

# **Second charge lending**

## **– OFT guidance for lenders and brokers**

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# 1 INTRODUCTION

- 1.1 Second charge lending involves consumers with an existing mortgage taking out further personal borrowing which is secured against the equity in their home. Firms offering or arranging such loans must be licensed by the OFT.
- 1.2 Most second charge mortgages are regulated under the Consumer Credit Act 1974 (the Act). The Act requires lenders and brokers 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, pre-contractual and post-contractual disclosure requirements, default and termination, the taking of securities, and judicial controls over the enforcement of debts.
- 1.3 The OFT will only issue a consumer credit licence if it is satisfied that a business is fit to hold that licence. In determining fitness the OFT will look at all relevant matters such as the trader's compliance with its legal obligations and with relevant OFT guidance, any evidence of unfair or improper business practices whether unlawful or not, as well as the general integrity and credit-competence of the trader and its employees and associates (including business associates).
- 1.4 This guidance constitutes the OFT's view on the minimum standards that we would expect from lenders and brokers in the sector. It should be read in conjunction with other OFT guidance, including the OFT's General Fitness Guidance (OFT969), and, in due course, the OFT's guidance on Irresponsible Lending which is due to be published at the beginning of 2010. For secured lending this guidance now supersedes existing OFT guidance on Non-Status Lending (OFT192v2).
- 1.5 The OFT expects all firms operating within the second charge lending sector to comply with this guidance, and expects firms to take active, documented steps to ensure that they have suitable business practices and procedures in place to ensure compliance (for example through training, compliance, auditing or disciplinary policies/procedures, or any

other means necessary and appropriate to the business). Further information on how the OFT will monitor compliance with this guidance can be found at chapter 7.

- 1.6 The OFT will consider taking enforcement action where it becomes aware of evidence that lenders or brokers are acting in breach of this guidance. Second charge lending is considered a high-risk credit activity by the OFT (given the increased risk to borrowers in the form of potential possession of their property) and therefore receives a high level of regulatory scrutiny. The OFT expects lenders and brokers in the sector to comply with both the letter and spirit of this guidance. The overriding principles of all businesses operating in the sector should be the need for appropriate consumer protection and fair business practice. In considering enforcement action against lenders and brokers operating in the sector, the appropriate level of OFT action will be guided by the level of actual or potential harm to the consumer and by the scale or frequency of breaches.

## 2 GENERAL PRINCIPLES OF FAIR BUSINESS PRACTICE

2.1 OFT considers that the following general principles of fair business practice apply to lenders and brokers in the second charge sector:

- **transparency** in all dealings with potential and actual borrowers, with early disclosure of key contract terms and conditions (including rates and charges).
- **fair and clear** contract terms and conditions, in plain and intelligible language, easily understood by borrowers.
- **no high-pressure selling**, with sufficient time allowed for the borrower to reflect on the terms and conditions of the proposed agreement, and the seriousness of the risk of taking out a loan secured on residential property. The borrower should be encouraged to obtain independent advice before signing and adequate opportunity should be allowed for this.
- **no irresponsible lending** with all underwriting decisions being subject to a proper assessment of the borrower's ability to repay the loan without undue hardship and without resort to the security (with the exception of those very limited circumstances where it is agreed expressly that the loan will be paid off by the security), taking full account of all relevant circumstances and any reasonably foreseeable future circumstances.
- **forbearance** towards consumers who are experiencing difficulty with sufficient opportunity to discuss the situation.
- **proportionate** action on arrears or default with due consideration of all available options. **Possession only to be used as a last resort** or where in the best interests of the borrower.
- lenders should take reasonable steps to ensure that brokers or other intermediaries who regularly act on their behalf do not engage in unfair business practices, or act unlawfully.

- lenders and brokers should not act in any way which is deceitful, oppressive, unfair or improper, whether unlawful or not.

### **3 PRE-CONTRACTUAL ISSUES**

- 3.1 All advertising and other promotional material for second-charge lending should comply with relevant legislative and regulatory requirements. Advertisers should also comply with the requirements of the Committee of Advertising Practice (CAP) and the Broadcast Committee of Advertising Practice (BCAP) Codes.
- 3.2 Advertising and other promotional material should be accurate and clear and should not in any way mislead, in particular with regard to the nature of the credit and the costs of borrowing.
- 3.3 Advertising and other promotional material should not in any way suggest or imply that loans are available regardless of the income or other financial circumstances of the borrower, or dependent only upon the value of equity in the property on which the loan is to be secured.
- 3.4 All risks to the borrower should be highlighted at an early stage of communications with potential borrowers allowing them sufficient time to consider the implications of these risks. Where appropriate, these risks should be explained orally to the borrower. In particular, the borrower should be informed of the potential consequences of missing payments, or under-paying, including default charges and risk of possession of the property. The possible risks to the borrower's credit record, and ability to obtain credit in future, should also be highlighted.
- 3.5 The OFT considers it very important that, when entering second charge arrangements, consumers understand the nature of the obligations and risks they are taking on. Lenders should not therefore enter into an agreement with a prospective borrower if they have reasonable grounds to suspect that the borrower does not understand material aspects of the obligations they are taking on and the risks involved. The lender should provide further explanation where they have reasonable grounds to suspect that the borrower does not understand a key aspect of the credit agreement and / or the pre contract information.

- 3.6 There should be transparency about the circumstances in which rates or charges may change, in particular where they may be varied at the discretion of the lender or by reference to some particular factor, for instance as a result of an increase in the lender's input costs. If rates are stated to be variable but do not vary in line with Bank of England base rate, this should be made clear, and if a particular rate is tracked, this rate should be stated.
- 3.7 There should be no undue emphasis on the speed with which loans can be obtained, nor any inappropriate incentives to sign the agreement quickly. The relevant provisions of the Act covering the time the consumer is allowed to consider the agreement for and the limits on the lender's contact with the borrower during that consideration period must be adhered to in respect of agreements regulated under the Act.
- 3.8 Second charge loans must not be canvassed off trade premises. Any visit to the borrower's home with a view to selling credit to be secured by a second charge, or increasing the total amount of credit, should be made only at the borrower's **specific** invitation, in writing, and only then if the purpose of the visit is made clear in advance.
- 3.9 There should be no high-pressure selling. Cold calling may only take place when there is an explicit understanding that the person called is under no obligation or inducement to deal with the caller or to take out a loan. Borrowers should not be put under pressure to enter into a new loan agreement or to extend an existing loan. Lenders or brokers should not mislead borrowers in any way about the terms on offer or use devices to pressurise borrowers into entering agreements without adequate time to reflect and consider. Examples of this would be staying in a borrower's home for an unnecessary length of time or after the borrower has indicated that the trader should leave or falsely suggesting that the terms are only available if the borrower signs up on the spot.
- 3.10 Brokers should disclose at the outset the nature and extent of the services offered to the borrower, together with any ties they may have to lenders or other brokers. If a brokerage fee is payable this should be made clear at the outset. The amount of the fee should be confirmed in

writing before entry into the credit agreement. All fees repayable under section 155 of the Act should be returned promptly in accordance with OFT guidance.

- 3.11 The existence of any commission or other payment payable by the lender to the broker should be disclosed to the borrower at an early stage, for instance before the broker engages in specific discussions based on the prospective borrowers circumstances, so that the borrower is aware of any potential conflict of interest. The amount of the commission or override commission should be disclosed.
- 3.12 Lenders should ensure that remuneration arrangements do not provide an undue incentive for brokers or salespersons to recommend particular products that may not be in the borrower's best interests. Differential commission rates or 'volume overrides' should be offered only where this is justified in terms of the relative work involved.
- 3.13 Brokers and salespersons should not pressurise the borrower to take out a loan for a higher amount than the borrower initially requests and brokers and salespersons should not suggest the borrower should take out a loan for a higher amount than they can afford to repay without undue hardship or without resort to the security.
- 3.14 Brokers and salespersons should ensure, based on their knowledge of the consumer's individual circumstances, that any recommendation given is in the best interests of the borrower. If it appears to the broker or salesperson to be the case that it would not be in the borrower's best interest to take out a secured loan this should be made clear to the borrower. Any recommendation given should be appropriate to the borrower's needs and circumstances. The borrower should be encouraged to consider whether they can afford the credit, including in the event that their circumstances change, for example through a change in their employment or retirement.
- 3.15 If the broker or salesperson has reason to suspect that the borrower does not understand material aspects of the credit agreement, additional explanation should be given, where appropriate orally. This should cover

in particular the costs of the credit and the importance of keeping up repayments. The borrower should be encouraged to ask questions if he is unsure of any element, and reasonable opportunity should be provided for this.

## **4 CONTRACTUAL ISSUES**

- 4.1 Contract documentation (as well as any pre-contract information) must comply with all relevant legislative requirements. It should set out clearly and fully the borrower's rights and responsibilities under the agreement. Contract terms should be written in plain and intelligible language, and should not be unfair within the meaning of the Unfair Terms in Consumer Contracts Regulations 1999.
- 4.2 The borrower should be encouraged to read all contract documentation carefully, and to consider obtaining independent legal or financial advice before entering into the agreement. Sufficient time should be allowed for this.
- 4.3 The contract documentation and any associated customer booklet or leaflet should set out the nature and purpose of any fees or charges payable by the borrower, including any sums payable on default.
- 4.4 If rates or charges are variable, this should be made clear. The potential implications of such variations should be explained, including the impact on the periodic instalments and / or the amount payable. Rates should only be increased on a loan to recover genuine increases in costs which have an effect on that loan and should not be misused, for example, to take advantage of a borrower's lack of ability to end the agreement. Clear explanations should be given to borrowers prior to rates or charges changing.
- 4.5 Early settlement charges should be fair and reasonable, and should reflect the lender's necessary costs on early settlement. For regulated agreements, they should be calculated in accordance with the relevant legislative requirements. There should be transparency of early settlement processes and costs. Provision should also be made to enable the consumer to repay part of the capital early, in order to reduce their indebtedness.
- 4.6 Brokers and salespersons should, as far as is reasonable and practicable, ensure that all information on a loan application is correct. They must

not falsify details (for example as to income or employment), nor encourage or actively allow the borrower to do so. If there are doubts as to the accuracy of information provided on or in support of the application, these should be brought to the lender's attention, so that a decision can be made on whether to refuse the application.

## **5 POST-CONTRACTUAL ISSUES**

- 5.1 If the borrower goes into arrears, lenders should deal with this in a considerate manner and proactively engage with the borrower to help address the problem. Where a borrower is behind by the equivalent of two periodic repayments, the lender should notify the borrower promptly, and in any case within 14 days. Where applicable, an arrears notice should be served in accordance with the relevant legislative requirements.
- 5.2 Lenders should provide further notices at intervals of not more than six months while the borrower remains in arrears. In particular, the borrower should be informed of any interest or default sums that have been added to the account.
- 5.3 Any charges on arrears or default should be limited to covering the lender's necessary costs. Charges should be set out clearly and fully as part of the credit agreement and in periodic statements.
- 5.4 Lenders should take measures to proactively monitor loan accounts and to engage with the borrower with a view to minimising ongoing problems. As well as seeking to assist the borrower themselves, lenders should also point borrowers who are experiencing payment difficulties to non-profit seeking providers of free, independent, impartial advice.
- 5.5 Lenders should not harass the borrower by, for example, making excessive or intimidatory telephone calls or contacting the borrower at unsociable hours. Lenders and their appointed representatives must comply in all respects with the OFT guidance on debt management and debt collection.
- 5.6 Lenders should not send letters or other documents which are made to appear as if they derive from a court or other legal institution or which make unfounded or unrealistic threats of legal action. Lenders should not make undue, excessive or inappropriate use of statutory demands.

- 5.7 Lenders should take particular account of the needs of customers with serious illnesses or mental health problems where they are aware that these issues exist.
- 5.8 Lenders should not disclose the fact that a borrower is in arrears to **any** third party without the borrower's consent, or without prior authorisation under the terms of the credit agreement (for example, consenting to disclosure to credit reference agencies).
- 5.9 When a borrower is experiencing difficulties, lenders should seek, wherever possible, to negotiate reasonable repayment plans which reflect the circumstances of the individual borrower and are based on an assessment of affordability having regard to the borrower's income and other financial commitments (for example, as would be disclosed in a Common Financial Statement).
- 5.10 Where appropriate, lenders should act with forbearance with a view to enabling the borrower to remedy the position, for example by freezing interest and other charges for a period, or allowing deferred payment of arrears.
- 5.11 Lenders should respond promptly to any telephone calls or correspondence from the borrower or from the borrower's agent or representative. They should not refuse to deal with appointed or authorised third parties who are acting on behalf of the borrower (for example, Citizens Advice Bureaux). This is particularly the case where the debt may be disputed or a proposal for a reasonable repayment plan is being formulated.

## **6 POSSESSION ACTIONS**

- 6.1 For actions in England and Wales lenders must comply with the requirements of the Pre-action Protocol for Possession Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property (PAP) as set out by the Civil Justice Council in October 2008.
- 6.2 The PAP applies to arrears on second charge loans as it does to first charge loans. The aims of the PAP are 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. In addition, the lender should ensure where permitted that contact is established with the first charge lender, to minimise any adverse impacts on the borrower.
- 6.3 Lenders should not seek to repossess the borrower's property except as a last resort, where other forbearance options have failed or have otherwise not proved suitable. This means they should explore all other possible options for dealing with the problem, and should give proper consideration to any reasonable offer by the borrower to pay by instalments. They should not insist unreasonably that the arrears are paid in one payment or in large amounts or within an arbitrarily short period. They should not institute court proceedings unless and until all other avenues have been explored and have failed or have otherwise not proved suitable.
- 6.4 There are currently no formal equivalents of the PAP in Scotland and Northern Ireland, however, the OFT expects that companies should look wherever possible to treat debtors in those areas with the same levels of forbearance as they would a debtor in England or Wales.
- 6.5 If a shortfall remains after the property has been sold the borrower should be notified promptly so that they can take steps to remedy the position.

## **7 REGULATORY COMPLIANCE AND ENFORCEMENT**

- 7.1 We are committed to fair, effective and proportionate enforcement. In practice this means that where we identify non-compliance with the law and / or relevant OFT guidance, we will decide on the appropriate regulatory response in the light of the facts and circumstances of the individual case, including the risk of detriment to consumers.
- 7.2 In cases of serious misconduct and / or where there are concerns about integrity, we may conclude that a trader is not fit to hold a licence and will act to revoke its licence. Failure by second charge lenders or brokers to employ adequate practices and procedures in order to ensure that consumers are not subject to unfair or improper treatment would constitute grounds for the OFT to consider fitness to hold a licence.
- 7.3 Where we think it sufficient just to ensure that conduct is changed, and we do not have fundamental concerns about integrity or other aspects of fitness, we may take a different approach in the first instance and use one of the other compliance tools available to us.
- 7.4 It may be appropriate to impose specific 'requirements' on a trader where we are dissatisfied with certain aspects of conduct or that of any associates. Failure to comply with a Consumer Credit Act section 33A requirement can lead to the imposition of a financial penalty of up to £50,000 per instance. We may also compulsorily vary a licence, for instance to limit the activities for which a trader is licensed, or limit the life of the licence.
- 7.5 Alternatively, it may, for example, be appropriate for the OFT to take action under Part 8 of the Enterprise Act 2002 in respect of domestic or Community infringements falling within sections 211 or 212 of that Act. Our approach to the use of these powers is discussed in Enforcement of consumer protection legislation – Guidance on Part 8 of the Enterprise Act (OFT512). We also co-ordinate such actions undertaken by other enforcers. The OFT also has both civil and criminal enforcement powers under the Consumer Protection from Unfair Trading Regulations 2008, which came into force on 26 May 2008.