EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES) (AMENDMENT) ORDER 2016

2016 No.

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument makes amendments to legislation about the regulation of activities relating to lending, and in particular activities relating to peer-to-peer lending, mortgage lending and other credit granted to consumers. Some provisions extend the scope of the regulated activities relating to the operation of peer-to-peer lending platforms and providing advice on lending through such platforms; some provisions supplement the implementation in the United Kingdom of Directive 2014/17/EU on credit agreements relating to residential immovable property, more commonly known as the EU Mortgage Credit Directive ("the MCD"); and some provisions clarify the regulatory position of credit provided to consumers before 1 April 2014. The instrument also amends the Small and Medium Sized Business (Finance Platforms) Regulations 2015 so that finance applications made by brokers are out of scope of those Regulations.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland.

4. Legislative Context

4.1 This instrument makes a number of legislative amendments. Several of the amendments supplement the Mortgage Credit Directive Order 2015 ("the Mortgages Order") and other legislation amended by that Order, which transposed in part the MCD and made other related provision through numerous amendments to the Financial Services and Markets Act 2000 ("FSMA") and other relevant legislation. The Mortgages Order was made under the power in section 2(2) of the European Communities Act 1972 and powers in FSMA itself, and this instrument is also made under such powers.

4.2 This instrument does not transpose any element of the MCD that was not already transposed by the Mortgages Order, but rather supplements the provision made by that Order.

4.3 Many of the changes made by the instrument are intended to amend the legislative approach to the application of the Mortgages Order to agreements entered into before 21 March 2016. The Mortgages Order included at article 28 a provision which disapplied that Order for agreements dating from before 21 March 2016, with certain exceptions. However it has been brought to HM Treasury's attention that the effect of this approach would be to preserve a version of legislation without the changes made by the Mortgages Order, applicable to agreements dating from before 21 March 2016. This might result in increasing legislative complexity over time as further amendments are made to the same legislation which may not state expressly whether the new amendments are intended to apply, or not to apply, to such agreements.

4.4 The instrument therefore amends article 28 of the Mortgages Order such that that Order applies to agreements dating from before 21 March 2016 as well as those entered into on or after that date, and amends other legislation amended by the Mortgages Order such that the position for agreements dating from before 21 March 2016 is stated in the legislation as amended.

4.5 The instrument also includes, in Part 4, an amendment to the Small and Medium Sized Business (Finance Platforms) Regulations 2015, made under the Small Business, Enterprise and Employment Act 2015.

4.6 As the instrument is an Order which includes provisions made under powers to make regulations, the instrument relies upon section 105 of the Deregulation Act 2015.

5. Extent and Territorial Application

5.1 The instrument extends to all of the United Kingdom.

5.2 The instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury, Harriett Baldwin MP, has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2016 are compatible with the Convention rights.

7. Policy background

What is being done and why

7.1 From 6 April 2016 repayments of interest and capital made to lenders on new peer-to-peer loans will qualify for tax advantages where these loans are held in a new type of ISA: the innovative finance ISA. The Government anticipates that this could significantly increase the provision of advice to investors on peer-to-peer lending. The Government is therefore aligning the treatment of peer-to-peer loans with other ISA qualifying investments and is making the provision of advice to lenders on entering into a peer-to-peer loan a regulated activity. This will ensure that the Financial Conduct Authority ("FCA") is able to make rules to ensure firms providing advice to investors on peer-to-peer loans act properly and in the best interests of their customer. This will mitigate the risk of unregulated firms setting up and acting improperly in providing advice to consumers. The instrument also extends the scope of the regulated activity of operating an electronic system in relation to lending, to ensure that all the

relevant activities are included within this, including notably the activity of facilitating the transfer of rights under a peer-to-peer loan between lenders.

7.2 So far as mortgage lending is concerned, the Government made the necessary legislative changes to implement the MCD in the Mortgages Order, which was made on 25 March 2015. The Government has engaged closely with industry to support implementation efforts. It has emerged, however, that in a number of areas further legislative change is necessary in order to ensure that the Government's policy aims are achieved fully.

7.3 The instrument provides for a transitional period until 21 March 2017 before first charge mortgages which were entered into before 31 October 2004 and are currently regulated as consumer credit agreements must be regulated as mortgages. Without this transitional period, amendments made by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 3) Order 2015 would require those agreements to be regulated as mortgages from 21 March 2016. The instrument also ensures that all of the regulated activities applicable to regulated mortgage contracts (including 'advising on regulated mortgage contracts' and 'arranging regulated mortgage contracts') apply to mortgages which were entered into before 31 October 2004, and that the promotion of those activities is regulated.

7.4 So far as other credit granted to consumers is concerned, the instrument clarifies that the regulatory status of consumer credit agreements and consumer hire agreements entered into before April 2014 is determined primarily by reference to the regulatory status of such agreements under the regime for the regulation of consumer credit before the transfer of regulatory oversight to the FCA in April 2014, whereas the regulatory status of loans entered into from April 2014 onwards is determined by reference to the relevant legislation as currently in force. This clarification comes into force on 20 March 2015, in order to ensure that there is a common understanding as to the types of agreements that are transferred from being regulated as consumer credit agreements to being regulated as mortgage contracts on 21 March 2016.

7.5 The instrument exempts from regulation second charge mortgage lending entered into on or after 1 April 2014 by Housing Associations in Wales and Northern Ireland, to ensure equal treatment with such lending by Housing Associations in England and Scotland. It also ensures that second charge loans by Housing Associations dating from before April 2014 remain regulated as consumer credit agreements and do not start to be regulated as mortgage contracts.

7.6 In addition, the instrument includes a minor amendment to the scope of the Small and Medium Sized Business (Finance Platforms) Regulations 2015. It ensures that unsuccessful applications for finance made by brokers on behalf of small businesses are out of scope of those Regulations. It is not necessary for these applications to be referred to finance platforms under the Regulations because the business seeking finance in such a scenario is already using a broker who will be able to advise on alternative sources of finance and fulfil a role analogous to that of a finance platform.

Consolidation

7.7 The Government does not currently intend to consolidate any of the legislation amended by this instrument.

8. Consultation outcome

8.1 So far as peer-to-peer lending is concerned, HM Treasury ran a consultation between 17 October 2014 and 20 December 2014 on the best way to implement the inclusion of peer-to-peer loans within ISAs[1]. The consultation addressed the appropriate regulation of peer-to-peer lending and particularly the regulation of advice. The consultation received 81 responses from 39 individuals and 42 interested organisations. The majority of respondents were broadly supportive of the proposed approach. In particular there was broad support for the government's proposed approach of making the provision of advice to investors in peer-to-peer loans a regulated activity. The Government published its Summary of Responses document[2] on 8 July 2015. The FCA and the Peer to Peer Finance Association were consulted, and were involved with the preparation of this instrument.

8.2 So far as other lending is concerned, following the making of the Mortgages Order and the General Election, the Government resumed engagement with industry groups in order to understand their emerging plans for compliance with the requirements of the MCD and support the transition to the new regulatory framework. During this engagement, it emerged that there were several issues that had not been identified previously but which warranted legislative action in order to ensure the policy intent that had previously been consulted on was put in place. This instrument was developed in coordination with relevant industry stakeholders.

9. Guidance

9.1 The Government provides guidance to savers, investors and ISA managers on various aspects of ISAs on the gov.uk website.

9.2 The FCA has responsibility for the regulation of the conduct of regulated activities, and provides guidance on the scope of regulation and on their rules where this is appropriate.

10. Impact

10.1 There is no significant impact on business, charities or voluntary bodies.

10.2 It is expected that 14,387 financial advice firms will be impacted by the inclusion of advice on peer-to-peer lending in the regulated activity of advising on investments, with aggregate familiarisation costs of less than £1m. The Government expects that there are few, if any, unauthorised firms that will need to seek authorisation as a result of the changes to regulation relating to peer-to-peer lending, however the total cost of seeking authorisation would be a £1,500 one-off set-up cost and a £2,545 annual cost.

10.3 Any minor impact that there may be relating to other lending remains within scope of the original impact assessment submitted with the Mortgages Order.

10.4 There is no impact on the public sector.

10.5 An Impact Assessment has not been prepared for this instrument.

[1]https://www.gov.uk/government/consultations/isa-qualifying-investments-consultation-on-including-peer-to-peer-loans/isa-qualifying-investments-consultation-on-including-peer-to-peer-loans

[2]www.gov.uk/government/uploads/system/uploads/attachment_data/file/443481/PU1808_ISA_qualifying_investments_consultation_response.pdf

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses.

11.2 No specific action is proposed to minimise regulatory burdens on small businesses.

11.3 The consultation on peer-to-peer lending showed broad support for making the provision of advice to investors in peer-to-peer loans a regulated activity, with some respondents noting that further regulation would be desirable. In order to provide adequate protection to consumers, businesses of any size intending to provide advice to investors in peer-to-peer loans will be required to be authorised by the FCA.

11.4 A Small Firms impact test was completed within the Impact Assessment submitted alongside the Mortgages Order. Any impact of this instrument relating to mortgage lending remains within the scope of that Impact Assessment.

12. Monitoring & review

12.1 This instrument does not contain a requirement to conduct a separate review in relation to it. The Economic Secretary to the Treasury, Harriett Baldwin MP, has made the following statement: "In my view, and having had regard to "Small Business, Enterprise and Employment Act 2015 – Statutory Guidance for Departments", it is not appropriate to make provision requiring the review of the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2016. Such a provision would be disproportionate taking into account the economic impact of this Order."

12.2 HM Treasury will however monitor the practical effects of the instrument. Further, the Mortgages Order contains a review clause requiring a review of that Order to be carried out by 1 September 2018. That review will need to consider the regulatory regime for mortgage lending as amended up to the date of the review, including the amendments made by this instrument.

12.3 The Small and Medium Sized Business (Finance Platforms) Regulations 2015 contain a review clause requiring a review of those Regulations to be carried out by 1st January 2021.

13. Contact

13.1 George Vernon (telephone: 020 7270 1083 or email: george.vernon@hmtreasury.gsi.gov.uk) or Rob Wareing (020 7270 4504 or email: rob.wareing@hmtreasury.gsi.gov.uk) at HM Treasury can answer any queries regarding the instrument.