mortgage holders vulnerable to the market failure set out above.

Option 2 would only provide the mortgage holder with protection at the point of sale of their mortgage, not on an ongoing basis. It would also require the SPV in a mortgage securitisation to be FSA regulated, which would have the undesirable outcome of adversely affecting the utility of securitisation for lenders.

Option 3, if drafted on a broad basis, would also require SPVs to be FSA regulated. Even if the SPV were to delegate all its decision-making powers to a TPA, it would have legal residual rights over the mortgages. These rights would be captured by a broad definition of 'managing'. HM Treasury consulted on this proposal in December 2009, estimating the costs to firms for this approach as £0-£10 million one-off and £0-£3.5 million in annual costs.

A narrower definition of managing would avoid this problem. However this would have no advantage over expanding the definition of 'administering' – option 4 – but would require more complicated legal drafting.

Following consultation with industry, the Government has decided to proceed with option 4. It will bring forward legislation extending the existing definition of 'administering' a regulated mortgage contract. This will extend the regulation of firms to all those who exercise specified rights such as changing interest rates or taking action to repossess the property against the borrower.

## **Costs**

This IA presents the Government's estimates of the incremental costs and benefits of Option 4.

In order to determine incremental costs, it is necessary to establish a counterfactual scenario. This may be considered the scenario that would hold if the Government had decided that Option 1 was more appropriate and maintained the existing the framework.

Creating a new regulated activity might be expected to impose direct costs on the FSA and firms engaged in administering a regulated mortgage contract. The firms would have to apply for and be granted permission to carry out the regulated activity, and to maintain regulated status. The FSA would have to consider applications for permission from the introduction of a new regulated activity, and to continue to monitor those firms.

Option 4 involves the expansion of an existing regulated activity. The Government's proposal is that only firms without existing permission to engage in the regulated activity of administering a regulated mortgage contract be required to apply for the new permission. Those firms which already have permission to engage in this regulated activity would simply have their permissions expanded to include the new definition of administering. The FSA has advised that all TPAs are already authorised to administer mortgages. This means that no TPAs would be required to apply for new permissions. The cost of familiarisation with the extended definition is expected to be negligible.

As there is already the requirement for those administering a mortgage contract to have regulatory permission to do so, this Impact Assessment assumes that all purchasers of mortgage books who are not regulated (for example, another mortgage lender) are likely to appoint a regulated TPA to administer their mortgage book. Therefore it is expected that purchasers of mortgage books will not face one-off costs themselves caused by this change in regulation.

The estimate for one-off costs to the purchasers of mortgage books and their TPAs is therefore £0.

The FSA estimate a one-off resource cost of around £250,000. There may also be negligible further one-off policy costs to the FSA from developing further regulation and rules applicable to TPAs.

The new regime will run alongside the existing mortgage regime and the active market is relatively small. It is anticipated that the ongoing costs to the FSA will be managed within the FSA's existing resources. The ongoing cost to the FSA is therefore negligible.

The TPAs are already regulated by the FSA. They may face a slightly higher compliance burden in future, but we believe that any increase in their ongoing costs will also be negligible.

The purchasers of mortgage books are already required to appoint a regulated TPA under the current definition of administering. Any increase in their ongoing costs will therefore be negligible.

There is expected to be a marginal impact on those lenders selling their mortgage books, as regulation will look to ensure that purchases are not buying them with the intention of quick repossessions to liquidate the asset. This Impact Assessment considers this cost to be a transfer between the mortgage lender and consumer. It is also expected that lenders looking to sell their mortgage books will still have access to buyers in the market with alternative investment strategies.

## **Benefits**

This impact assessment does not seek to monetise the significant wider benefits of improved consumer protections and better outcomes for mortgage holders.

These benefits are greatest in minimising consumer detriment when things go wrong. This can be in ensuring fair treatment when a mortgage holder is struggling with their payment obligations, and most obviously by ensuring that repossession is always a last resort.

The benefits for a mortgage holder of being able to remain in their own home, when it is financially viable to do so, rather than being repossessed, are significant. There are emotional benefits in avoiding the misery and stress of repossession, such as relocating a family. There are also financial benefits, as repossession imposes significant costs on a mortgage holder, including court costs, home-moving costs, and fees and charges levied by their mortgage lender.

Repossession has a negative impact on wider communities. At least in the short-term, repossession creates vacant properties, which drags down house prices and can attract crime. In the longer term it results in a lack of stability in the community, with an accompanying decrease in community cohesion.

Repossession also creates significant direct costs for Government. Over a third of those who lose their homes will go on to need support from Government, for example social housing or housing benefits.

A recent report by the Centre for Housing Policy, on behalf of the Department for Communities and Local Government, said "It is appropriate to discuss wider social costs of home repossession ... because the narrower financial /resource cost assessments do not provide an unambiguous picture of net value-for-money. ... the available evidence would probably not provide a basis for quantification of either the incidence or severity of relevant social consequences, and that it was highly unlikely that we would be able to 'monetise' these effects.

## **Market impacts**

Expanding the definition of the regulated activity of administering a regulated mortgage contract is expected to have a negligible market impact.

A market where the decisions which have a real impact on consumers are controlled by authorised and regulated specialist TPAs is likely to provide a better outcome for mortgage holders.

The potential impact on competition in the market is also expected to be negligible.

## **Specific Impact Tests for Option 4**

Option 4 – expanding the definition of the regulated activity of administering a regulated mortgage contract will involve Government intervention, and so Specific Impact Tests have been performed for this option.

### *Small Firms Impact Test*

The potential impact on small firms is expected to be negligible.

### *Competition Assessment*

The potential impact on competition in the market is also expected to be negligible. Buyers will not be impacted by regulation, while a market of authorised and regulated specialist TPAs is likely to provide a better outcome for consumers.

### *Gender Equality Impact Test*

It is not thought that there will be any risk of exclusion on the basis of gender. This was not raised by respondents during consultation.

### *Disability Equality Impact Test*

It is not thought that there will be any risk of exclusion on the basis of disability. This was not raised by respondents during consultation.

### *Race Equality Impact Test*

It is not thought that there will be any risk of exclusion on the basis of race. This was not raised by respondents during consultation.



## Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

### Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

<p><b>Basis of the review:</b> [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review];</p> <p>The Government keeps all legislation under review, and in line with good practice would expect to review the policy within three years.</p>
<p><b>Review objective:</b> [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p> <p>The objective of the review is to undertaken proportionate check that regulation is operating as expected to tackle the problem of concern.</p>
<p><b>Review approach and rationale:</b> [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p> <p>The review approach will be to evaluate monitoring data collected by the FSA as market regulator.</p>
<p><b>Baseline:</b> [The current (baseline) position against which the change introduced by the legislation can be measured]</p> <p>The baseline position will be the current market conditions.</p>
<p><b>Success criteria:</b> [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p> <p>Better outcomes for consumers and the market under FSA regulation.</p>
<p><b>Monitoring information arrangements:</b> [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]</p> <p>The FSA will provide a systemic collection of monitoring information as part of their regulation of the mortgage market.</p>
<p><b>Reasons for not planning a PIR:</b> [If there is no plan to do a PIR please provide reasons here]</p> <p>N/A</p>

Add annexes here.