TOPIC 11

Checking the applicant’s credit status

LEARNING OBJECTIVES

We looked in Topic 10 at the main ways that lenders can assess whether an applicant can afford the proposed mortgage, and the ways in which they can verify an applicant’s income. Before making a mortgage offer, the lender will also need to be satisfied that the applicant is not hiding any debts or past credit problems that would affect their application. It is also important that the lender ensures, as far as possible, that the application is genuine and not an attempt at fraud or money laundering.

By the end of this topic, you should have an understanding of:

- how lenders assess an applicant’s credit status;
- how and why lenders use credit searches;
- credit scoring;
- the role of guarantors;
- credit problems and their implications for borrowers and lenders;
- mortgage fraud and the measures lenders can take to combat it;
- references and the requirements of data protection legislation;
- anti-money-laundering requirements.

THINK . . .

Before you start work, take a moment to think about what you already know about the content of this topic.

For instance:

- What sorts of factor affect an applicant’s credit score?
- How does being subject to a bankruptcy order or IVA affect an individual’s access to credit?

- What information about themselves do individuals have the right to access under data protection legislation?
- What laws are in place to try to prevent money laundering?

11.1 What is credit assessment?

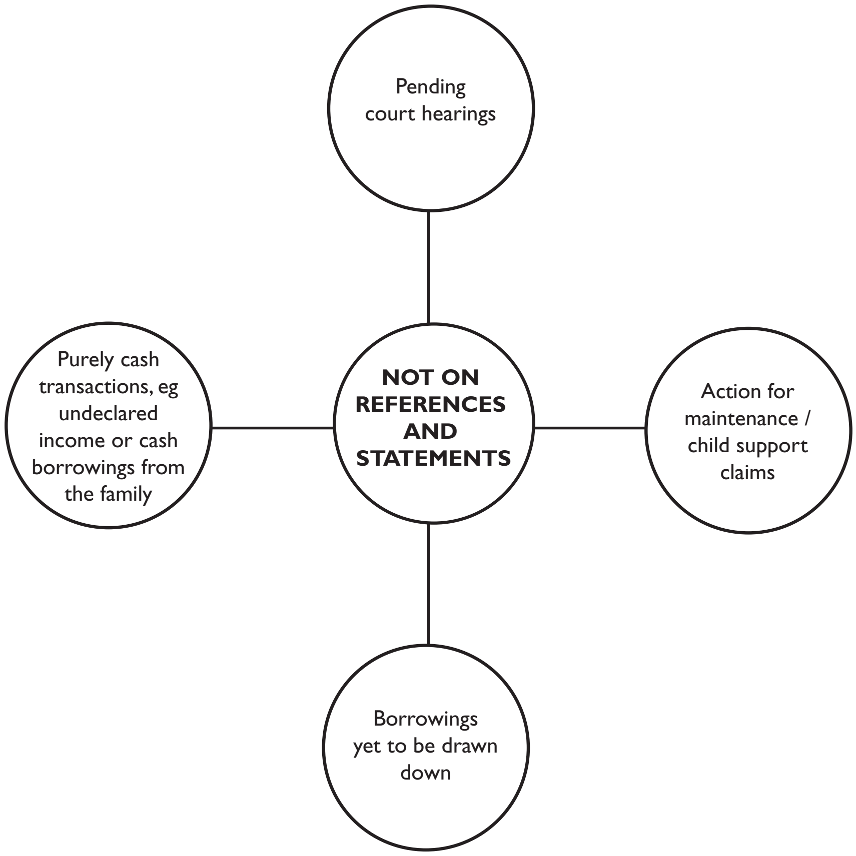
Although lenders can take references from a number of sources, including employers, lenders and landlords, financial statements are also useful as they can provide a good indication of track record and lifestyle.

Bank statements may appear to give a favourable impression of the applicant – but the adviser and lender should check that the applicant does not have bank accounts with other institutions that are being deliberately concealed. Figure 11.1 indicates some key points that the lender should look for, while Figure 11.2 highlights some important information that does not show up in financial statements.

FIGURE 11.1 WHAT SHOULD THE LENDER LOOK FOR IN FINANCIAL STATEMENTS?

Bottom line balance on bank statements	Whether there is a surplus or a deficit or there are fluctuations, and the reasons
Regular income	Compare this with information on the application form and employer's reference
Regular payments out	Compare this with information on the application form
Overdrafts	Amount, frequency and reasons
Fees and charges	Unauthorised overdraft fees and bank charges
Returned cheques / failed direct debits	Frequency and amounts involved
Maintenance payments	Continuous or irregular
Mortgage statements	Regularity of payments, outstanding arrears, fees and charges and whether information is consistent with that on the mortgage application form

FIGURE 11.2 INFORMATION NOT REVEALED BY REFERENCES AND STATEMENTS



11.1.1 Credit searches

> **CREDIT BUREAU**
>
> An organisation with a vast database of information on individuals, relating to previous bad debts and default, county/sheriff court judgments and insolvency.

Credit searches are an integral part of the credit assessment process. The starting point is to establish whether the person applying for the mortgage is permanently resident at the address given in the application form. This can be confirmed by checking the electoral roll, although the roll is not totally up to date at all times. It tends to be amended once a year, using 1 October as a cut-off date. If a person has moved recently, the lender will cross-refer to the immediate previous address given on the application form. In a minority of cases, there will be no record on the electoral roll – for example, a family moving back to the UK after living and working abroad – and in this case the lender must simply use whatever evidence can be obtained.

Credit reference searches can be made through credit bureaux (ie credit reference agencies) such as Experian, Equifax and TransUnion, which store and maintain financial and public records of people who have received credit. Credit references provide an insight into the activities and credit problems of specific individuals based on historical information. A credit search could show a ‘default’ (see Figure 11.3).

FIGURE 11.3 WHAT IS DEFAULT?

Default

Where the borrower missed one or more payments, and did not respond satisfactorily to requests to correct the problem

The lender can issue a notice of default to the borrower

Consequences

The credit record shows the default for six years from the date of the default notice, even if the arrears are paid off

The record will show the amount of the original default and the balance at the date of the report, including any payments made since default

Lenders will be wary of agreeing to provide a mortgage for someone who has defaulted and, if they do agree to an advance, may charge a higher interest rate. If the default happened some time ago, was satisfactorily resolved and the applicant has had a good track record since, the lender is likely to be more sympathetic and may agree to a mortgage on standard terms.

11.1.2 Payday loans

Current or previous payday loans may affect a lender’s attitude towards agreeing to a mortgage. Using payday loans may be seen as an indication that the applicant is not able to manage their finances effectively, as they tend to be used as last-resort borrowing.

The lender may see the need to take out a payday loan as an indication that the applicant cannot budget effectively or may have a regular income shortfall.

PAYDAY LOAN

Short term, very high interest unsecured lending designed to be paid off on the borrower’s next payday.

Due to the short duration of payday loans, they may not show up on all credit searches. However, lenders tend to use multiple data searches as part of the due diligence process for assessing the applicant, some of which may show payday loans taken out in the previous six years.

11.1.3 Credit scoring

Almost all lending institutions use credit scoring as an integral feature of the assessment process. Scores are given to certain aspects of the application, based on historical data relating to risk. In simple terms, a certain number of points are then allocated in each category so that, once the points for each category are added up, the total score reflects the credit score. Applications that receive more than a certain score (often known as the cut-off score) are accepted, while those that do not are declined.

The lender will consider specific factors such as:

- age;
- income;
- occupation;
- existing commitments;
- credit searches;
- conduct of any existing bank or loan accounts with the lender.

In addition, the credit score will consider more general factors that, from experience, are considered important in assessing risk (Figure 11.4).

FIGURE 11.4 WHAT GENERAL FACTORS DOES THE CREDIT SCORE CONSIDER?

Does the applicant have experience of managing credit?	Has the applicant shown poor debt management in the past?
Assuming an existing mortgage holder has had no problems, they tend to be scored higher than first-time buyers, who have no mortgage track record	If the applicant makes only minimum payments on a credit card balance, this could show problems with debt and could reduce the score
Applicants who have never applied for any form of credit before may receive a low score	If the applicant has applied for multiple credit cards or loans, this could indicate poor debt management

Critics of credit scoring suggest that it removes the 'human element' from lending but, although there is some truth in this, a good system is able to incorporate override features to enable discretion. Many lenders' systems will allow for scrutiny of 'borderline' applications – those that achieve a score within a certain number of points of the cut-off point. Such applications can be referred to a supervisor or lending officer for review.

Credit-scoring models are not static: they have to change with the changing environment and lenders keep them under constant review to ensure they are robust. In addition, it is important to recognise the following points.

- There is no single scoring model. Different organisations have different lending policies and scoring systems – some will be happy to entertain a higher risk profile, compensating for the risk with higher interest rates. Others will have a policy of maintaining the lowest interest rates they can to keep their competitive edge, and will be keen to screen out all but the most creditworthy borrowers.
- Credit scoring is no more than a statistical tool. It cannot predict what will actually happen with an individual case – all it can do is highlight the probability that a particular proposition will do well or badly. As such, it can help lenders to screen out applicants where there is a high likelihood of default and thus manage their risk exposure.
- Credit scoring evolves over time as lenders learn from experience and refine their techniques. Some criteria can be shown to be consistently useful: for example, employment status and length of employment, income, credit history, home ownership status and length of time in current residence.

Credit scoring is best applied when:

- the institution has a well-developed database on its existing mortgage book;
- it is built into a mortgage processing system;
- dealing with high volumes of business, ie reasonable statistical sample size;
- lending policy is well defined.

Many advisers recommend that applicants check their credit score before making an application, using services provided by organisations such as Experian, Credit Karma and Equifax. Many people have accounts with such organisations that allow them to make regular checks on their own credit score.

11.2 What is the role of a guarantor?

Sometimes lenders feel that a borrower may be able to afford a slightly higher mortgage than they would normally offer, but are reluctant to lend the higher amount without additional security over and above the property. They require something more – and that something may be the support of a guarantor.

A guarantor makes a guarantee, which is defined under the Statute of Frauds Act 1677 as a written undertaking to answer for the debt, default or miscarriage of others. Typically, guarantees are taken from parents on behalf of their child's borrowing. Frequently, the directors of a company are asked to give personal guarantees to secure a loan made to the company because a loan made to a company is enforceable only against the company, not its shareholders and not normally against the directors. Undertaking to guarantee the loan ensures the support of the directors in making sure the company meets its obligations.

KEY TERMS

GUARANTEE

A formal agreement to accept legal responsibility for the repayment of a loan if the borrower cannot, or will not, repay it themselves.

GUARANTOR

An individual, a company or a partnership that provides a guarantee. Also known as a surety.

FIGURE 11.5 WHAT ARE THE TWO TYPES OF MORTGAGE GUARANTEE?

Full liability

- The guarantor is liable for the entire debt if the borrower defaults on the mortgage payments.
- The guarantor must usually be able to demonstrate that they can afford at least 100% of the mortgage, in addition to their own existing commitments.

Limited liability

- The liability is limited to the difference between the loan the lender would normally agree and the loan needed, with a possible additional percentage of perhaps 10%.
  - Eg: if the property was purchased for £200,000, the borrower had a £20,000 deposit and the lender would normally lend £150,000 based on the borrower's income, the guarantee would be for £30,000 plus 10% of the borrower's shortfall, totalling £33,000.
- The liability is shown as a percentage of the mortgage.

A lender must exercise great care in how it takes guarantees. On the one hand, it will want to be sure that it does all it legally can to ensure the guarantor pays; on the other, it must be careful to prevent the guarantor from being legitimately able to avoid their obligations.

A major risk to guard against is the guarantor arguing that the guarantee is invalid because they did not receive adequate explanation of the terms or that undue pressure made them sign it. Lenders should always advise prospective guarantors to seek independent legal advice before agreeing to act as a guarantor.

Steps should be taken to ensure that prospective guarantors understand what they are taking on, including the amount they are guaranteeing. Unlimited guarantees are not permitted.

TABLE 11.1 WHAT ISSUES CAN RENDER A GUARANTEE INVALID?

Issue	Description
Lack of capacity to contract	Such as where the guarantor is a minor with no legal capacity to contract, where the guarantor has reduced mental capacity or suffers from a mental illness, or where the guarantor is a company with no powers to give guarantees
Undue influence	Where one party is dominant over another and can persuade them to do something they probably would not otherwise do This may simply be by virtue of the nature of the relationship between the guarantor and the borrower Examples of relationships where it might be possible to demonstrate undue influence include husband and wife, parent and child, doctor and patient, or solicitor and client
Misrepresentation	Where the terms of the guarantee were misrepresented to the prospective guarantor – whether because of negligence, fraud or accident
Misapprehension	Where the prospective guarantor is under an incorrect impression about the nature and effect of the guarantee and it is fundamentally different from what they had agreed If the lender becomes aware of this, it has a duty to correct the misapprehension or it may find itself liable for misrepresentation
Mistake	Where the guarantor can show that they have not understood the nature of the document being signed
Duress	Where the guarantor has been forced, perhaps by way of physical threats, to sign the guarantee document

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KEY LEGAL CASES

In *Barclays Bank plc v O'Brien* [1994], the plaintiff, Mrs O'Brien, was able to prove that the guarantee she gave to support her husband's borrowing was invalid due to misrepresentation and undue influence, and that she had not been advised to seek truly independent advice.

It is now an established feature of lending practice that prospective guarantors are advised to seek independent legal advice before agreeing to act in that capacity.

In *Lloyds Bank v Waterhouse* [1991], the defendant, who was illiterate, signed a guarantee for his son, after first contacting the bank to check what he was being asked to sign. The bank told him he was signing a limited guarantee but it was in fact unlimited and left the defendant liable for all his son's debts. The bank's claim to enforce the guarantee was rejected by the court because the bank had given the defendant incorrect information when he sought to clarify the terms of the guarantee.

IN BRIEF

KEY FACTS ABOUT GUARANTEES

- The lender has the right to enforce the guarantee should the borrower default on repayment.
- The borrower has no duty to disclose information to the guarantor unless the guarantor asks for specific information.
- The guarantor does not have an interest in the property on which they are guaranteeing the mortgage and does not have the right to inspect mortgage documentation or be informed of mortgage payments missed. In many cases the first the guarantor will hear of a problem is when the lender demands payment.
- The guarantor must be informed if the mortgage holder requests a further advance or an extension of the term, and can refuse their consent.
- The guarantor can make a request to be released from the guarantee, but the lender will only usually agree to this if it is felt that the borrower will be able to manage the mortgage without danger to the lender. In many cases, the lender will simply refuse to release a guarantor.

The updated MCOB rules require lenders to assess whether the guarantor could afford to take on the payments should the guarantee be called upon. MCOB 11.6, which deals with responsible lending, states that "references to the customer must be read as referring also to any guarantor of the customer's obligations under the regulated mortgage contract, where the context permits". In essence, the lender must make the same checks on the guarantor as they would on the applicant.

As you will see in Unit 6 (Topic 24), several lenders now offer 'guarantor' mortgages, where a parent or other relative acts as guarantor for their relative's mortgage. With many of these mortgages, the guarantor is required to deposit a sum of money into a savings account with the lender. Although it earns interest, the money cannot be withdrawn until the end of an agreed period and can be used by the lender during that period to offset any losses if the borrower defaults.

JOINT BORROWER, SOLE PROPRIETOR

Some lenders offer a joint borrower, sole proprietor mortgage, where the property is purchased in the sole name of the buyer but a family member agrees to be a joint borrower, and their income (less commitments) is taken into account when assessing affordability. As joint borrower they are jointly and severally liable for the mortgage, but they have no rights over the property. This avoids two potential SDLT problems if a property-owning family member becomes joint owner and joint borrower:

- Becoming joint owner would result in the SDLT surcharge on the purchase.
- If one owner was already a property owner, the first-time buyer SDLT exemption would not apply to the purchase.

However, the joint borrower should fully understand the potential risks in being liable for the mortgage without any rights over the property.

11.3 Insolvency and debt problems

Most people manage to meet the terms of their credit agreements. However, some borrowers find themselves in a position where they default on credit, either through misfortune or through bad financial management. Insolvency occurs when:

- a person's liabilities exceed their assets; and

- they cannot meet their financial obligations when they fall due.

When it becomes clear that they will not be able to meet their obligations, there are a number of legal processes that can be used to address the problem.

11.3.1 County/sheriff court judgments

In England and Wales, when a person is unable to pay their creditor(s), the creditor(s) can bring a civil case to the county court. The court can make a county court judgment (CCJ) against the debtor, setting out how the debt should be repaid. This will normally be as a lump sum or by regular instalments. If the terms of the judgment are not met, the creditor can go back to court for further action, which may result in an 'attachment of earnings' order. This means that the individual's employer must deduct a certain amount from their pay and pass it on to the court for onward payment to the creditor. Attachment of earnings orders can only be made against employees.

CCJs are listed on the Register of Judgments, Orders and Fines for England and Wales. They stay on the register for six years, unless they are paid in full within a month of the judgment. If they are paid after one month, they are shown as satisfied on the register. CCJs that have not been paid are shown as 'unsatisfied' for the six-year period. The credit reports used by lenders take information from the register, so such reports will also show the CCJ for six years unless it was satisfied within a month.

SHERIFF COURT JUDGMENTS

Cases are brought to the sheriff court in Scotland, with the judgments held on a register of sheriff court judgments. Awards for debts are known as 'money decrees'. As with the process in England and Wales, the record is held for six years from the date of the judgment.

!

CONCEALMENT OF CCJS

A mortgage application form always requires details of CCJs or sheriff court judgments and it is a criminal offence to knowingly conceal them from a prospective lender.

Although CCJs do not rule out the ability to get a mortgage, they have to be considered within the context of the application as a whole. A person who has been unable or unprepared to meet obligations in the past may be regarded as less reliable in the future. However, some lenders are prepared to consider 'high risk' clients with a poor track record – several charge high rates of interest and impose onerous conditions for late payment.

11.3.2 Bankruptcy

Bankruptcy is a formal process for dealing with personal insolvency. Even if a potential borrower does not declare that they are or have been bankrupt, it will be revealed by credit searches.

CHECK YOUR UNDERSTANDING 1

✓

We looked at bankruptcy in Topic 2. See what you can remember.

a) How much must a creditor be owed in order to petition for a debtor's bankruptcy?

b) For how long does a bankruptcy order remain in force?

c) What restrictions are there on a bankruptcy individual's ability to borrow?

If the bankrupt is the sole owner of a property with at least £1,000 equity in it, the property will transfer to the trustee in bankruptcy, who becomes the legal owner and can sell it to settle debts. A bankruptcy restriction notice is entered at the Land Registry against a property. This shows that the bankrupt is no longer the legal owner of the property and cannot sell or deal with matters relating to the property; only the trustee can do so.

EQUITY

The difference between a property's sale price and any expenses such as the mortgage settlement figure and conveyancing fees.

Situations sometimes arise where a couple own a property, and one of them is bankrupt but the other is not. The following applies:

- The bankrupt's interest in the property does not pass to the trustee in bankruptcy.
- The trustee in bankruptcy can apply for a possession order and sell the property if the bankrupt's interest in the property (share of the equity) is £1,000 or more.
- The trustee enters a Form J restriction at the Land Registry. It records the trustee's interest in the property, and requires the Land Registry to notify the trustee of any dealings relating to the property. The restriction remains in place until the trustee's interest in the property has been settled. The restriction does not stop the bankrupt and the joint owner selling the property, but the restriction will not be lifted until the trustee has been paid.

- Where the bankrupt's interest exceeds £1,000, the forced sale of the mortgaged property can be delayed for at least one year to allow the family to make alternative arrangements.
- The joint owner can 'buy out' the bankrupt's interest in the property from the trustee in bankruptcy.
- If the property is the bankrupt's main residence, the trustee has three years from the date of the bankruptcy order to decide whether to sell the property to pay the debts. If no action has been taken by that deadline, the property reverts to the bankrupt. If the property is not the bankrupt's main residence, the trustee has no deadline by which to take action.

WHAT ARE THE DIFFERENCES BETWEEN BANKRUPTCY AND SEQUESTRATION?

The formal term for bankruptcy in Scotland is 'sequestration'. The differences are as follows:

- The debtor can apply to the court for a sequestration order for a minimum debt of £3,000.
- One or more creditors can apply for a sequestration order for a minimum debt of £3,000.

The debtor must be 'apparently insolvent' – or unable to pay their debts.

On the grant of a sequestration order, the debtor's assets are transferred to a trustee to be sold, with any money raised going to the creditors.

THE BANKRUPTCY (SCOTLAND) ACT

The Scottish government responded to concerns that the sequestration process in Scotland was complicated and confusing, with various pieces of legislation having built up over many years. The Bankruptcy (Scotland) Act came into force on 30 November 2016, and applies to all applications from that date. It is referred to as a 'consolidation' act because, although it does not make any significant changes to the basic bankruptcy law as such, it consolidates more than six previous pieces of legislation into one logically presented act, the purpose of which is to set out the process in one place and make it easier for those working in bankruptcy to follow the process for bankruptcy applications.

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11.3.3 Individual voluntary arrangements

An individual voluntary arrangement (IVA) is an alternative to bankruptcy, supervised by an insolvency practitioner. If the arrangement is agreed, the creditors accept a reduced payment, for example 60p for every £1 owed.

CHECK YOUR UNDERSTANDING 2

Is an individual legally prevented from taking out a mortgage if they are subject to an IVA? Think back to your studies in Topic 2.

A creditors' meeting must be held for an IVA to be arranged, and creditors representing at least 75 per cent of the debt amount must agree to the IVA. For example, if the debt is £100,000, creditors owed at least £75,000 in total must agree to the IVA. Once the agreement is confirmed, interest and charges on the debts are frozen and the debtor makes fixed monthly payments towards the debts, as set out in the agreement.

Those subject to IVAs are considered by all lenders to be a poor credit risk, although in a minority of instances a mortgage may be a solution to the overall problem.

WHAT IS A PROTECTED TRUST DEED?

A protected trust deed in Scotland is similar to an IVA. The key points are as follows:

- The arrangement is made through an insolvency practitioner (known as the trustee).
- The debtor may be required to sell certain assets to help repay the debts.
- The debtor cannot take out any further credit during the term of the agreement.
- The arrangement lasts for four years, at which point the creditors write off the debts, assuming all the terms of the agreement have been met.
- The trustee must advertise the proposal in the *Edinburgh Gazette* and write to the creditors advising that the debtor wants to arrange a protected trust deed.
- Creditors have five weeks from publication of the notice to object.
- The trust deed takes automatic effect if no more than 33 per cent of creditors by value (or more than half by number) object.

11.3.4 Company voluntary arrangements

Company voluntary arrangements (CVAs) are the equivalent of IVAs for limited companies, and are subject to the same conditions as an IVA. A company or limited liability partnership can apply for a CVA if all the directors or partners agree.

11.3.5 Debt relief orders

Debt relief orders (DROs) are intended to help those living in England and Wales who are struggling to pay their debts, and who:

- owe a maximum of £30,000;
- have total gross assets not exceeding £2,000 – vehicles valued at £2,000 or lower are not included in the calculation;
- have disposable monthly income (after tax, NICs and normal household expenses) of no more than £75.

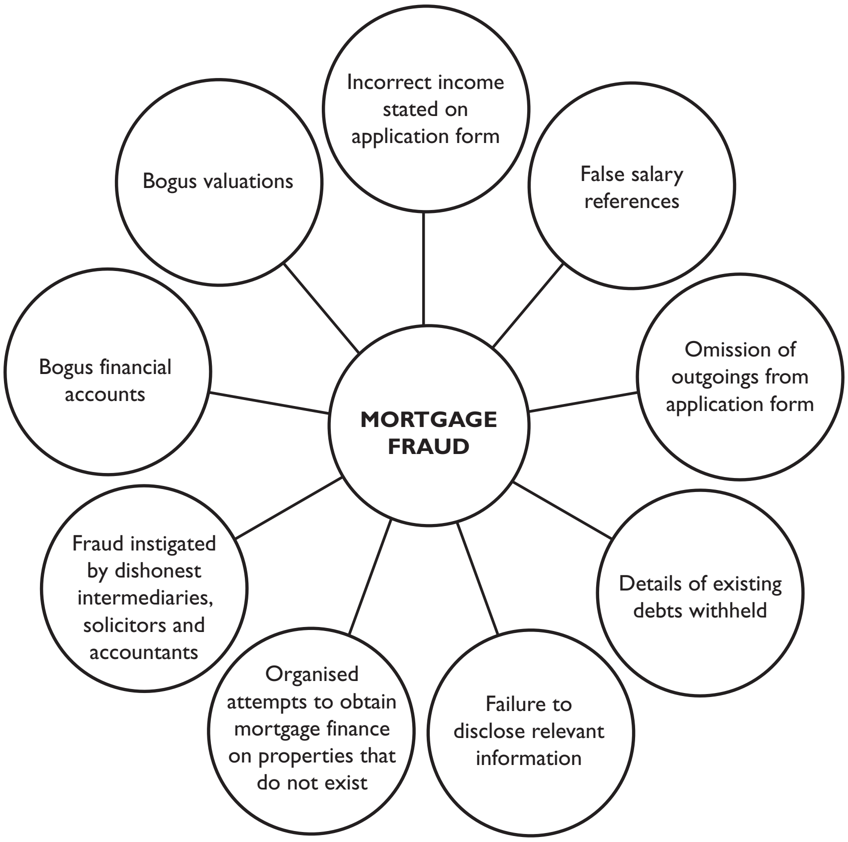
If a DRO is granted, the creditors listed in the order are subject to a 'moratorium' on debts owed to them, usually lasting for 12 months, during which they cannot seek repayment or enforcement of debts owed to them. At the end of the moratorium, assuming the debtor has met the terms of the DRO, the debts are written off and they are discharged.

An individual with a DRO is very unlikely to be in a financial position to take out a mortgage, and lenders would be reluctant to lend to such an individual.

11.4 Fraud

Fraud occurs when a person deliberately sets out to obtain funds from another person or organisation by dishonest means. In recent years, the incidence of mortgage fraud has increased significantly. The extent of the crime may vary from a simple overstatement of income to highly organised and systematic professional fraud attempts. Figure 11.6 provides some examples.

FIGURE 11.6 WHAT IS MORTGAGE FRAUD?



Advisers also have to be aware of fraud that can arise in respect of:

- money laundering;
- life assurance;
- household and other general insurance.

Fraud costs the financial sector millions of pounds each year. It is therefore a major area of concern to individual lenders and trade bodies such as UK Finance.

Measures that can be taken to combat fraud include:

- a rigorous approach to corroboration of income and outgoings, with written confirmation and telephone follow-up where necessary;
- special attention to applications from sole traders and partnerships to ensure that information supplied is signed off by a qualified and reputable accountant, where possible, and double-checking details with bodies such as HMRC where appropriate;
- lenders dealing only with reputable intermediaries;
- engaging in ongoing dialogue on fraud prevention measures with bodies such as the Building Societies Association, UK Finance, the Law Society of

England and Wales, the Law Society of Scotland and the main accountancy bodies;

- use of credit bureaux checks for all applications;
- use of other searches, such as the Companies Registry for corporate applications;
- only using solicitors, valuers and other professional advisers with a known track record;
- having proper systems of audit, control and inspection;
- adopting a strong approach to detection of fraud, referring cases to the police authorities as necessary;
- carrying out audits of adviser files to check consistency of information.

The Fraud Act 2006 includes the offences of false representation and failing to disclose information where there may be a legal duty to disclose the information, as in a mortgage application. Fraud occurs whether or not the mortgage is actually granted. The value of a mortgage gained in this way will be regarded as proceeds of crime under the Proceeds of Crime Act 2002, and the borrower will be regarded as having committed a money-laundering offence. Sentences depend on the severity of the offence, ranging from community service orders through to large fines and/or prison sentences.

11.5 Reference checks and data protection legislation

During the application process references may be taken on the individual applicant, on the partners in the case of a partnership, and on the directors where the applicant is a company.

Data protection legislation exists to protect the rights of individuals where information is held about them. The term 'data' includes both facts and expressions of opinion about people – so the statement 'we consider this individual to be creditworthy', in response to a credit reference request, would be covered under the legislation.

The Data Protection Act 2018 superseded the 1998 Act on 25 May 2018, enacting the EU General Data Protection Regulation (GDPR). The GDPR strengthened existing data protection rules.

✓

CHECK YOUR UNDERSTANDING 3

You studied the requirements of data protection legislation in UK Financial Regulation. Refer back to your UK Financial Regulation study text if you would like to refresh your memory.

11.6 Anti-money-laundering regulations

Money laundering is covered by the Proceeds of Crime Act 2002 and the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, strengthened by 2019 amendments. Firms are able to structure their controls and procedures to reflect the specific risks they face, drawing guidance from the Joint Money Laundering Steering Group's guidance notes.

CHECK YOUR UNDERSTANDING 4

✓

You studied money-laundering prevention in UK Financial Regulation. How much can you remember?

a) What are the three principal money-laundering offences?

b) Can you name two other offences in relation to money laundering that are particularly relevant to advisers?

c) What is the Joint Money Laundering Steering Group?

Taking out a mortgage may not appear the most obvious route for a money launderer: after all, lenders go to some lengths to confirm the identity of applicants for credit purposes. Money raised through a mortgage might be expected to remain tied up for a considerable length of time and there is a common perception that accounts used for laundering purposes are highly transactional in nature and have a large volume of turnover.

The anti-money-laundering provisions do, however, apply to mortgage business as much as they do to other financial products and services. As part of customer due diligence procedures, financial services providers must take specific initial steps to ensure that they obtain evidence of a client's identity. They also require evidence of the source of any funds deposited with them, which might include, for example, the deposit on a property being bought.

CUSTOMER DUE DILIGENCE

The regulatory term for the process of verifying a customer and their identity.

Firms must understand the purpose of the customer's relationship with them, and collect sufficient information to form a complete picture of the risk associated with the business relationship and provide a basis for subsequent monitoring.

The firm should also ensure that its staff are alert to any use of accounts that does not fit the expected pattern, and understand that they must report this to the lender's designated money laundering reporting officer. Not every unusual or unexpected transaction is evidence of crime: there may be a reasonable explanation arising out of a customer's changing circumstances. However, staff must remain alert to the possibility and take appropriate action whenever they have concerns.

The definition of satisfactory evidence of identity can be vague. It must be reasonably capable of establishing that the applicant is the person that they claim to be to the satisfaction of the person who obtains the evidence. Acceptable forms of identification include:

- current passport;
- driving licence with photograph;
- entry on electoral roll;
- recent utility bill or council tax bill in the customer's name;
- credit card statements accompanied by the credit card.

Documents such as mobile phone bills are not acceptable forms of ID.

WHEN CAN A LENDER ACCEPT AN ADVISER'S ASSURANCE OF CUSTOMER IDENTITY?

If a financial intermediary (such as a mortgage adviser) or other authorised firm introduces a customer to a lender, the lender can accept the introducer's written assurance that they have obtained sufficient evidence of identity.

11.6.1 Financial exclusion

Financial exclusion describes the situation in which people are unable to access financial services because they are unable to produce the type of identity document required (for example, people who do not have a passport or driving licence, or whose name does not appear on utility bills). In such circumstances, a firm may accept as evidence of identification a letter or statement from a person in a position of responsibility (such as a solicitor, doctor or minister of religion) who knows the client.

RECORD-KEEPING FOR MONEY-LAUNDERING PREVENTION

Institutions must keep appropriate records for use as evidence in any investigation into money laundering. This means that:

- evidence of identification must be retained until at least five years after the relationship with the customer has ended;
- supporting evidence of transactions (originals or copies admissible in court proceedings) must be retained until at least five years after the transaction was executed.

THINK AGAIN . . .

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- list the issues that a lender should consider carefully when reviewing a prospective borrower's financial statements?
- explain some advantages and drawbacks of using credit scoring?
- describe the role of the guarantor and potential pitfalls that the lender needs to consider?
- explain the different ways in which an individual's insolvency might be addressed?
- outline examples of mortgage fraud and steps that can be taken to prevent fraud and money laundering?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

Test your knowledge

?

Use these questions to assess your learning for Topic 11. Review the text if necessary.

Answers can be found at the end of this book.

1) Which of the following could not be identified by reviewing a prospective borrower's financial statements?

    a) Whether the borrower regularly exceeds their overdraft limit.

    b) Whether the borrower regularly receives income in cash.

    c) Whether the borrower's regular income is as stated on their mortgage application.

    d) The borrower's ability to manage their financial affairs soundly.

2) Which of the following is most likely to receive a good credit score?

    a) Ranbir, who has a personal loan and a mortgage and no record of missed payments.

    b) Joleena, who has never had a credit card, loan or mortgage.

    c) Barry, who has seven credit cards and has just applied for another one.

    d) Debbie, who has applied for payday loans twice in the past year.

3) An individual who assumes full liability as a guarantor for a mortgage loan must be in a position to repay 100 per cent of the outstanding loan if the borrower defaults. True or false?

4) Which of the following is most likely to invalidate a guarantee?

    a) The guarantor writing to the lender requesting to be released from the guarantee.

    b) The guarantor losing their job.

    c) The lender failing to advise the guarantor that the borrower had missed several repayments.

    d) The guarantor having experienced an episode of mental illness at the time of signing the guarantee.

5) A sole trader who fails to make payments under a CCJ may be issued with an attachment of earnings order. True or false?

6) What is the effect of a trustee in bankruptcy filing a 'Form J restriction' with the Land Registry in relation to a bankrupt's property?

   a) It prevents the owners from selling the property.

   b) It permits the trustee in bankruptcy to sell the property without recourse to the owners.

   c) It requires the Land Registry to note the trustee's interest in the property and notify the trustee of any dealings relating to it.

   d) It restricts the owner's right of entry to the property.

7) When completing a mortgage application, making false statements or providing false information is only a crime if the application leads to a mortgage being granted. True or false?

8) An expression of opinion as to an applicant's creditworthiness is not regarded as personal data under data protection legislation. True or false?

9) Which of the following would potentially be regarded as mortgage fraud?

   a) Omitting information from the mortgage application about repayments due on a loan from a friend.

   b) Including a variable annual bonus in the figure for regular income on the application.

   c) Stating a purchase price 10 per cent more than the agreed price.

   d) Submitting a mortgage application while under notice of redundancy without mentioning the fact.

10) In relation to anti-money-laundering requirements, for how long must evidence of a customer's identity be retained?