

**EXPLANATORY MEMORANDUM TO**  
**THE FINANCIAL SERVICES AND MARKETS ACT 2000 (CONSEQUENTIAL**  
**AMENDMENTS) ORDER 2008**

**2008 No. 733**

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

2.1 This instrument amends section 82 of the Consumer Credit Act 1974 (“CCA”). It removes the scope for dual regulation of those regulated mortgage contracts which have been modified by a subsequent agreement. It will have the effect of ensuring that the two agreements will be treated as separate and distinct for regulatory purposes with the original regulated mortgage contract being subject only to regulation by the Financial Services Authority (“FSA”).

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

4. **Legislative Background**

4.1 The FSA has been responsible for regulating first charge residential mortgages since October 2004, when the relevant provisions of the Regulated Activities Order 2001 (SI 2001/544) relating to regulated mortgage contracts came into effect<sup>1</sup>. The Regulated Activities Order 2001 is made under section 22 of the Financial Services and Markets Act 2000 (“FSMA”). At the same time, amendments were made to insert a new section 16(6C) into the CCA to exempt regulated mortgage contracts from regulation under that Act.

4.2 In 2005 amendments were made to section 82 CCA by the Financial Services and Markets Act 2000 (Consequential Amendments) Order 2005 (2005/2967). Section 82 deals with the treatment of agreements which have been varied or supplemented by a new agreement. The amendments made by the 2005 Order (amongst other things) inserted a new section 82(2A) which provided that section 82(2) does not apply where the modifying agreement is an exempt agreement under section 16(6C) CCA i.e. a regulated mortgage contract. In such cases, the two agreements are to be treated as separate and distinct, with the original agreement remaining subject to the jurisdiction of the CCA and the modifying agreement – the regulated mortgage contract – being regulated under FSMA.

4.3 In 2006, the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment No 2) Order 2006 (SI 2006/2383) was made which introduced regulation of home reversion plans and home purchase plans. That Order also amended section 16(6C) CCA to exempt these agreements from CCA regulation, in addition to regulated mortgage contracts.

---

<sup>1</sup> See Article 61 of the Regulated Activities Order 2001. The Regulated Activities Order was amended by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2001 (SI 2001/3544) and came into force in accordance with the Financial Services and Markets Act 2000 (Commencement of Mortgage Regulation)(Amendment) Order 2002 (SI 2002/1777).

4.4 This Order now extends section 82(2A) so that, in addition, section 82(2) does not apply where the earlier agreement which is being varied is exempt as a result of section 16(6C). At the same time as this Order comes into force, section 2 of the Consumer Credit Act 2006 will also come into force, which removes the financial limit of £25 000 on agreements subject to the CCA.

## **5. Territorial Extent and Application**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

6.1 The Exchequer Secretary to the Treasury, Angela Eagle MP, has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services and Markets Act 2000 (Consequential Amendments) Order 2008 are compatible with the Convention rights.

## **7. Policy background**

7.1 In 2004 the FSA became responsible for regulating all first charge residential mortgages on a UK property where the borrower, or related person, uses at least 40% of the property as a dwelling. Under the CCA, the Office of Fair Trading (“OFT”) regulates most other types of credit agreement under £25,000. This financial limit will be removed from 6 April 2008.

7.2 When the FSA regulatory regime applicable to mortgages was originally introduced, changes were made to the CCA with the intention of excluding FSA regulated mortgage contracts (“RMCs”) from its scope, thereby avoiding the potential complications of agreements being subject to dual regulation.

7.3 Following these changes it was drawn to the Government’s attention that there remained circumstances in which lenders might be subject to dual regulation under FSMA and the CCA as a result of the operation of section 82 of the CCA, which deals with the variation of agreements. Concern focused on the cases where a CCA regulated credit agreement was varied by an FSA-regulated RMC, or where an unregulated agreement was varied by an RMC.

7.4 In order to address these concerns the Government introduced legislation in 2005 disapplying section 82(2) and section 82(3) wherever the modifying agreement was an RMC. In effect, this meant that the original agreement and the modifying agreement were treated as separate agreements for the purposes of the CCA. The RMC would be regulated only by the FSA and the first agreement would be subject to the CCA, where applicable.

7.5 Since these amendments to section 82 were made, a further dual regulation concern has been brought to the Government’s attention. This relates to the situation where an RMC is modified by a later agreement, but where no new credit is provided. A common example would be where a consumer with a fixed-rate mortgage that switches to a base rate tracker after a certain length of time agrees with the lender to switch to a new fixed-rate deal.

7.6 This Order addresses that concern by providing that in such situations, section 82(2) is also disapplying and the original RMC agreement and the modifying agreement are treated as separate agreements for the purposes of the CCA. The RMC will be regulated only by the FSA and the modifying agreement will, if applicable, be subject to the CCA.

7.7 The instrument is a deregulatory measure that will remove the scope for dual regulation.

7.8 A consultation document was published in November 2007. The consultation period lasted 12 weeks, in accordance with the Code of Practice for written consultation, and closed on 14 February 2008. HM Treasury received 14 official written responses during the consultation period. These came mainly from lenders (7 responses), trade associations (4 responses) and consumer groups (3 responses). All respondents were broadly supportive of the Government's approach to this issue, although some respondents expressed the view that the scope of the consultation was narrow and raised wider concerns about the regulation of mortgage and credit contracts. A summary of responses to the consultation is available at: <http://www.hm-treasury.gov.uk/>

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 The impact on the public sector is greater clarity for the OFT and FSA as to which regulatory regime applies to modified agreements and a reduction of enforcement burdens due to the removal of the scope for dual regulation.

## **9. Contact**

Michael Cornford at HM Treasury, Tel: 0207 270 5266 or e-mail: [michael.cornford@hm-treasury.gov.uk](mailto:michael.cornford@hm-treasury.gov.uk) can answer any queries regarding the instrument.

## Summary: Intervention & Options

Department /Agency: HM Treasury & BERR	Title: Impact Assessment of The Financial Services and Markets Act 2000 (Consequential Amendments) Order 2008	
Stage: Legislation	Version: Final	Date: 6 March 2008
Related Publications: Regulation of Modified Credit Agreements: summary of responses to consultation		

### Available to view or download at:

<http://www.hm->

Contact for enquiries: Michael Cornford

Telephone: 020 7270 5266

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

When parties to a Financial Services Authority (FSA) regulated mortgage contract (RMC) agree to vary the contract without the provision of further finance (for example where a consumer wants to switch interest rates and repayment period but receives no extra credit) there is a risk that in addition to FSA regulation, the RMC would be caught by Office of Fair Trading (OFT) consumer credit regulation. The two regimes should be kept distinct. Legal uncertainty could lead to a lack of clarity for consumers, and lenders would run the risk that their agreements are not legally enforceable.

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

The purpose of the Statutory Instrument (SI) is to remove the scope for dual regulation of lending agreements under the Consumer Credit Act 1974 (CCA 1974) and the Financial Services and Markets Act 2000 (FSMA).

Where an existing RMC is varied by a new agreement that is not an RMC, the SI will have the effect of ensuring that the two agreements will be treated as separate and distinct, with the RMC subject only to FSMA rules and the other agreement subject to the CCA 1974 (where applicable).

### What policy options have been considered? Please justify any preferred option.

Option 1 - Do nothing. This leaves open the possibility of dual regulation.

Option 2 - Consult on proposed legislation to remove the scope for dual regulation of lending agreements, and then bring forward legislation to come into force on 6 April 2008. This is the preferred option because it removes legal uncertainty.

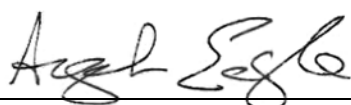
The Government published a formal consultation document in November. "Regulation of Modified Credit Agreements: a consultation" closed on 14 February 2008. A summary of responses received is available at: <http://www.hm->

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The Government keeps all legislation under review, and in line with good practice would expect to review the policy within three years.

### Ministerial Sign-off For Impact Assessment:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



Date: 07.03.08

## Summary: Analysis & Evidence

Policy Option: 1

Description: Do nothing

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Both one-off and average annual costs represent the total cost to lenders within the mortgage industry.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ Nil - 550m	1	
	<b>Average Annual Cost</b> (excluding one-off)		
	£ Nil		<b>Total Cost (PV)</b> £ Nil - 550m
Other <b>key non-monetised costs</b> by 'main affected groups' Legal uncertainty caused by possible dual regulation. Unenforceability of incorrectly documented agreements.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b>	<b>Yrs</b>	
	£ Nil	0	
	<b>Average Annual Benefit</b> (excluding one-off)		
	£ Nil		<b>Total Benefit (PV)</b> £ Nil
Other <b>key non-monetised benefits</b> by 'main affected groups'			

**Key Assumptions/Sensitivities/Risks** The above costs assume that, in the face of uncertainty as to whether both regimes apply, firms will attempt to mitigate this risk by re-writing the agreements affected. The explanation of the costs above are provided in the evidence base section of this impact assessment.

Price Base Year 2007	Time Period Years 1	<b>Net Benefit Range (NPV)</b> £ Nil	<b>NET BENEFIT (NPV Best estimate)</b> £ Nil
-------------------------	------------------------	---	---

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			N/A	
Which organisation(s) will enforce the policy?			N/A	
What is the total annual cost of enforcement for these organisations?			£ N/A	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ Nil	
What is the value of changes in greenhouse gas emissions?			£ Nil	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)	
Increase of	£ Nil	Decrease	£ Nil	<b>Net Impact</b> £ Nil

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Summary: Analysis & Evidence

Policy Option: 2

Description: Legislation

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' As this is a deregulatory measure, we do not anticipate any additional costs to industry. We have consulted the FSA and the OFT and they do not believe they will incur any additional costs as a result of the proposed SI.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ Nil	0	
	<b>Average Annual Cost</b> (excluding one-off)		
	£ Nil		
<b>Total Cost (PV)</b>			£ Nil
Other <b>key non-monetised costs</b> by 'main affected groups'			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b>	<b>Yrs</b>	
	£ Nil - 550m	0	
	<b>Average Annual Benefit</b> (excluding one-off)		
	£ Nil		
<b>Total Benefit (PV)</b>			£ Nil
Other <b>key non-monetised benefits</b> by 'main affected groups' Legal certainty for lenders and consumers, particularly regarding the enforceability of agreements for lenders. Avoidance of costs that would have been incurred in changing lender systems to avoid potential dual regulation.			

**Key Assumptions/Sensitivities/Risks** See assumptions in description and scale of monetary costs above and under the "Do Nothing" option.

Price Base Year 0	Time Period Years 0	<b>Net Benefit Range</b> (NPV) £ Nil	<b>NET BENEFIT</b> (NPV Best estimate) £ Nil
----------------------	------------------------	---	---

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			06/04/2008	
Which organisation(s) will enforce the policy?			FSA and OFT	
What is the total annual cost of enforcement for these organisations?			£ Nil additional	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ Nil	
What is the value of changes in greenhouse gas emissions?			£ Nil	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)		
Increase of	£ Nil	Decrease	£ Nil	<b>Net Impact</b>	£ Nil

Key: Annual costs and benefits: Constant Prices (Net) Present Value

### Background to current proposal

When FSA mortgage regulation was introduced in October 2004, amendments were made to the CCA so that regulated mortgage contracts were exempt under the CCA. In 2005, following consultation, the Government made further amendments to the provisions in the CCA dealing with variations, to address concerns about the potential for dual regulation arising when an existing agreement was varied by a regulated mortgage contract.

The Council for Mortgage Lenders (CML) subsequently brought to the Government's attention a further circumstance in which lenders might be subject to the risk of dual regulation. This was where a regulated mortgage contract was itself amended by an agreement under which no new credit was being provided. Following discussions with industry a shortlist of two policy options emerged, these being to do nothing, or to legislate to remove the scope for possible dual regulation.

The Government decided that the second option, to bring forward secondary legislation, is preferable, and published a formal consultation on this proposal in November 2007. The consultation period for "Regulation of Modified Credit Agreements: a consultation" lasted 12 weeks, in accordance with the Code of Practice for written consultations, and closed on 14 February.

A partial impact assessment was published as part of the consultation, and stakeholders were asked for their views on this impact assessment. The Government has published a summary of responses at: [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/regulation\\_credit/consult\\_regulation\\_credit.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/regulation_credit/consult_regulation_credit.cfm)

Responses were broadly supportive of the Government's approach to this issue. Comments on the costs and benefits of the options presented have been reflected in this revised impact assessment. The analysis behind the decision that legislation is the preferred option below.

### Option 1 – Do nothing

#### *Costs*

The option not to legislate leaves open the possibility of dual regulation. This possibility will arise on 6 April 2008, when the cap of £25,000 for CCA regulated lending is removed.

It is possible that a court could decide that dual regulation did apply, setting an unfavourable precedent, as a result of which lenders would find their lending agreements were unenforceable.

In such an event, lenders would be obliged to redraft all their agreements in this category to avoid further legal challenges. From estimates presented by CML, this would lead to a one-off cost to the industry of £550 million.

CML presented an estimate for the minimum additional sum for each remortgage of £250 and an estimate for the total number of transactions across the whole industry that could trigger a modifying agreement without creating a new RMC of £2.2 million.

Three respondents to the consultation document were unable to quantify the costs to industry or consumers. One respondent considered that the actual costs might be lower. This comment was based on that respondent's view that the number of transactions across the industry that could trigger a modifying agreement without

creating new RMC was much lower than that presented by CML. However, four respondents agreed that the costs presented by CML and used in the partial impact assessment were realistic.

The Government accepts the views of stakeholders that the potential cost of not legislating is not easy to quantify, and for this reason presents a range of costs, with CML's figure as an upper cost limit, as in the partial impact assessment.

Without a legal challenge, it is possible that lenders may attempt to mitigate the risk by putting consumers through a full remortgage process as a pre-emptive measure. It is difficult to assess the probability of any legal challenge occurring, and what its outcome may be, and hence we present a range of potential costs (from nil - no challenge, to £550 million – upper cost limit of successful challenge requiring extensive action by lenders) in this Impact Assessment. However, possible dual-regulation has been identified by both the Government and industry as a risk which has the potential to generate costs, and the Government believes that eliminating this risk through a new SI is the most effective mitigation strategy.

It is assumed that following this large one-off cost of redrafting existing agreements, the ongoing costs would be negligible, as lenders draft agreements in a way which avoids the possibility of dual regulation.

#### *Benefits*

If lenders were to take action to remortgage all existing agreements, consumers may experience a benefit as they would have a single contract and a single set of regulatory rules. However, respondents to the consultation were clear that the remortgaging process would present a cost to lenders, at least some of which they would be likely to pass on to the consumer. In addition, the sort of contractual variations which would lead to the uncertainty are likely to be easily understandable, and the clarity gain would be likely to be marginal.

### **Option 2 – Legislation**

#### *Costs*

As this is a deregulatory measure, the Government does not anticipate any additional costs to industry. None of the respondents to the consultation document highlighted cost concerns in relation to the removal of the scope of dual regulation. When consulted, the FSA and OFT considered there would be no additional costs for them in terms of regulation.

#### *Benefits*

The main benefit from this legislation is the certainty for lenders that dual regulation is avoided. This would remove the risk of future costs. The legislation:

- gives clarity on the regulatory position and prevents compliance costs and burdens associated with dual regulation for lenders;
- retains the mutual exclusivity of the FSMA and CCA; and
- prevents liability for lenders due to complicated legal issues under dual regulation.

#### **Note on Specific Impacts Test**

The impact on competition is likely to be negligible. As the proposed policy is deregulatory, the legislative change may lower the barriers to entry faced by firms in the mortgage industry through reducing the complexity of the industry regulation. Therefore the policy may be pro-competitive.



It is not believed that there will be any disproportionate impact on business from the proposal to remove the scope for dual regulation. If anything, as the measure will reduce the administrative burden on business, small businesses, which may be less able to absorb the cost of additional administrative burden, will find this deregulatory measure beneficial.

The Government consider that the other specific impact tests are not relevant to this proposal.

## Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No