EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (CONSEQUENTIAL AMENDMENTS) ORDER 2005

2005 No. 2967

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 sections 82 and 146 of the Consumer Credit Act 1974(**b**) (CCA). It removes the scope for dual regulation of some mortgage agreements and ancillary services under the CCA and the Financial Services and Markets Act 2000 (FSMA) where:

- An existing credit agreement is varied or supplemented by a regulated mortgage contract. This Statutory Instrument will have the effect of ensuring that the two agreements will be treated as separate and distinct, with the regulated mortgage contract subject only to FSMA rules and the original agreement to remain under the jurisdiction of the CCA.

- Mortgage brokers, debt-adjusters and debt-counsellors provide their services in relation to a regulated mortgage contract greater than £25,000. This Statutory Instrument will ensure that the broking of, giving advice or negotiating for discharge of a debt in connection with regulated mortgage contracts are not inadvertently licensable activities under the CCA.

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

3.1 None

4. Legislative Background

4.1 When setting up the FSMA regulatory regime applicable to mortgage business, a Regulated Activities Order was made by HMT, which made changes to the CCA so as to exclude certain activities from the scope of the CCA. These amendments made agreements that were subject to regulation under FSMA exempt from regulation under the CCA in most circumstances, thereby avoiding the complications of individual agreements being subject to

dual regulation. The two situations mentioned in paragraph 2.1 still have the potential for regulatory overlap. The Instrument will remove the scope for dual regulation.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Economic Secretary to the Treasury Ivan Lewis 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 2005 are compatible with the Convention rights.

7. Policy background

7.1 On 31 October 2004 the Financial Services Authority (FSA) became responsible for regulating all first charge 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 types of credit agreement under £25,000.

7.2 When setting up the FSA regulatory regime applicable to mortgage business, a Regulated Activities Order was made by HMT, which made changes to the CCA so as to exclude certain activities from the scope of the CCA. These amendments made agreements that were subject to FSA regulation exempt from regulation under the CCA in most circumstances, thereby avoiding the complications of individual agreements being subject to dual regulation.

7.3 There still exist two situations were there is a potential for regulatory overlap (paragraph 2.1). The Instrument is a deregulatory measure that will remove the scope for dual regulation. An informal discussion paper has been circulated to various trade representatives and consumer groups, inviting them to give their views on the proposed measures. Six responses were received. All respondents support the removal of the scope for dual regulation.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum

8.2 The impact on the public sector is clarity for the OFT and FSA as to which regulatory regime would apply to which agreements and reduced enforcement burdens on the OFT and FSA due to the removal of the scope for dual regulation.

9. Contact

Charles Morgan at HM Treasury Tel: 020 7270 5266 or e-mail: charles.morgan@hm-treasury.gov.uk can answer any queries regarding the instrument.

Regulatory Impact Assessment

1. Title of Proposal

The Financial Services and Markets Act 2000 (Consequential Amendments) Order 2005. (Section 82)

2. Purpose and intended effect

2.1. Objectives

The purpose of the Statutory Instrument (SI) is to remove the scope for dual regulation under sections 82 and 145 of the Consumer Credit Act 1974(**b**) (CCA) and the Financial Services and Markets Act 2000 (FSMA) where:

- An existing credit agreement is varied or supplemented by a regulated mortgage contract (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 original agreement to remain under the jurisdiction of the CCA.

- Mortgage brokers, debt adjusters and debt counsellors provide their services in relation to a RMC greater than £25,000. The SI will ensure that the broking of, giving advice or negotiating for discharge of a debt in connection with RMCs are not inadvertently licensable activities under the CCA.

The SI will cover the whole of the UK.

2.2. Background

On 31 October 2004 the FSA became responsible for regulating all first charge 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 types of credit agreement under £25,000. When setting up the Financial Services and Markets Act (FSMA) regime, a Regulated Activities Order (RAO) was made by HMT, which made changes to the CCA so as to exclude certain activities from the scope of the CCA. These amendments made agreements that were subject to FSA regulation exempt from regulation under the CCA in most circumstances, thereby avoiding the complications of individual agreements being subject to dual regulation. Two particular situations still exist with potential for regulatory overlap.

2.2.1. Modified Agreements

In the CCA, there are provisions (under section 82) for dealing with the situation where an existing credit agreement (either regulated under the CCA or not) is varied or supplemented by a new contract. The effect of those provisions is that firstly, the existing credit agreement and the later modifying agreement are to be treated as one combined agreement; and secondly, if the existing credit agreement is regulated, then the modifying agreement is to be treated as a regulated agreement.

Since mortgage regulation was introduced there is the possibility that changes to an existing credit agreement, such as making a further advance, could mean

that the modifying agreement is regulated under the CCA as well as constituting entry into a RMC and therefore being regulated by the FSA under FSMA.

2.2.2. Ancillary Credit Business

It was also the intention of the RAO that mortgage brokers, debt-adjusters and debt-counsellors would not need a CCA licence where:

i. Mortgage brokers effect introductions of an individual to a lender or another broker with a view to the individual entering into a RMC.
ii. Debt-adjusters and –counsellors engage in any regulated activity specified in the RAO (e.g. negotiating the terms of repayment or advising on the liquidation of debts) relating to debts due under RMCs.

The effect of the amendment has proved to be narrower than originally intended. This is because "relevant agreement", to which the exclusions apply, was defined by reference to a "consumer credit agreement". This means that mortgage brokers, debt adjusters and -counsellors require a consumer credit licence in addition to conforming to the FSA's rules, if the value of the agreement concerned exceeds £25,000. Mortgage brokers would also, in certain circumstances, be required to refund brokerage fees under section 155 of the CCA. This is in addition to conforming to the FSA rules on disclosure and refunds.

2.3. Rationale for Government intervention

With the introduction of mortgage regulation by the FSA, a RAO was made to exempt activities regulated by the FSA from regulation by OFT under the CCA, thus avoiding the complications of dual regulation of activities. This SI aims to further reduce the scope of dual regulation by dealing with the two situations that have previously been overlooked.

With regards to modified agreements, 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 original agreement to remain under the jurisdiction of the CCA, by simply stating that subsections (2), (3) and (5) of section 82 of the CCA do not apply when the modifying agreement is a RMC.

There is a concern that the problem will increase in the future if the provisions of the Consumer Credit Bill, removing the £25,000 upper limit on the agreements regulated under the CCA, are enacted, thereby increasing the number of RMCs that could fall within the scope of section 82. This concern will be removed when the SI comes into force.

With regards to ancillary credit business, the SI will ensure that the activities mentioned above are not inadvertently licensable activities under the CCA, by removing the reference to "consumer credit agreement" in defining exempt activities in section 146 (Exceptions from section 145) of the CCA.

As part of Governments drive towards Better Regulation, this SI should be welcomed as it reduces the scope for dual regulation, making it easier, cheaper and simpler for industry to comply.

3. Options

3.1. Option 1

Do Nothing

3.1.1. Risks

The continuing application of Section 82(2), where the modifying agreement is a RMC, has the potential to create dual regulation, giving rise to the following risks:

- Creates uncertainty over the regulatory position and places unnecessary compliance burdens (including costs) on industry.
- Providers of RMCs that do not understand these dual regulation requirements may find that their agreements are not legally enforceable if they had not followed CCA requirements (under Section 127 of the CCA).
- In an attempt to avoid dual regulation, lenders may not offer modifying agreements that are RMCs. This has complications for market efficiency and completeness.

The continuing application of Section 146(5D) in its current form gives rise to the risk of dual regulation of mortgage brokers (broking RMCs exceeding £25,000) and debt-adjusters and –counsellors (engaged in regulated activities relating to RMCs exceeding £25,000), with associated costs and burdens, until such time as the £25,000 limit is removed under the Consumer Credit Bill.

3.2. Option 2

Making a SI that would ensure that the two agreements are kept separate and distinct when an original agreement is modified by a RMC, and would ensure that the broking of RMCs exceeding £25,000 and the regulated activities of debt-adjusters and –counsellors (relating to RMCs exceeding £25,000) are not inadvertently licensable activities under the CCA.

3.2.1. Risks

Informal consultation indicated that this deregulating legislation will be welcomed by industry and the risks are minimal:

- With regards to modified agreements, there is a small risk that legislation solves a problem that could possibly be solved by industry (at the cost of customer service and market efficiency).
- With regards to ancillary credit business, there is a risk that legislation solves a problem that would eventually be solved by other legislation. (Work on the Consumer Credit Bill includes the removal of the £25,000 threshold in the definition of a ‘consumer credit agreement’)

3.2.2. Compliance and Enforcement

This legislation would make it very clear to firms under which regime their agreements fall and will ensure that dual regulation is not possible. This will make compliance easier and more cost effective.

The Office of Fair Trading (OFT) and the FSA rules are well established and the OFT and the FSA are responsible for enforcement of those rules.

3.2.3. Unintended Consequences

Most respondents to the informal consultation welcomed the changes to section 82 and 146 of the CCA and none of the respondents identified any unintended consequences. HMT and DTI have not been able to identify any unintended consequences either.

3.2.4. Implementation and Delivery plans

HMT will be responsible for the Parliamentary procedures of the SI. OFT and FSA will ensure that industry is kept informed of developments and the timing of any possible rule changes.

Responses to the informal consultation were received on 30 September 2005. SI was finalised on 11 October 2005. SI to be laid before Parliament on 26 October 2005 and legislation to come into force on 16 November 2005.

4. Costs and Benefits

4.1. Analysing the Benefits

4.1.1. Option 1

No additional benefits can be discerned from option 1. (See risks for option 1.)

4.1.2. Option 2

The main benefits from this legislation include:

- It gives clarity on the regulatory position and reduces compliance costs and burdens associated with dual regulation for lenders, credit brokers, debt adjusters and -counsellors.
- Lenders will be more willing to offer RMCs to modify existing agreements if the RMC will not be subject to dual regulation.
- Reduced enforcement burden on the FSA and OFT and reduced conflict between the two regulatory regimes.
- Reduced liability for lenders, credit brokers, debt adjusters and -counsellors due to complicated legal issues under dual regulation.

4.2. Analysing the costs

4.2.1. Option 1

Dual regulation brings with it unnecessary costs to lenders who have to comply with two regulatory regimes, these costs are then passed on to consumers.

4.2.2. Option 2

As this is a deregulatory measure, we do not anticipate any additional costs to industry. None of the respondents to the informal consultation highlighted cost concerns in relation to the removal of the scope for dual regulation.

5. Small Firms Impact Test

When the scope for dual regulation is removed, the compliance costs and burdens for lenders offering modifying agreements, that are RMCs, will be lower. The compliance costs and burdens for brokers of RMCs, debt adjusters and -counsellors will also be lower. Various trade bodies indicated their approval for this change in the informal consultation. Small firms that already operate in these markets will benefit from lower compliance costs and reduced regulatory burdens. This should improve their ability to compete as higher costs have a bigger impact on small firms than their larger counterparts. The Small Business Service at DTI agrees that the SI should make life easier for small firms.

6. Competition Assessment

The issues under consideration relate to the very large and broad consumer credit market. The specific participants concerned are: Any lender who will consider agreeing to a further advance (in the form of a RMC) to an existing (non regulated or CCA regulated) loan; existing borrowers interested in receiving a further advance (in the form of a RMC) on an existing (non regulated or CCA regulated) loan; all brokers of RMCs in excess of £25,000; debt-adjusters and –counsellors who engage in regulated activities related to RMCs in excess of £25,000.

Due to the specific nature of the market participants concerned, it is very difficult to get an idea of the number of participants and possible transaction volumes from existing data sources. What we do know is that there are 3,686 firms directly authorised by the FSA which consider their primary business to be mortgage advising and arranging, the majority of which satisfy the definition under the CCA of 'credit broker'. In a letter to HMT a building society has indicated that they (and other lenders) are very wary of offering further advances on existing loans due to the costs and implications of dual regulation and also of alternative arrangements.

When the SI comes into force, it will ensure that the unnecessary costs and burdens associated with dual regulation do not apply. This will benefit all market participants equally. It will reduce the restrictions on the ability of lenders to choose price, quality and range of products, creating a level playing field in the industry. In short, the legislation should improve competition in the mortgage market.

7. Enforcements, Sanctions and monitoring

Enforcement, sanctions and monitoring is already being administered by the FSA in respect of RMCs and brokers of such under FSMA and by OFT in respect of loans subject to regulation under the CCA. The legislation aims to reduce the scope of dual regulation under these regimes to clarify for lenders and regulators the regulatory regime that applies.

8. Declaration

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

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IVAN LEWIS MP
Economic Secretary to the Treasury

[Date]

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