

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Buy-to-let mortgages – implementing the Mortgage Credit Directive Order 2015 (PS 15/11)

Lead regulator: FCA

Date of assessment: 16 November 2016

Commencement date: 21 March 2016 (unless otherwise stated)

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of UK

Brief outline of proposed new or amended regulatory activity

The Mortgage Credit Directive (MCD) introduced a European framework of conduct standards for firms selling mortgages¹.

The government chose to use a derogation in the MCD that allowed member states to not apply the Directive's requirements to buy-to-let (BTL) mortgage activity. In order to do so, a member state needed to have in place an 'appropriate framework' for this type of activity from 21 March 2016.² The government established in legislation a framework for 'consumer buy-to-let' (CBTL) mortgages (HM Treasury's consultation, summary of responses and final stage impact assessment (<https://www.gov.uk/government/consultations/implementation-of-the-eu-mortgage-credit-directive>)). The FCA was required to implement this framework.

The government's appropriate framework and supporting legislation did not give the FCA general rule-making powers, such as the ability to modify the conduct standards that firms must follow. However, we were given powers to register, supervise and enforce against firms in relation to this framework.

In CP15/3, we consulted on our approach to implementing the framework, including our proposed Handbook changes to allow us to use those powers when necessary.

This impact assessment covers the aspects over which we had discretion:

- Complaints and redress – for the purposes of this IA, an element of those costs is attributed to the Financial Ombudsman Service (the Ombudsman)
- Data reporting

¹ See separate IA on the FCA's overall implementation of MCD.

² MCD Article 3(4)

NB. The compulsory aspects have been costed and published by HMT: <https://www.gov.uk/government/consultations/implementation-of-the-eu-mortgage-credit-directive>.

Which type of business will be affected? How many are estimated to be affected?

Any firm that advises on, arranges, enters into or administers a CBTL credit agreement must be registered by the FCA.

As the government's legislation created a separate category of BTL mortgages, creating a distinction between BTL activity involving (a) consumers and (b) customers acting by way of business), we could not say with certainty how many firms would register to undertake CBTL activity. We estimated that around 900 firms would register (up to 100 lenders and 800 intermediaries).

November 2016 data shows that just under 3200 firms have registered (around 100 of these are lenders and around 3100 are intermediaries).

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2014	21 March 2016	10	-£8.26	£0.9	£4.5

Please set out the impact to business clearly with a breakdown of costs and benefits

Summary of costs

Costs to firms (£'000)	One-off	Ongoing per year
Complaints and redress:		
Redress		Exempt
Ombudsman service case fees		+4 per year * (attributable to the Ombudsman)
Complaints process administrative costs		+3 per year *
Set up complaints handling process	160	
Data reporting:		
Set up data reporting requirements	2,800	
Ongoing data reporting costs		600
Total	2,960	607

* These costs are assumed to be cumulative (up to 10 years) as the total number of CBTL mortgage loans increases year after year. For instance, the ombudsman service case fees are assumed to be £4k in year 1, £8k in year 2, £12k in year 3, etc.

Complaints and redress

The Ombudsman could already consider complaints against authorised buy-to-let credit brokers and authorised mortgage lenders relating to BTL mortgages. The government's legislation extended the ombudsman service's compulsory jurisdiction (CJ) to cover CBTL firms. It also allowed the ombudsman service to recommend that a firm should pay redress, and the FCA will be able to act against a firm that refuses to do so. We introduced Handbook

changes to effect this, and to make CBTL firms subject to the same case fee arrangements that apply to other firms in the CJ. Therefore, firms do not pay a case fee for the first 25 cases referred to the ombudsman service each year, with each case after that attracting a case fee, currently £550.

The legislation also allowed us to establish appropriate procedures for resolving complaints. The ombudsman service is not able to consider a complaint until the firm concerned has had an opportunity to consider it. We believe it is important for firms to establish and operate appropriate and effective complaints handling procedures, to ensure that complaints are handled promptly and fairly, and to reduce the number referred to the ombudsman service. We therefore applied the majority of our complaints handling rules to firms' CBTL activity. These rules cover a range of issues including complaints handling procedures and controls, timeframes for resolving complaints, the requirement for final response letters and how we expect firms to cooperate with the ombudsman service. We expected the vast majority of CBTL firms to already hold FCA permissions and to therefore be familiar with our complaints handling rules.

We did not introduce all of our complaints handling rules due to the expected low volumes of CBTL and the extent of our powers under the legislation. For example, we did not alter the application or format of the complaints data return, or require firms to publish details of CBTL complaints. Nor did we apply the complaints record keeping rule, as the legislation required CBTL firms to retain relevant information.

The table below outlines the estimated benefits and costs during the first year following implementation.

<p>Estimated additional redress paid to consumers by CBTL lenders following the introduction of DISP [annual ongoing]</p> <p>We have used the Treasury's estimate that CBTL mortgages will constitute 11% of the BTL market, which itself amounted to 160,000 transactions in 2013. The expected complaints rate is estimated to be 1% in line with the existing complaints rate in the home finance market. We further assume approximately 50% of complaints would be upheld (broadly in line with data for the home finance market) and around half of these are already compensated voluntarily by firms. Finally, we estimate an average redress paid of £350, based on FCA data for the average redress paid on upheld home finance complaints across July 2013 and June 2014.</p>	<p>£15k (Exempt from BIT score under the redress exemption)</p>
<p>Additional ombudsman service case fees incurred [annual ongoing & accumulative]</p> <p>This assumes that 25% of cases would be resolved through the ombudsman service. As firms incur no fee on the first 25 cases submitted to the ombudsman service, we assume that no fees become payable on a third of additional cases. Any chargeable cases to the ombudsman service incur a fee of £550. For the purposes of this IA, these costs are attributed to the Ombudsman.</p>	<p>£4k</p>
<p>Industry administrative costs from processing increased number of complaints [annual ongoing & accumulative]</p> <p>The Financial Services Authority previously estimated that the cost of handling a complaint compliantly ranged between £30 and £120. We have assumed an average cost per complaint of £75.</p>	<p>£3k</p>
<p>Potential one-off compliance costs for firms to set up complaints handling process [one-off familiarisation].</p> <p>This assumes that 20% of the population of firms would need to spend on average 1 day of effort to understand and establish complaints</p>	<p>£160k</p>

handling processes which we cost at £250 per day. This results in an industry-wide one-off cost of $3200 \times 20\% \times £250 = £160,000$.	
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The total population of CBTL loans will grow over the years resulting in a proportionate increase in aggregate costs. It is difficult to accurately estimate this increase over time given that it is dependent on uncertain factors, such as:

- how the BTL and CBTL markets will develop;
- the maturity and redemption of loans; and
- the extent to which improved industry standards might lead to ongoing costs becoming marginal.

For the purposes of this impact assessment, we have assumed flat growth when calculating the ongoing costs over a 10 year period.

Data reporting

We need data about firms and their activities so we can supervise them appropriately in support of our objectives. We introduced a standalone, aggregate quarterly reporting requirement for CBTL lenders, covering:

- the volume of CBTL transactions – through lending data;
- the performance of CBTL loans and individual firms’ treatment of consumers in financial difficulty – through arrears, receivers and repossessions data; and
- the extent of any consumer detriment – through complaints data.

We had considered introducing transaction (loan) level reporting requirements and/or amending existing reporting mechanisms (such as the Mortgage Lenders and Administrators Return (MLAR)), but considered that either of these options would be disproportionately burdensome for firms given the size of the market.

In consulting on our aggregate reporting requirements, we gathered compliance costs from a sample of a dozen lenders. The median of lenders’ estimated one-off compliance costs is in the region of £28,000. Scaling up to 100 lenders, places the aggregate one-off costs in the region of £2.8m.

However, individual lenders’ assessments of these costs were subject to a high degree of variance, ranging between ‘not significant’ and £200,000. This variance was present across small, medium and large lenders. We believe that the higher estimates overstate the true additional costs of complying with our CBTL data proposals. CBTL lenders will incur systems costs in identifying CBTL mortgages to support their own compliance with government’s legislation and, in all likelihood, generate their own management information. In addition, firms’ estimates of complying with a new, relatively complex data reporting form for the purposes of first charge lending were comparatively lower, ranging between £1,500 and £28,000.³

The median of lenders’ estimated annual ongoing costs was around £6,000. Scaled up to 100 firms, this would present ongoing costs of £600,000 to the industry. These estimates were subject to less variance when compared to one-off costs, ranging between ‘not significant’ and £30,000. As with one-off costs, we believe that the top end represent over-estimates. However, we have calculated this impact assessment on the basis of those median figures.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

³ The estimated one-off costs of delivering MLAR-L, as set out in CP13/2.