B Impact assessment

B.1 This annex contains a 'consultation stage' impact assessment (IA) which assesses the costs and benefits of the legislative changes needed to for the UK to meet the mortgage credit directive (MCD). A 'final stage' impact assessment will be issued when the government lays legislation before Parliament.

B.2 The government is keen to use this consultation exercise to gather further evidence to support the analysis of the impact of the changes. We would therefore welcome responses in relation to the costs and benefits to industry and consumers of the proposed regime, and on any unintended consequences. Responses should include evidence where possible.

B.3 Consultation responses on the costs and benefits of government's proposals are requested to a slightly earlier deadline of 16 October. This is in order to allow government sufficient time to take account of stakeholder views and evidence in the final stage impact assessment and for the independent Regulatory Policy Committee to scrutinise the IA before publication. We are grateful for respondents' understanding and cooperation in this matter.

`Title: The implementation of the EU Mortgage Credit Directive	Impact Assessment (IA)
IA No:	**Date:** 02/09/2014
Lead department or agency: HM Treasury	**Stage:** Consultation
Other departments or agencies:	**Source of intervention:** EU
	Type of measure: Secondary legislation
	Contact for enquiries: 020 7270 5000, mcdconsultation@hmtreasury.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: AMBER

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£0	£0	£0	No	NA

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

The UK is required to implement the EU Mortgage Credit Directive (MCD) requirements by 21 March 2016, in order for the UK to meet its treaty obligations and avoid the risk of facing legal proceedings as a result of infraction. The MCD sets common regulatory standards that Member States are required to meet in order to protect consumers purchasing mortgage loans.
The UK Government needs to make some changes to its existing regime for mortgage regulation in order to meet the requirements set out in the MCD.

What are the policy objectives and the intended effects?

The policy objective in our implementation is to achieve compliance with the MCD while minimising the impact on UK industry in terms of their costs and competitiveness. The UK Government does not believe that the MCD offers many benefits to consumers beyond that which is already provided by the high level of protection offered by the existing Financial Conduct Authority regime for mortgages.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The Government has considered two options.
Option 1 - Remove the existing framework for mortgage regulation under the FCA and copy out the MCD's requirements into UK legislation
Option 2 - Seek to maintain the existing regulatory framework, minimising any adjustments required to meet the MCD.
Option 2 is the preferred option. While option 1 would avoid 'gold-plating', it would also remove valuable consumer protections and replace a familiar and robust regulatory system, designed to meet the requirements of the UK market, with a completely new framework that is not well adapted to the UK. Option 2 has the benefit of working alongside what is already in place, making minimal changes to achieve compliance where necessary.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 09/2018

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a	**Non-traded:** n/a	

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: Andrea Leadsom Date: 02/09/2014

Summary: Analysis & Evidence — Policy Option 1

Description: Remove the existing framework for mortgage regulation under the FCA and copy out the MCD's requirements into UK legislation

FULL ECONOMIC ASSESSMENT

Price Base Year n/a	PV Base Year n/a	Time Period Years n/a	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** n/a

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	n/a		n/a	**n/a**

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

No monetised costs at this stage. The Government will seek to gather evidence during consultation to provide fuller picture of these in the final stage impact assessment.

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

Mortgage lenders and intermediaries: these firms would face significant transition costs, in terms of familiarising themselves with an entirely new regulatory regime and putting in place the right infrastructure (including IT) for compliance.
Mortgage consumers: most consumers of mortgages in the UK would suffer detriment from a regime that was not tailored to the UK market, while some consumers would have all protections removed.

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'

No monetised costs at this stage. The Government will seek to gather evidence during consultation to provide fuller picture of these in the final stage impact assessment.

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

Mortgage lenders and intermediaries: it is reasonable to assume that there would be reduced ongoing compliance costs, as the existing mortgages regime goes further than the MCD in a number of areas. But this would be offset to some extent by higher compliance costs of a regime that is not appropriately tailored.
Mortgage consumers: some benefit to buy-to-let mortgage consumers who would be subject to MCD protections.

Key assumptions/sensitivities/risks — **Discount rate (%)** n/a

n/a

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: n/a	**Benefits:** n/a	**Net:** n/a	No	NA

Summary: Analysis & Evidence

Policy Option 2

Description: Seek to maintain the existing regulatory framework, minimising any adjustments required to meet the MCD

FULL ECONOMIC ASSESSMENT

Price Base Year n/a	PV Base Year n/a	Time Period Years n/a	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** £0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	£0		£0	**£0**

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

Mortgage lenders and intermediaries: for second charge mortgage lenders, £0 additional costs as a result of requiring an FCA mortgage permission rather than a consumer credit permission.

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

Mortgage lenders and intermediaries: some potential costs to second charge mortgage firms having to familiarise themselves with new regime, although mitigated by fact that many second charge firms also do first charge lending. There will also be costs to firms from the MCD requirements for buy-to-let lending. These will be calculatd following consultation.

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'

No monetised costs at this stage. The Government will seek to gather evidence during consultation to provide fuller picture of these in the final stage impact assessment.

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

Mortgage consumers: some benefits, in particular for second-charge and buy-to-let mortgage consumers. However, this is not expected to be significant, as existing FCA regime already provides high level of protection, and some of MCD's requirements risk causing confusion for customers.

Mortgage lenders and intermediaries:Firms undertaking both first and second charge mortgage activity may benefit in terms of reduced ongoing costs from only having to operate under one FCA regime.

Key assumptions/sensitivities/risks | **Discount rate (%)** 3.5

That the final FCA application fees for a mortgage permission impose the same overall cost on second charge firms as those for consumer credit permissions.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £0	**Benefits:** £0	**Net:** £0	No	NA

Evidence Base (for summary sheets)

Problem under consideration

The Directive on Credit Agreements for Consumers Relating to Residential Immovable Property, more commonly referred to as the Mortgage Credit Directive (MCD), was published in February 2014. The UK is required to implement the MCD requirements by 21 March 2016, in order for the UK to meet its treaty obligations and avoid the risk of facing legal proceedings as a result of infraction. The UK Government needs to make changes to its existing regime for mortgage regulation in order to meet the requirements set out in the MCD.

The MCD sets out the minimum regulatory requirements that Member States are required to meet in order to protect consumers purchasing mortgage loans. The key areas in which the MCD places requirements on Members States aim to ensure that:

- mortgage firms to act fairly and professionally, and that their staff must have an appropriate level of knowledge and competence;
- advertising of products must be fair and not misleading, with certain standard information included where specific rates are being quoted;
- certain information is provided to the consumer ahead of a contract being concluded;
- lenders conduct an affordability test, looking at customers' income and expenditure, to determine whether they can afford the mortgage loan;
- minimum standards are followed where advice is provided to consumers;
- lenders put in place additional consumer safeguards where loans are in a foreign currency, to protect the customer against exchange rate risk;
- consumers are given a right to be able to exit a mortgage before it reaches the end of the term;
- lenders exercise reasonable forbearance to customers in payment difficulties before initiating repossession proceedings;
- it is easier for mortgage intermediaries to operate across borders; and
- consumers have access to cross-border redress.

Policy objective

As explained above, the MCD sets the minimum regulatory requirements that Member States are required to meet in order to protect consumers taking out credit agreements relating to residential property. The UK Government does not believe that the MCD offers many benefits to UK consumers beyond those already provided by the high level of protection offered by the existing Financial Conduct Authority (FCA) regime for mortgages. However, it does add a number of costs to industry.

A further aim of the MCD is to facilitate a better internal market in mortgage lending across Europe. However, the Government does not believe that it offers much benefit in this area in practice because it does not address the primary obstacles for such a market. From a lender's perspective, these include the relative difficulty in understanding credit risk in unfamiliar markets and the complexity in enforcing loans under foreign legal systems. For consumers, the scale and nature of a mortgage commitment drives a preference for dealing with well established, or local, brands.

The UK has therefore been sceptical about the value of the MCD. Throughout the negotiation of the MCD, the UK focused on aligning the Directive requirements as far as possible with the existing UK regulation, with a view to minimising the impact on UK industry and consumers. This is also the objective for the Government's proposed approach to implementing the MCD.

In considering the implementation of the MCD the Government has considered 2 options:

<u>Option 1</u> - Remove the existing framework for mortgage regulation under the FCA and copy out the MCD's requirements into UK legislation

<u>Option 2</u> - Seek to maintain the existing regulatory framework, minimising any adjustments required to meet the MCD.

The Government believes option 2 best meets these policy objectives. While it is likely that option 1 would be less costly for firms to comply with over the longer term, it would cause huge disruption in the near term, and would dismantle the robust consumer protections which have been developed specifically for the UK market over the last decade.

The preferred option 2 achieves the Government's objectives more effectively, as it builds on the existing regulatory framework, recently strengthened by the Mortgage Market Review, and does not seek to remove existing protections. However, the approach does seek to minimise the impact of the changes on UK mortgage firms where that is possible.

The 'do nothing' scenario

In our assessment of options 1 and 2 we have taken the hypothetical 'do nothing' scenario to be the counterfactual. In practice it will not be possible to 'do nothing' as the MCD places legal obligations on the UK, and so it has not been included as an option. However, it is useful to set out the key characteristics of the 'do nothing' scenario, so that the impacts of options 1 and 2 can be better understood.

- First charge mortgage lending is regulated by the FCA under the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB). This includes equity release mortgage lending.
- Second charge lending is regulated by the FCA under the Consumer Credit sourcebook (CONC)
- Buy-to-let lending by consumers is not conduct regulated by the FCA

One-in, two-out

As this measure involves the implementation of an EU Directive, it does not need to be counted as part of one-in, two-out. However, in line with the Government's objectives, we are seeking to minimise the impact on industry where possible.

Option 1 - Remove the existing framework for mortgage regulation under the FCA and copy out the MCD's requirements into UK legislation

Option 1 would involve the UK Government copying out the MCD into legislation. The MCD would then form the legal basis of the regulatory framework for mortgage lending in the UK, which would then be supervised and enforced, most likely by the FCA.

The changes involved in option 1 are so fundamental that it is challenging to quantify them. We will seek to gather more information over the consultation to provide a fuller assessment of the costs of this option in our final stage impact assessment. However, we do not judge it proportionate to do a full analysis of the costs and benefits of this option, as it is misaligned with Government policy in a number of areas.

Costs of option 1

We have examined the potential costs of option 1 on the main affected groups in the UK.

- **UK mortgage lenders and intermediaries**

There would be significant transitional costs associated with option 1, including familiarisation costs. Lenders would need to significantly alter their processes and systems in order to align with a regulatory approach that was different to that of the existing UK regulatory regime. To give a sense of the scale of this, one could consider the estimated cost of other major changes to lender systems. In April this year lenders put in place a wide-ranging set of changes to the regulations known as the Mortgage Market Review. The FCA's cost-benefit analysis put the transition cost to lenders and intermediaries of this change at £40-65m.

- **Consumers**

There would be a significant cost to consumers under this option in terms of reduced protection available. The copy out regime would not be tailored to the UK market, and therefore borrowers would lose many of the protections designed to address situations that arise in the UK but may not arise in other markets. For example, the significant share of intermediary sales (more than 50% of mortgage sales) and the thousands of different products available make advice a key feature of the UK market. The MCD does not address the standards expected of advisers, unlike the existing FCA regulation. Moreover, as a consequence of the significant differences between national mortgage markets within the EU, the requirements in the MCD are at a much higher level. Consumers would therefore lose many of the detailed protections provided by the existing regime, for example the requirement of lenders to consider a variety of forbearance options for those in payment difficulties.

There are also a number of areas of the mortgage market that the UK currently regulates but where the MCD provides an exemption. For example, the MCD does not apply to equity release lending. The UK Government believes it is important for industry and consumers that a robust regulatory regime is in place for equity release, and would not want to remove this.

Benefits of option 1

- **UK mortgage lenders and intermediaries**

The higher-level nature of the MCD requirements may mean lower ongoing compliance costs for the industry. There may also be a reduction in FCA supervision and enforcement costs, which would also feed through to lower costs to firms (as the FCA is funded by firms). However, this benefit may well be offset by a lack of clarity about the regulatory obligations that lenders and intermediaries must comply with. This uncertainty may lead firms to go further than required in a number of areas, or would perhaps be addressed through the provision of FCA guidance.

- **Consumers**

In a few areas the scope of MCD regulation extends beyond the scope of existing UK regulation. The key example here is buy-to-let, so under option 1 buy-to-let consumers would benefit from increased protection (although this will also be the case under option 2).

Option 2 - Seek to maintain the existing regulatory framework, minimising any adjustments required to meet the MCD

Option 2 is the Government's preferred option. It involves the Government making a number of adjustments to the existing regulatory framework, so that the UK is able to put the appropriate rules in place to meet the requirements of the MCD.

The following sections describe the areas where adjustments will be required.

Second charge mortgage lending

Second charge mortgages are loans secured on property that is already acting as security for a first-charge mortgage. The terms first and second charge refer to the priority of securities held by the lenders. A second charge is subordinate to a first charge: in the event of default and the sale of a property a first-charge mortgage lender will recoup its money first and the second-charge mortgage lender's interests in the property are only activated after all liabilities to the first-charge mortgage lender have been settled. The term second charge mortgage is used here to refer to second and subsequent charge loans. Typical uses for second charge mortgages include debt consolidation and home improvements.

The second charge mortgage market grew rapidly in the decade prior to 2007, representing around 2% of the total mortgage market in that year. In 2009 it had dropped to around 0.25% of gross mortgage lending, or around 18,000 new second charge mortgages. This reduction was caused by a significant contraction in supply as second charge lenders struggled to secure funding in the wholesale markets and a reduction in homeowners' equity dampening demand. The market has grown since, with an increase of 14% in the value of new business in 2012 and an increase in the number of new contracts of 2%.

There are approximately 300,000 existing second charge mortgage accounts in the UK. The number of second charge mortgage holders is unclear, as borrowers may have multiple loans secured on a property. HMT analysis of the market suggests that there are currently about 35 lenders active in the second charge market. But it should be noted that second charge mortgage lending is a relatively small market compared to the overall mortgage market - by value second charge lending represents less than 1% of the total UK mortgage market.

The second charge mortgage market is characterised by a high level of intermediary activity. However, it is difficult to build an accurate picture of the numbers of intermediaries active in the second charge market. FCA data from their consumer credit interim permissions exercise has shown that there are 4577 intermediary firms that have registered for second charge broking. However, it is likely this number is a significant overestimate of those active in the market, and who we would expect to seek a permission under a new regime. This is because the cost to firms of registering for an interim permission for second charge broking alongside other consumer credit activities was negligible. As with first charge lending, second charge mortgage intermediaries are involved only with new loans, not the ongoing administration of loans.

The scope of FCA mortgage regulation is currently limited to first charge mortgage lending while second charge mortgage lending is regulated as part of the consumer credit regime. This has been the case since 2004, when the current regulatory framework for mortgage lending was introduced. At that time the decision was made to keep second charge lending regulated by the Office of Fair Trading (OFT) alongside unsecured consumer credit. This remained the situation until April 2014 when responsibility for regulation of consumer credit transferred to the FCA. Since April, second charge lenders and intermediaries have been operating within the FCA's interim consumer credit regime.

However, the Government has an existing policy commitment to move second charge mortgage lending into the regulatory regime for mortgage lending rather than the regime for consumer credit. This is on the basis that it is more appropriate to regulate lending secured on the borrower's home consistently regardless of whether it is a first or subsequent charge. Moreover, a single regime would make the regulatory landscape simpler for those firms engaged in both the first and second charge markets.

The MCD applies to all loans secured against residential property and so its provisions apply equally to first and second charge mortgages. The Government therefore proposes that the implementation of the MCD in March 2016 should be the occasion at which the second charge regulatory regime is transferred to the same regime as first charge lending.

Buy-to-let mortgage lending

Buy-to-let lending accounts for a significant part of the UK mortgage market. In 2013, 151,000 buy-to-let mortgages were taken out for house purchase or remortgaging in the UK, making up 12% of total mortgage lending for these purposes. This number is significantly higher than the trough in buy-to-let lending that the UK experienced immediately after the financial crisis, but is still below the peak of buy-to-let lending in 2007 where 339,000 such mortgages were taken out representing 15% of the market at that time.[1]

Most buy-to-let mortgage lending is currently outside of the scope of FCA regulation. When mortgage regulation was introduced in October 2004, the Government drew a distinction between owner-occupiers who face losing their home if things go wrong and buy-to-let landlords, who tend to be conducting a business activity and do not require the same protection.

The scope of the MCD is wider than existing UK regulation and encompasses all mortgage lending to consumers. However, the Directive does recognise that buy-to-let lending is not the same as lending to individuals who are buying their own home, and provides Member States with the option to exempt buy-to-let from the detailed requirements of the Directive, and instead put in place an alternative appropriate framework for the regulation of these mortgages. The Government is proposing to use this option to put in place the minimum requirements to meet the UK's legal obligations. Further details of the nature of this appropriate framework are provided in the consultation document and the accompanying draft regulations.

Alongside the legislative changes needed to introduce an appropriate framework for buy-to-let lending to consumers, a change is also needed to ensure that the distinction between buy-to-let mortgage lending and lending to owner-occupiers is drawn in the same way as it is in the MCD. This will ensure that the FCA has the appropriate authority to apply the detailed MCD requirements to the right mortgages.

Other adjustments to the scope of FCA mortgage regulation

There are a number of further legislative adjustments required to ensure the scope of FCA regulation is aligned with that of the MCD. These are small differences in the definition of what constitutes a 'regulated mortgage' and require the Government to make a number of changes to UK legislation so that the FCA have the necessary powers to make and enforce the rules necessary to comply with the MCD. These changes include:

- Bringing equitable mortgage lending into regulation
- Bringing secured lending on timeshare properties into regulation
- Amending the existing exemption from FCA regulation for lending by government
- Alignment of UK regulations with MCD requirements on the location of the property
- Clarification of the definition of the regulated activity of 'arranging regulated mortgage contracts'
- Limiting the application of some existing regulatory exemptions for mortgage firms

We do not estimate the impacts of these changes to be significant, as they affect markets that are either small or non-existent in the UK. However, these changes will apply to all regulated mortgage lenders and intermediaries. Currently there are 253 lenders and 4800 intermediaries with FCA mortgage permissions.

Approach to analysis of costs and benefits

The sections below look at the costs and benefits of these changes to UK mortgage lenders and intermediaries, where appropriate breaking this down to describe how different firms might be affected in different ways. It also considers the impact on consumers. These costs and benefits are considered in greater detail in option 2 than option 1 as it is our proposed option. However, there are some gaps in the

[1] Council for Mortgage Lenders, http://www.cml.org.uk/cml/statistics

analysis that we will only be able to complete using information gathered through consultation. These will be addressed in the final stage impact assessment.

This analysis is focused on the costs and benefits of the legislative changes that HMT is proposing. It does not seek to quantify the costs and benefits of the changes that the FCA will make to implement the MCD using existing powers. The FCA is an independent regulator, and will publish its own cost-benefit analysis as part of its consultation on its proposed rule changes. It is therefore not appropriate for HM Treasury to seek to quantify these costs or benefits in its impact assessment.

<u>Costs of option 2</u>

- UK mortgage lenders and intermediaries

Second charge mortgage lending

The legislative changes will mean that second charge firms (lenders and intermediaries) will need to obtain the same FCA permissions that currently apply to first charge firms. This impact assessment does not seek to quantify costs driven by the detailed rules that lenders will be required to meet under this regime, including any additional costs incurred by the FCA (which would be passed onto firms). These will be quantified in the FCA's cost benefit analysis.

The FCA has undertaken analysis to establish the population of second charge lenders based on those that applied for interim authorisation as a second charge lender under the new FCA consumer credit regime. The analysis showed that 161 firms (excluding house builders) do second charge business, either as an active lender, an administrator of a back book or as a non-core activity. Of the 161, 69 are already authorised as first charge lenders or administrators and will not be required to extend their existing permissions. This leaves 92 who may apply for authorisation as a lender or administrator of second charge loans. The FCA's working assumption is that 60-70 firms will apply for authorisation. Equity loans are also captured by the MCD which means that house builders may also seek authorisation; 140 have registered for an interim credit authorisation as a second charge lender.

In order to obtain a consumer credit or mortgage permission, firms are required to undertake an application for which a fee is incurred. Different permissions are subject to different fees, reflecting the cost to the FCA of assessing those applications (although in practice some of the costs are also covered by ongoing fees levied on all firms, because this both reduces barriers to entry and because all firms benefit from the integrity of a market with specific entry conditions). Fees also vary according to the level of complexity of the firms' activities, again to reflect the different cost to the FCA of assessing the application. There are three categories of complexity: 'straightforward', 'moderately complex' and 'complex'. The FCA have indicated that an application from a second charge intermediary will be categorised as 'straightforward' while an application from a second charge lender will be categorised as 'moderately complex'.

Under the proposals in this consultation, from March 2016 second charge firms will be conducting a regulated mortgage activity and so will need to apply, and pay the associated fee, to secure a mortgage permission. Depending on whether they are a lender or an intermediary they will have to pay the fees either for a 'moderately complex' or 'straightforward' application.

The decision to bring second charge lending into the FCA mortgages regime therefore may have a cost impact for second charge firms, as the fee for the mortgage application may be different from that they would otherwise have incurred to apply for the full consumer credit regime.

The FCA have set the application fees for the new consumer credit regime. They vary according to the income the firm generates from their consumer credit activity, between £600 and £5000 for a straightforward application and between £800 and £10,000 for a moderately complex application.

The FCA have not yet set out the proposed application fees for second charge firms seeking a mortgages permission. This will be provided in their consultation on fees, planned for October. Without this information it is difficult to make an assessment of the cost to second charge firms of having to apply for a mortgages permission rather than a consumer credit permission. A further assessment of this will be made in due course and reflected in the Government's final stage impact assessment for this Directive.

It should be noted, however, that these fees are set on a cost-reflective basis and the costs to the FCA of assessing these applications would be broadly the same regardless of whether they fell into the mortgages or consumer credit regime. If the fees were substantially lower in one regime than the other, this would be compensated for by a larger contribution from other firms within that regime (for which the costs of assessment were lower). For that reason, this consultation stage impact assessment estimates the net cost to business of this change, in terms of application fees charged, as £0.

It is reasonable to assume that there would still be some associated costs for firms, for example, around having to familiarise themselves with a new application and complete the necessary documents. However, this impact may not be significantly greater than the counterfactual, which would be familiarisation with a full consumer credit permission. The impact will also be different depending on the activity the firm is already undertaking. For example, based on the FCA analysis, about half of the lenders likely to require a mortgages permission to continue with the second charge mortgage activity already hold such a permission. We will seek during consultation to develop a closer understanding of the familiarisation costs for second charge mortgage lenders and intermediaries in order to provide an estimate of these costs for the final stage impact assessment.

Buy-to-let mortgage lending

At this stage the Government has not been able to make an estimate of the costs to firms of the proposed approach for buy-to-let lending to consumers. One of the purposes of this consultation is to seek more information about the likely impact, which can then be used to assess the policy approach and provide an estimate of costs for the Government's final impact assessment. As the proposals are refined, the key information that Government will seek to gather to estimate the associated costs are:

- The number of UK mortgage firms engaged in buy-to-let lending to consumers
- The number of UK mortgage firms, if any, that will no longer engage in such activity following the introduction of an appropriate framework
- The proportion of total UK buy-to-let lending that is to consumers rather than business, and will therefore need to be subject to an appropriate framework
- The cost to firms of setting up the systems and processes to meet the appropriate framework
- The ongoing compliance costs to firms associated with the appropriate framework
- The additional costs of setting up and supervising a regime to enforce the appropriate framework (these costs would be charged to industry)

Other adjustments to the scope of FCA mortgage regulation

We do not anticipate significant ongoing costs arising from the small changes to the scope of FCA mortgage regulation, given the small number of mortgages affected by the changes. However, the changes apply to all firms undertaking regulated mortgage lending and there may be some transitional costs for firms associated with making these changes to their systems and processes. We will seek to quantify this through the consultation.

- Consumers

The policy intention of option 2 is to maintain existing levels of consumer protection so we would not anticipate significant costs to consumers.
However, there may be a cost to consumers resulting from the introduction of an appropriate framework. If fewer lenders offer such mortgages there may be a reduction in consumer choice, and potentially higher product costs. We will seek to understand the likelihood of this risk materialising through the consultation.

<u>**Benefits of option 2**</u>

- UK mortgage lenders and intermediaries

Second charge mortgage lending

There may be some benefits of option 2 to second charge firms already doing first charge lending, as there may be efficiencies to be gained from operating under a single regulatory regime. It may also encourage some first charge lenders that do not currently undertake second charge lending to enter the market.

- Consumers

Second charge mortgage lending

Consumers may benefit from closer alignment with the mortgages regime. However, the key benefits will be driven by the FCA rules, and quantified in their impact assessment.

Buy-to-let mortgage lending

There may also be some benefits to buy-to-let consumers from the introduction of this framework, although in as far as the requirements reflect good practice in much of the market anyway, the incremental benefit may be marginal. The Government will seek to gather information through the consultation to make a quantitative estimate of this benefit.

Other adjustments to the scope of FCA mortgage regulation

Given the small number of transactions affected by these changes, we would expect a negligible benefit to consumers.

Impact on micro and small businesses

The Directive does not provide Member States with flexibility with regard to the application of the requirements to micro and small businesses. This means the Government is limited in its ability to offer tailored treatment to mitigate the impact on these businesses. The Government's proposed approach seeks to minimise the impact on business where possible, which will also benefit micro and small businesses.

Wider impacts

HM Treasury has not identified any wider impacts resulting from this proposal, including on our responsibilities under the Equalities Act 2010.

Preferred option and implementation plan

The Government's preferred option is option 2 as it best meets the Government's objectives:

- to meet the UK's legal obligations – both options 1 and 2 achieve this.
- to minimise the disruption to UK mortgage lenders and intermediaries – option 2 meets this objective more effectively than option 1 as it supplements the existing regulatory framework, making adjustments to a regime developed for the UK market over many years, rather than replacing it with a new and unfamiliar approach. It also seeks to minimise the changes that firms need to make wherever possible.
- to ensure the UK mortgage regime continues to provide a high level of consumer protection – option 2 meets this objective more effectively than option 1 as it ensures that the existing regime to protect mortgage consumers remains intact, and does not remove a number of valuable protections.

The Government is consulting on these proposals. Following the Government's consultation, the FCA will consult on the rule changes it will make to implement the MCD. The FCA's consultation will include a cost benefit analysis of their proposed changes. The Government and the FCA then aim to have all their legislation and rules finalised and published a year ahead of the date at which the MCD comes into force, in order to give firms time to make the necessary systems changes. The Government will provide a final stage impact assessment alongside its final legislative proposals, which will include more details of the estimated costs of implementation.