

Second Charge Lending Guidance – Q&A

What is second charge lending?

Second charge mortgages or 'homeowner loans' are where a consumer takes out further borrowing secured against their home. While a first mortgage is primarily for house purchase, second charge loans are typically used to fund consumption or for debt consolidation. A second charge lender can repossess a borrower's home if they default on their loan but the proceeds of sale will be used to pay off outstanding debts to the primary charge holder first.

How is the sector regulated?

Most 2nd charge mortgages are regulated by the OFT under the Consumer Credit Act 1974 (CCA74). The Act requires lenders to hold a consumer credit licence, issued by the OFT, and sets out a range of consumer protection requirements in relation to the advertising and marketing of loans, the form, content and execution of credit agreements, post-contractual disclosure requirements, default and termination, the taking of securities, and judicial controls over the enforcement of debts.

Until recently, in practice, regulation of the 2nd charge market was fairly limited. This was due to lenders being able to take advantage of significant exemptions from the CCA. Prior to April 2008 the CCA only applied to agreements worth £25,000 or less.

There are two main industry trade associations, the Finance and Leasing Association (FLA), and the Association of Finance Brokers (AFB).

The first-charge mortgage sector (your traditional home-purchase mortgage) is regulated by the FSA.

How big is the market?

Second charge lending represents approximately 2-3 per cent by value of all mortgage lending. At their peak in 2006, new advances were estimated at approximately £7bn. In 2008 they were closer to £3bn. Anecdotal evidence suggests that the impact of the financial crisis has severely limited the number of firms currently offering new business in the sector.

Average loan sizes are around the £20,000 mark.

Why is the OFT producing this guidance?

Concerns arose in early/mid 2008 about a rise in repossessions across first and second charge mortgages. This led to an internal Government review carried out by BERR, OFT, FSA, HMT and DCLG.

The review examined arrears and repossessions policies and practice in the second charge sector. The available evidence did not reveal systemic problems in these areas and found that there were examples of good practice within the second charge lending sector. However, the review did find that there were a number of areas in which improvements could be made.

Key to these areas for improvement is the need for clear guidance, and greater monitoring and oversight to ensure that second charge lenders exercise forbearance with borrowers in difficulty. The need for such guidance was announced by the Government in the Pre-Budget Report on 24 November 2008.

Our guidance was issued for consultation on the 13 February 2009.

Are there not a number of regulatory changes occurring which may impact on the sector (impact of Consumer Credit Directive, Treasury announcement that Government will review the case for transferring the regulation of second charge lending to the FSA)? Why are you issuing your guidance given all these potential changes?

Although it is certainly the case that there are a number of ongoing developments which could or will have an impact in the sector, given the current circumstances of the market and the economy and the consequent risks to consumers, the OFT does not consider it appropriate to delay production of this guidance. It is a sector where borrowers are subject to increased risks due to the potential possession of their property if they default and where there is existing evidence of consumer detriment which the OFT is addressing separately through a enforcement project (see below).

Given these factors it is important that the OFT, as regulator of the sector, issues guidance on the practices and procedures expected from those operating in the sector.

In producing this guidance the OFT has worked very closely with the FSA, BIS and other parts of government in order to ensure consistency of approach pending any future change of regulation arising from either a transfer of responsibilities to the FSA or any other proposed legislative changes.

Who responded to the consultation on the guidance?

We received a total of 32 responses to the document from a variety of large and small businesses operating in the sector, trade associations, professional bodies, regulators, enforcement agencies and consumer groups. A number of meetings were also held with stakeholders. A summary of responses to the consultation is available on the website.

How will the guidance be used / enforced by the OFT?

This guidance constitutes the OFT's view on the minimum standards that we would expect from lenders and brokers in the sector. If any breaches of the guidance are identified the OFT will consider enforcement or regulatory action where necessary, proportionate and appropriate.

Why is second charge lending considered a high risk area by the OFT?

Secured loans can often be used by those who may have difficulty in obtaining credit by other means. As defaulting on a second charge loan can lead to possession of the borrower's property, the product is considered to be high-risk under the OFT's approach to regulation.

Is there any current enforcement action covering the sector?

Yes. As a high risk area, the OFT retains a strong ongoing monitoring role over the sector and, as a result of concerns about the practices of a number of particular lenders, has recently launched an investigation into their activities.

The OFT's enquiry is focused around the entire lending process from the initial lending decision up to the handling of arrears and defaults and possession actions. The OFT has obtained further information from a number of lenders seeking further information to assess the level of consumer detriment in relation to the above. If evidence of malpractice is identified action would be taken under the licensing provisions of the Consumer Credit Act. An update on our work in this area is proposed by the end of August.

What is the Pre-action Protocol?

Since October 2008 lenders have had to comply with the Pre-action Protocol for Repossession Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property (PAP) as set out by the Civil Justice Council. This protocol covers cases going to court for possession and aims to ensure that a lender and a borrower act fairly and reasonably with each other in resolving any matter concerning arrears, and to encourage more pre-action contact in an effort to seek agreement between the parties on alternatives to possession.

What else is the OFT doing to protect borrowers?

The OFT is currently undertaking a project looking into what it considers to be irresponsible lending practices generally for the purposes of section 25(2B) of the Consumer Credit Act 1974 (see next question). The production of second charge lending guidance at this time is not intended

to pre-empt the outcomes of that project, but rather to provide greater clarity, **specifically** to second charge brokers and lenders, as to the practices and procedures that it expects them to employ to ensure that consumers are not treated unfairly or improperly by them.

How does this guidance fit with/affect the irresponsible lending guidance the OFT will be publishing?

The Second Charge guidance has been brought forward specifically for the second-charge sector. As noted above, the OFT will also be producing guidance on irresponsible lending practices which it considers inconsistent with a business' fitness to hold a consumer credit licence. Stakeholders will also be consulted on that guidance which will cover the full range of credit businesses and be specifically about behaviour or practices which may lead the OFT to take the view that a business has engaged in irresponsible lending within the terms of section 25 of the Consumer Credit Act (the fitness test). In consulting on that guidance we will take fully into account responses made on, and amendments made to, the second charge guidance which are relevant.

When will the irresponsible lending guidance be issued?

We propose to issue a draft version of the Irresponsible Lending guidance this summer with the final guidance produced early in 2010.

What should consumers do if they are in trouble?

There are things they can do and people who can help. Get free help and advice as soon as possible. A consumer's rights and options depend on the type of agreement, and the law can be complex. People can get free independent help and advice from a number of organisations.

A debt adviser may be able to negotiate on a consumer's behalf. They can suggest ways to deal with the problem and to make sure the most important debts are paid first.

A consumer may be able to ask a court for more time to repay a debt – but only in some circumstances. Consumers should speak to a debt adviser before considering court action and should keep copies of letters and emails in case these are needed by the court.

Consumers can contact the following non-profit making organisations for free, confidential and impartial advice:

National Debtline: If you live in England, Wales or Scotland phone 0808 808 4000 or visit www.nationaldebtline.co.uk for debt advice and information.

Consumer Credit Counselling Service: for debt advice throughout the UK – including Northern Ireland – phone 0800 138 1111 or visit www.cccs.co.uk

Citizens Advice: for advice and information on debt and other topics, visit your nearest Citizens Advice Bureau – check the phone book for the address.

Consumer Direct: if you live in England, Wales or Scotland phone 08454 04 05 06 or visit www.consumerdirect.gov.uk for general consumer advice and information. Consumer Direct's website includes information about credit and hire agreements and a fuller list of independent advice agencies.

ConsumerLine If you live in Northern Ireland phone 0845 600 62 62 or visit www.consumerline.org for general consumer advice

Community Legal Advice For free advice phone 0845 345 4 345 if you qualify for legal aid or visit www.communitylegaladvice.org.uk

Financial Ombudsman Service If you have a complaint that you can't resolve with your lender, the Financial Ombudsman Service may be able to help – phone 0845 080 1800 or visit www.financial-ombudsman.org.uk