THE VIRGIN MONEY GUIDE TO THE MORTGAGE CREDIT DIRECTIVE

INTRODUCING THE MORTGAGE CREDIT DIRECTIVE

The MCD provides an EU-wide framework of conduct rules for mortgage activities. It sets minimum regulatory requirements that member states must meet to provide consistency in protecting consumers taking out credit agreements for residential property.

Although the UK has a robust set of regulations for mortgage activities already, which protect consumers in a similar way, the introduction of MCD will bring new legislation and changes to the FCA handbook, and particularly MCOB. If you'd like to read the full detail, then visit the Financial Conduct Authority (FCA) website. However, we have summarised the key changes in this guide, and how we intend to meet these before the implementation date of 21 March 2016.

First and Second Charge Lending

The MCD applies across first and second charge mortgages equally.

The MCD also introduces additional protections to first charge lending that lenders and intermediaries must meet. The key additional protections are covered in the following sections.

Regulation of second charge lending will move from the FCA consumer credit regulations to the FCA mortgage regulations. Any firm advising on second charge mortgages must adopt the MCD rules by 21 March 2016.

To carry out second charge mortgage business after 21 March 2016, all firms must be FCA authorised and hold the correct mortgage permissions.

As there is no equivalent KFI disclosure document, all second charge lending must adopt an ESIS.

Virgin Money's approach and what it means for you

> We currently only undertake first charge lending and this will continue after 21 March 2016.

> We are aiming to be fully MCD compliant from February 2016. We will keep you updated with our plans.

European Standardised Information Sheet (ESIS)

The European Standardised Information Sheet (ESIS) will replace the Key Facts Illustration (KFI). Lenders must begin using the ESIS by 21 March 2019. Until then, lenders can continue to issue a KFI. In order to provide the same level of information as an ESIS, additional disclosures will be required (see page 4).

There is no prescribed format for the Offer document under MCD. This may mean that, where currently the Offer tends to look the same as the KFI, under MCD these documents could look different. An example where this may be the case is when comparing quotes from lenders and sourcing systems i.e. where a sourcing system offers the option to produce an ESIS but the lender provides a KFI.

There is no change to when existing documents are provided to customers.

The UK industry has chosen to call the ESIS a 'Mortgage Illustration' going forward.

Virgin Money's approach and what it means for you

> We will be adding the additional information required to our existing KFI with the aim to offer this from February 2016.

> You will be able to produce a KFI in exactly the same way as today, through Virgin Money Online (VMO) or sourcing systems.

> Our Offers will continue to look as they do now, however, we will also include the additional disclosures that are required for the KFI.

Disclosures with the KFI

Any lenders or intermediaries choosing to use a KFI need to make additional disclosures to ensure it is equivalent to an ESIS and complies with the new MCD rules:

1. Information on the new reflection period.
2. The requirement to provide a second APRC where the interest rate is variable.
3. Extra information for foreign currency loans (where applicable). See page 7.

These disclosures should be provided at the same time as the KFI, either within the KFI or as a separate document.

Virgin Money's approach and what it means for you

> To make it easier for our customers, we will include the additional MCD disclosures in the relevant sections of our KFI, rather than on a separate document.

Annual Percentage Rate of Charge (APRC) and second APRC

We use an Annual Percentage Rate (APR) to allow customers to compare the overall cost of a deal. Under MCD this will now be known as the Annual Percentage Rate of Charge (APRC). The APRC is calculated in a similar way to the APR, but follows MCD rules.

The MCD also requires a second APRC for loans which have a variable interest rate at any point during the loan term – e.g. trackers or SVR. The second APRC is an illustrative example of the cost of the loan using a 20 year high interest rate – this 20 year high interest rate can either be based on a relevant external reference rate or the benchmark rate as set by the FCA. For more detailed information on this requirement visit the FCA website.

Virgin Money's approach and what it means for you

> For Virgin Money loans, the second APRC will be based on the FCA's benchmark rate and will replace the 1% risk warning in the KFI.

Sales process

Customers looking to increase borrowing secured on their home should be made aware of their **'alternative finance options'**. For example, if a customer is remortgaging and looking to raise money, they should be informed that an unsecured loan or second charge mortgage could be more appropriate. Firms are not required to provide advice on the suitability of alternative finance options if they do not offer those services themselves.

Before a binding Offer is issued, intermediaries are required to provide an **'adequate explanation'** of the features of the mortgage, and any ancillary products. Although this should not bring too much change, all firms should check that their existing processes comply, especially from an execution-only perspective.

The MCD requires lenders to provide the customer with a **'binding Offer'**. As now, a binding Offer may be subject to lawful conditions surrounding its withdrawal or variation, including where there has been a material change in the circumstances related to the Offer or where false or inaccurate information has been provided.

There is also a new requirement for lenders to provide the customer with a **'reflection period'** lasting a minimum of seven days. The reflection period will begin when the lender issues its binding Offer of Loan. The purpose of the reflection period is to give the customer time to review their Offer, make comparisons and assess the implications of accepting it and taking out a mortgage. During this period the Offer must remain binding on the lender.

Lenders and intermediaries can communicate with customers during the reflection period. Customers can also choose to accept an Offer and proceed with their loan during the reflection period.

Virgin Money's approach and what it means for you

> We consider an Offer to be binding on the date it is issued, subject to conditions. We will continue to issue Offers at the same stage of the application process as we do now.

> The lending agreement between Virgin Money and the customer will be entered into following the acceptance of the Offer and Mortgage Conditions by the customer.

> We propose to provide our customers with peace of mind by giving them a reflection period that starts from the day we make the Offer, for as long as the Offer is valid.

> The customer can accept the Offer at any time and the introduction of the reflection period does not restrict the customer's ability to request funds at any time the Offer is valid.

Consumer Buy-to-Let (CBTL)

The MCD Order 2015 introduces a new BTL concept – the consumer buy-to-let mortgage. This means a buy-to-let mortgage contract which is 'not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower'.

CBTL loans will be subject to an FCA supervisory regime, although they will not be regulated under MCOB and there is no requirement for advice to be provided for these loans.

Any firms wanting to offer CBTL loans must apply for and hold the relevant new FCA CBTL permissions. Firms were able to register for FCA CBTL permissions from September 2015.

For intermediated applications, lenders can rely on the regulatory status as determined by the intermediary or they can choose to gather information to validate the regulatory status. Lenders will not necessarily verify or conduct additional checks on the information provided by intermediaries.

Customers taking out a business BTL may be given a declaration stating they understand the contract is wholly or predominately for a business purpose. Whilst not mandatory, we expect most lenders to include a declaration. When and how the declaration is offered to the borrower will differ between lenders. Some lenders may choose to provide this during the sales process and others as part of the Offer or as a separate piece of documentation.

Virgin Money's approach and what it means for you

We will offer CBTL loans and **we will require our intermediary partners to hold regulated mortgage and CBTL FCA permissions before they submit CBTL business to us**.

As the intermediary, we will ask you to determine whether an application is CBTL or BTL, which you will need to confirm when submitting an application. We will not ask additional questions to determine the status of the loan as we will rely on the information provided by you.

Our business BTL Offer will contain a condition stating the customer understands the contract is wholly or predominantly for business purposes. This acts as the business declaration.

When we implement our changes in February 2016 we will not be changing our approach to affordability and rental income assessments. All of our BTL product range will also be available for CBTL.

Below are some examples we would consider to be CBTL and BTL:

> If a remortgage application is for a customer's only BTL property and they have previously resided in it as owner (e.g. Let to Buy), we will expect this to be treated as a CBTL application.

> If a customer is remortgaging a property which they have inherited we expect the application to be treated as a business BTL, unless they have lived in it since inheriting it, which would make it a CBTL application.

> If a customer is purchasing a property with the sole intention of letting it out, we expect this to be considered a business BTL application.

> If a customer already has other BTL properties we expect their application to be considered a business BTL.

Prior to our system change in February 2016 we will provide further updates and support to ensure you are prepared for the changes.

Foreign Currency (FC) Loans

MCD describes a foreign currency loan as either:

- A loan in a different currency from that in which the customer receives the income or holds the assets from which the credit is to be repaid; or
- A loan in a different currency from that of the country in which the customer is resident.

All firms must disclose the potential impact of an exchange rate fluctuation and notify customers if there is an adverse 20% exchange rate movement. Firms must also put in extra steps to protect customers from exchange rate risks, like the right to revert to another currency.

Virgin Money's approach and what it means for you

> We will no longer offer foreign currency loans from 20 October 2015, due to the low demand for these mortgages for us. This will allow us to invest in our wider proposition to support our intermediary partners.

> Customers will need to pass our affordability assessment on the basis of their Sterling income alone.

> Where a customer is paid in both Sterling and a foreign currency, we will only consider their Sterling income for the purposes of affordability.

> For interest only loans we will not accept repayment strategies denominated in a foreign currency.

> We will continue to accept non-Sterling income for minimum income requirements on BTL applications.

> As our intermediary partner, we will require you to be responsible for identifying customers looking for a foreign currency loan.

> Our current policy around residency remains unchanged.

Financial Promotions

The MCD rules bring minimal changes to our existing advertising rules. The aim to be clear, fair and not misleading still stands.

However, if a financial promotion mentions an interest rate, the cost of the loan or any other price information, a representative example may need to be provided.

While the FCA has simplified its rules on when risk warnings need to be provided, it is unlikely this will be widely adopted as there is a benefit to customers continuing to see these warnings.

Virgin Money's approach and what it means for you

> Our intermediary advertising will not be impacted by the changes to Financial Promotions, although some of our marketing material for customers will change to show representative examples.

Training and Competency (T&C)

The MCD sets the minimum standards for both lenders and intermediaries involved in the manufacture of mortgages or in the granting of credit. The FCA's existing requirements will need to change to reflect MCD. Knowledge and competency requirements are also extended to CBTL.

Firms have until 21 March 2017 to comply with the MCD requirements on knowledge and competency, and until 21 March 2019 to stop using 'professional experience' as the basis to assess this.

Virgin Money's approach and what it means for you

> We will make sure we meet the T&C requirements within the given timeframes.

> You should also be aware and understand your own T&C obligations.

Information free of charge

The MCD prevents a firm from charging for disclosure materials.

Virgin Money's approach and what it means for you

> There is no change. We will continue to meet this requirement.

Early repayment

The MCD gives customers the right to repay a loan early, either partially or in full. Firms must disclose the implications of a customer repaying early - for example, early repayment charges.

Virgin Money's approach and what it means for you

> There is no change. We will continue to meet this requirement.

Intermediary service disclosure

On request, intermediaries must tell customers which lenders they have a relationship with. Where they are paid commission, they must also provide details of these payments. These disclosures must be in writing (email is fine).

Virgin Money's approach and what it means for you

> This will not impact how we make commission payments to you currently.

Passporting

From 21 March 2016, the MCD allows FCA authorised intermediaries to 'passport' into other EU countries without needing to be authorised in those countries. This provides mortgage intermediaries with legal freedoms similar to insurance and investment intermediaries in the EU.

A further FCA consultation is expected around this.

Virgin Money's approach and what it means for you

> We do not expect this requirement to impact us as a lender at this time.

Restrictions on firms calling themselves independent

Under MCD rules, a firm cannot describe themselves as independent unless they give advice and recommend products from the whole Secured Lending market (this includes first and second charge mortgages where offered).

Virgin Money's approach and what it means for you

> As this may affect the way you currently carry out business we would suggest you seek guidance from your chosen Network, Club or compliance support business, working closely with them to implement these changes.

> You need to ensure you have a representative range of products and providers to be able to call yourself independent.

Removal of transitional arrangements

The FCA has withdrawn certain transitional arrangements that were not MCD compliant.

This means lenders must carry out a full affordability assessment when customers are remortgaging from other lenders, or when existing customers are being advanced additional borrowing to fund essential repairs to the property.

Virgin Money's approach and what it means for you

> We will continue to meet this requirement.

Pipeline arrangements

The MCD does not provide transitional arrangements for firms adopting MCD.

The MCD requirements apply to regulated mortgages entered into after 21 March 2016 and will be referred to as 'MCD Regulated Mortgage Contracts'.

Virgin Money's approach and what it means for you

- To help minimise the impact of the changes to our customers, partners and the wider market, we will make our system changes in February 2016. For applications submitted but not at Offer at the time of our February system change, we will aim to ensure that these applications are at Offer by 21 March 2016. For new applications after we've made our system changes in February, you will be asked for additional MCD information (including CBTL), to enable us to make an Offer.
- We will not be re-issuing any new or additional documentation for previously offered mortgages on 21 March 2016. After 21 March 2016, if you request a change to a case which was submitted prior to the system changes and which has an open Offer, the additional MCD information will be required.
- **We will introduce changes for FC loans earlier and from 20 October 2015, we will no longer accept this type of application.**
- So we can be MCD compliant, we will work with you, our intermediary partners, to make sure any applications submitted prior to our changes are at Offer stage by 21 March 2016.

GETTING IN TOUCH

We hope this introduction to the MCD and our approach has been useful to you, and will help you prepare for the upcoming changes. We look forward to working with you to ensure the support you need is there when you need it.

If you have any questions, please get in touch with your dedicated **Business Development Manager** who will be happy to help.

Please note, we have produced this document to help summarise and provide information around the key requirements of the MCD. However, this should not be solely relied upon for your understanding. For more detailed information on any aspect of the MCD, please visit the **FCA website**.

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