

Conduct of business requirements II

LEARNING OBJECTIVES

In Topic 20 we focused on the requirements of the Conduct of Business Sourcebook, which applies to all firms that carry out regulated investment business. In this topic we are going to look more closely at the rules surrounding the provision of mortgage and insurance advice, and banking conduct and lending requirements. We will also consider other categories of advice and the circumstances in which they are appropriate.

By the end of this topic, you should understand:

- the rules relating to the provision of mortgage advice;
- the rules relating to the provision of insurance advice;
- the provisions of BCOBS, the Payment Services Regulations and the Standards of Lending Practice;
- the rules relating to the provision of basic advice;
- generic, focused and simplified advice, and when they may be appropriate.

This topic covers Unit 2 syllabus learning outcomes U3.11-U3.13.



THINK ...

If you have ever applied for a mortgage, you might have been surprised – or even irritated! – by the lengthy application process. Much of the information gathered is used to assess whether or not the prospective borrower can really afford the mortgage they are applying for.

If significant numbers of people find that they can't keep up repayments on their mortgage, what do you think the implications might be for:

- individual borrowers;
- lenders;
- the UK economy?

21.1 How is the provision of mortgage advice regulated?

The FCA's rules on mortgage advice are detailed in the Mortgages and Home Finance: Conduct of Business (MCOB) sourcebook. The rules cover lending, administration, advice and the arranging of loans. Banks, building societies, specialist lenders and mortgage intermediaries must be authorised to carry out these activities.

In terms of training and competence requirements, every seller must hold a relevant mortgage qualification (such as CeMAP®). Mortgage advisers, arrangers and lenders fall within the remit of the Financial Ombudsman Service and the Financial Services Compensation Scheme.

When the FCA's predecessor, the FSA, began regulating mortgage advice in 2004, its rules covered loans taken out by individuals or trustees that were subject to a first charge on the borrower's property. This included not only mortgages but also other loans where the security was a first charge on residential property.

As a consequence of the way the provisions of the EU Mortgage Credit Directive (MCD) were implemented in the UK, the scope of MCOB was extended in March 2016 to cover second charge loans.

A regulated mortgage, subject to MCOB is defined as a contract that satisfies the following conditions:

- the lender provides credit to an individual or trustees (the borrower);
- the contract provides for the obligation of the borrower to repay to be secured on land; and
- at least 40 per cent of that land is used or intended to be used, as or in connection with a dwelling.

Following the UK's departure from the European Union, the meaning of 'land' has been modified as follows:

- For regulated mortgage contracts entered into before 1 January 2021 (the end of the UK's transition period), 'land' refers to:
 - land in the United Kingdom; or
 - if the contract was entered into on or after 21 March 2016, land in the UK or within the European Economic Area (EEA) at the time the contract was entered into.
- For regulated mortgage contracts entered into from 1 January 2021, 'land' refers to:
 - land in the United Kingdom only.

KEY TERMS**FIRST CHARGE**

If a lender has to take possession of a property and sell it as a result of the borrower defaulting on the loan, the holder of a first-charge loan has the right to be repaid ahead of other chargeholders from the proceeds of the sale.

SECOND CHARGE

In the event of a property being possessed by a lender and sold as a result of default by the borrower, the holder of a second-charge loan ranks behind the first-charge lender for repayment; they will only have a claim on the proceeds of the sale once the first-charge lender has been repaid in full.

This means that the regime covers home improvement loans, debt consolidation loans and equity release schemes, such as lifetime mortgages and home reversion schemes.

The MCD introduced a new category of consumer buy to let (CBTL). Advising on, arranging, lending and administering CBTL mortgages is subject to a legal framework detailed in the MCD Order 2015, rather than the MCOB rules.

The FCA is responsible for regulating, supervising and, if necessary, taking action against firms engaged in CBTL activity. Whilst the MCOB rules do not apply in full, the government has prescribed rules in respect of the sale, underwriting and administration of CBTL mortgages. The rules include requirements in respect of:

- pre-contract disclosure;
- assessing creditworthiness;
- arrears management.

**IN
BRIEF****APPLICATION OF MCOB**

MCOB applies to:

- first-charge loans secured on residential property;
- second-charge loans secured on residential property.

21.1.1 What is ‘consumer buy to let’?

To understand what is meant by ‘consumer buy to let’, it is helpful to compare it to ‘business buy to let’, which is not regulated. Business BTL activity is carried out by professional landlords who, typically, have one or more BTL properties that they run as a business to generate profit. A consumer BTL mortgage is defined as one where the mortgage has not been entered into wholly or predominantly for the purpose of a business carried out by the borrower.

The regulation of consumer BTL mortgages is aimed at providing protection for those who have taken out a BTL mortgage more as a result of circumstances than from a particular desire to operate a BTL business.

CONSUMER BUY TO LET

A transaction where the mortgage has not been entered into wholly or predominantly for the purpose of a business carried out by the borrower.

Such scenarios could include a person who needs to relocate for their job but is unable to sell their property, or someone who has inherited a property that they have opted to rent out because it proves difficult to sell. In such circumstances, it would be reasonable to assume that the individual would not have the same experience or expertise as a person who owns a portfolio of BTL properties; hence the additional protections provided by the conduct standards applying to CBTL mortgages.

Lenders can use their own procedures to establish whether a borrower is a business and therefore not subject to the conduct standards applying to CBTL mortgages; they can also rely on the customer completing a declaration to confirm they are a business borrower.

If a mortgage is taken out to support the purchase of a property that is to be let out to a close relative then, unless the mortgage meets the criteria to be classed as a business buy to let, the mortgage is regulated under the MCOB rules, rather than the CBTL regime. MCOB defines a close relative as being a spouse, civil partner, parent, brother, sister or grandparent of borrower.



CHECK YOUR UNDERSTANDING I

Ella and Martin’s daughter, Lydia, is in the first year of her three-year university degree; she is currently in halls of residence but will need to rent accommodation privately next year. Ella and Martin are planning to buy a four-bedroom house in the university town; Lydia will be able to live there until she completes her degree, and they will get rental income on the other rooms. If they apply for a mortgage to buy the property, will it qualify as a consumer buy to let?

21.2 What are the key elements of MCOB?

A summary of the provisions of MCOB is provided here.

MCOB 1: Application and purpose

Explains the scope of the rules, ie to whom they apply and for what types of mortgage.

MCOB 2: Conduct of business standards: general

Includes:

- the use of correct terminology ('early repayment charge' and 'higher lending charge');
- the requirement for communications with customers to be 'clear, fair and not misleading';
- rules about the payment of fees/commission and the accessibility of records for inspection by the FCA.

MCOB 2A: Mortgage Credit Directive:

Includes rules on a range of matters that apply to a lender classed as a Mortgage Credit Directive mortgage lender, including:

- remuneration;
- the tying of products (making a mortgage conditional on the purchase of other products);
- foreign currency loans; and
- early repayments.

MCOB 3A: Financial promotions and communications with customers

Distinguishes between 'real-time' promotions (by personal visit or telephone call) and 'non-real-time' (by letter, email, or adverts in newspapers and magazines, or on television, radio or the internet).

- Unsolicited real-time promotions are not permitted.
- Non-real-time promotions must include the name and contact details of the firm. They must be clear, fair and not misleading. If comparisons are used, they must be with products that meet the same needs. They must state that "your home may be repossessed if you do not keep up repayments on your mortgage". Records of non-real-time promotions must be retained for one year after their last use. Financial promotions must be approved. To

approve financial promotions, a firm must be a permitted approver or be exempt from approver permission.

MCOB 3B: MCD general information

Specifies the requirements relating to information that must be provided to customers, for lenders who make mortgage advances regulated under the Mortgage Credit Directive.

MCOB 4 and 4A: Advising and selling standards

It must be clear whether advice is based on the products of the whole market, a limited number of home finance providers, or a single lender.

- Independent advisers are not required to be able to access all products from all providers: they can source products from a panel of lenders as long as the panel is representative of the market.
- Any mortgage recommended must be suitable for the customer and appropriate to their needs and circumstances; records to demonstrate this must be kept for three years. However, there is no requirement to issue a suitability report to the client.
- Special requirements apply if the mortgage will be used to consolidate existing debts.

On first making contact with a customer, certain information must be disclosed prominently and clearly to the customer. An initial disclosure document (IDD) can be given to detail the required information, but this is not a formal requirement as long as the required information is clearly communicated. The customer must be provided with the following information:

- name and contact details;
- whose mortgages are offered;
- details of any limitations in service;
- details of any fee payable for the mortgage advice;
- the firm's FCA registration details;
- how to complain; and
- details of the compensation scheme.

MCOB 5 and 5A: Pre-application disclosure

Details the information that must be provided at the point at which a personal recommendation is made and before an application is submitted to the lender. This must include:

- the annual percentage rate of charge (APRC), which shows the interest rate with any fees added;
- the amount of the monthly instalment; and
- the amount by which the instalment would increase for each 1 per cent rise in interest rates.

The required information must be provided via a European Standardised Information Sheet (ESIS). The contents of the ESIS are set out in the rules, and variations from the prescribed format are not permitted.

MCOB 6 and 6A: Disclosure at the offer stage

If a mortgage offer is made, the lender must provide a detailed offer document. This is based on the information given at pre-application stage, subject to any changes between application and offer illustration. The offer is binding on the lender but can be made conditional on the confirmation of certain details. The offer must also:

- state how long the offer will remain valid;
- point out that there will be no right of withdrawal after the mortgage has been completed; and
- include or be accompanied by a tariff of charges.

The borrower must be granted a period of reflection of at least seven days to consider whether to accept the offer or not.

MCOB 7 and 7A: Disclosure at start of contract and after sale

Before the first mortgage payment is made, the lender must confirm:

- details of amounts, dates and methods of payment;
- details of any related products such as insurance;
- (for interest-only mortgages) the responsibility of the borrower to ensure that a repayment vehicle is in place; and
- what the customer should do if they fall into arrears.

Annual statements must be issued, showing:

- the amount owed and remaining term;
- what type of mortgage it is;
- for interest-only mortgages, a reminder to check the performance of the repayment vehicle;
- interest, fees or other payments made since the last statement;

- any changes to the charges tariff since the last statement.

If the mortgage is arranged on an interest-only basis, then the lender must contact the borrower at least once during the term to confirm that a credible repayment vehicle remains in place.

If a change is to be made to the monthly payment, the customer must be informed of the new amount, revised interest rate and date of the change.

MCOB 8 and 9: Equity release – advising and selling standards, and product disclosure

Details the FCA's requirements in respect of lifetime mortgages and home reversion schemes. Special rules apply to equity release in relation to advising and selling standards, and to product disclosure. The FCA Training and Competence rules require that anyone giving advice on equity release must hold a specialist qualification in this area of business.

MCOB 10: Annual percentage rate (APR)

Describes how to calculate APR (see section 22.1.1).

MCOB 10A: Annual percentage rate of charge

Describes how to calculate APRC (see section 22.1.1).

MCOB 11 and 11A: Responsible lending

Lenders must put in place a written responsible lending policy, and must be able to show that they have taken into consideration a customer's ability to pay when offering a mortgage. For interest-only mortgages, this means obtaining evidence that the customer will have in place a clearly understood and credible repayment strategy; and that this repayment strategy has the potential to repay the capital borrowed and any interest reasonably expected to be accrued.

MCOB 12: Charges

Excessive charges are not permitted. Early repayment charges must be a reasonable approximation of the costs incurred by the lender if the borrower repays the full amount early. Similarly, arrears charges must be a reasonable approximation of the cost of additional administration as the result of a borrower being in arrears.

MCOB 13: Arrears and reposessions

Firms must deal fairly with customers who have mortgage arrears or mortgage shortfall debt. This includes:

- trying to reach an agreement on how to repay the arrears, taking into account the borrower's circumstances;

- liaising with third-party sources of advice;
- not putting unreasonable pressure on customers in arrears;
- repossessing a property only when all other reasonable measures have failed;
- only applying arrears charges that are a reasonable reflection of the costs of the work involved in dealing with the arrears.

Records must be kept of all dealings with borrowers in arrears.

Customers in arrears must be given the following information within 15 working days of the lender becoming aware of arrears:

- the MoneyHelper information sheet 'Problems paying your mortgage';
- the missed payments and the total of arrears including any charges incurred;
- the outstanding debt;
- any further charges that may be incurred unless arrears are cleared.

FACTFIND

MCOB is available on the FCA website:

www.handbook.fca.org.uk/handbook/MCOB/

21.3 Providing mortgage advice to clients

The MCOB rules specify that one of two different levels of service can be provided:

- advice;
- execution only.

There is no scope to offer an information-only service, whereby the borrower selects their own mortgage based on information provided.

The execution-only service can only be provided in a limited range of situations defined in the MCOB rules, ie for transactions involving business borrowers, high-net-worth individuals and mortgage professionals. Evidence that the individual falls into one of these categories must be retained. In the case of joint applications where only one party is a mortgage professional, advice has to be given to the non-professional. Should a customer opt for execution only, then the lender is required to make customers aware of the consequences of proceeding on an execution-only basis.

VULNERABLE CUSTOMERS

In Topic 14 we explained that firms have a responsibility to identify and deal appropriately with vulnerable customers, tailoring their service provision to customer needs.

In respect of mortgages, the FCA views the following as being vulnerable customers on the basis of the financial arrangement they are considering:

- those buying a property using the statutory Right-to-Buy;
- those entering a sale-and-rent-back agreement;
- equity release applicants.

Because of the additional risks posed by these types of arrangement, the FCA requires that an individual falling into any of the categories above must, in the first instance, be given advice. Should they subsequently wish to proceed on an execution-only basis, then they can do so.

If you would like to find out more about the FCA's guidance in relation to vulnerable customers, go to:

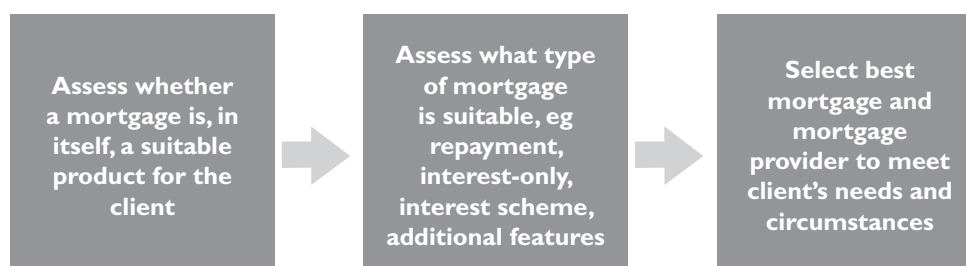
www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf

A mortgage adviser must take reasonable care to:

- establish (from the prospective borrower) all information that is likely to be relevant;
- ensure that the advice they give is suitable given the customer's circumstances and needs.

Determining the suitability of a mortgage involves three stages (see Figure 21.1).

FIGURE 21.1 DETERMINING SUITABILITY OF A MORTGAGE



If it is established that a mortgage is suitable, then the next stage is to recommend a suitable mortgage contract. The following questions must be considered:

- Which mortgage type is most suitable? Repayment, interest-only or a combination of the two?
- Which interest rate option is most suitable? Fixed, variable, capped, etc?
- Over how long a term should the mortgage run?
- What are the costs involved? Are they affordable?

There is no requirement under MCOB to issue a suitability report although many lenders will do so.

21.3.1 Assessing affordability and verifying income

Mortgage lenders must verify income for every mortgage application, and verification must be provided from a source independent of the borrower.

A lender must be able to demonstrate that the mortgage it is proposing is affordable, taking into account specific categories of expenditure (committed expenditure and basic essential expenditure). In assessing long-term affordability, lenders can take into account positive expected changes, if they have evidence to support such changes.

In respect of interest-only mortgages, the lender must be satisfied that there is a clear and credible alternative source of capital repayment in place; if not, affordability must be assessed on a repayment basis.

Lenders must take reasonable steps to ensure that the mortgage proposed is affordable not just at the time the application is assessed but on an ongoing basis. This is achieved by means of a stress test, which involves checking that an applicant will be able to afford the payments if interest rates should rise.

KEY TERMS

COMMITTED EXPENDITURE

Repayments on credit agreements or other contractual arrangements.

BASIC ESSENTIAL EXPENDITURE

Expenditure on food and other housekeeping costs, utilities, telephone, council tax, buildings insurance, ground rent and service charges for leasehold properties, and essential travel to work and school.

21.4 What are the Insurance: Conduct of Business rules?

Firms and individuals working in the areas of general insurance, protection, critical illness, long-term care and income protection insurance have to be authorised through the same processes of permission and approval as those that apply to the rest of the industry.

Rules applicable to intermediaries who sell, administer or advise on general insurance are contained in the Insurance: Conduct of Business Sourcebook (ICOBS). The ICOBS rules are split into eight sections, which are summarised here.

ICOBS 1: Application

Explains that the rules cover firms that deal with retail and commercial customers for the sale of non-investment insurance products. The activities regulated by these rules include:

- insurance distribution activities;
- effecting and carrying out contracts of insurance;
- managing the underwriting capacity of a Lloyds syndicate as a managing agent at Lloyds;
- communicating or approving a financial promotion.

ICOBS 2: General matters

Covers categorisation of clients:

- policyholders (anyone who, upon the occurrence of the contingency insured against, is entitled to make a claim);
- customers (anyone who makes arrangements preparatory to concluding a contract of insurance, ie a prospective policyholder).

Customers are further categorised as:

- consumers (natural persons for purposes outside his or her profession);
- commercial customers (anyone who is not a consumer).

ICOBS 2 also covers:

- communications (which must be clear, fair and not misleading);
- inducements (managing conflicts of interest fairly, and not soliciting or accepting inducements that would conflict with a firm's duties to its customers);
- record-keeping; and

- 'exclusion of liability' (a firm must not seek to exclude or restrict liability unless it is reasonable to do so).

ICOBS 3: Distance communications

Covers rules that ensure compliance with distance marketing disclosure rules, which include the following:

- A firm must provide a consumer with distance marketing information before the conclusion of a distance consumer contract.
- The identity of the firm and the purpose of the call must be made explicitly clear at the beginning of any telephone communications.
- Contractual obligations must be communicated to a consumer during the pre-contractual phase, and these obligations must comply with the law presumed to apply to a distance contract.
- Terms and conditions must be communicated to a consumer in writing before the conclusion of a distance contract.
- The consumer is entitled to receive a copy of the contractual terms and conditions in hard copy on request.

ICOBS 3 also covers e-commerce activities and states that a firm must make the following information easily, directly and permanently accessible:

- name and address;
- details of the firm (including email address) that allow it to be contacted in a direct and effective manner;
- status disclosure statement, and confirmation that it is on the FCA Financial Services Register, including its FCA register number.

Other rules include that any:

- prices advertised must be clear and unambiguous, and the firm must indicate whether the price includes relevant taxes; and
- unsolicited commercial communication sent by email must be clearly identifiable as such as soon as it is received.

ICOBS 4: Information about the firm, its services and remuneration

States that a firm must provide a customer with at least the following information before the conclusion of an initial contract of insurance and, if necessary, on its amendment or renewal:

- its identity, address and whether it is an insurance intermediary or an insurance undertaking;
- whether it provides a personal recommendation about the insurance products offered;

- the procedures for making complaints to the firm and the FOS or, if the FOS does not apply, information about the out-of-court complaint and redress procedures available for the settlement of disputes.

An insurance intermediary must also provide the customer with the following information:

- the fact that it is included in the FCA Register and the means for verifying this;
- whether it has a direct or indirect holding representing 10 per cent or more of the voting rights or capital in a given insurance undertaking (that is not a pure reinsurer);
- whether a given insurance undertaking (that is not a pure reinsurer) or its parent undertaking has a direct or indirect holding representing 10 per cent or more of the voting rights or capital in the firm; and
- whether it is representing the customer or is acting for and on behalf of the insurer.

Where an insurance intermediary proposes or advises on a contract of insurance then before the conclusion of the initial contract, the intermediary must provide information on whether the firm:

- gives a personal recommendation on the basis of a fair and personal analysis; or
- is under a contractual obligation to conduct insurance distribution exclusively with one or more insurance undertakings; or
- neither of the above apply.

In which case it must provide its customer with the name of those insurance undertakings with which the insurance intermediary may, and does, conduct business.

Where a firm has given the above information, before the conclusion of an initial contract of insurance with a consumer, a firm must also state whether it is giving:

- a personal recommendation, but not on the basis of a fair and personal analysis;
- other advice on the basis of a fair analysis of the market;
- other advice not on the basis of a fair analysis of the market; or
- just information.

A firm must provide details to a customer of any remuneration, including fees, commission and economic benefits of any kind given in connection with the contract in good time before the conclusion of the initial contract of insurance,

amendment or renewal. The firm must inform its customer of the amount of any fee, where payable.

An insurance intermediary must, on a commercial customer's request, promptly disclose the commission that it or any associate may receive in connection with a policy.

ICOBS 5: Identifying client needs and advising

States that:

- a firm should take reasonable steps to ensure that a customer only buys a policy from which they are eligible to claim benefits;
- if a firm finds that parts of the cover do not apply, they should inform the customer so that they can make an informed choice;
- a firm should explain the duty not to misrepresent information, what this includes, and the consequences of deliberate, reckless or careless misrepresentation;
- prior to the conclusion of a contract a firm must specify, on the basis of information obtained from the customer, their needs;
- a statement of demands and needs must be communicated in writing to the customer in a clear and accurate manner, comprehensible to the customer;
- the firm must take reasonable steps to ensure the suitability of its advice to any customer who is entitled to rely upon its judgement, taking account of level of cover and cost, relevant exclusions, excesses, limitations and conditions - it must inform the customer of any demands and needs not met.

ICOBS 6: Product information and 6A: Product specific rules

An insurer is responsible for producing, and an insurance intermediary for providing to a customer, the product information required by ICOBS 6.

ICOBS 6 states that a firm must take reasonable steps to ensure a customer is given appropriate information about a policy so that they can make an informed choice about the arrangements proposed.

The information given will vary according to matters such as:

- knowledge, experience and ability of a typical customer for the policy;
- policy terms, benefits, exclusions, limitations, conditions and duration;
- the policy's complexity;
- whether the policy is purchased in connection with other products and services;

- distance communication information requirements; and
- whether the same information has been provided to the customer previously.

When dealing with a consumer, a firm must provide an Insurance Product Information Document (IPID) in a durable medium. The IPID is drawn up by the manufacturer of the policy.

A firm should provide evidence of cover promptly after the inception of a policy.

Information disclosed ‘pre-contract’ includes the arrangements for handling complaints and the right to cancel.

Before a pure protection contract is concluded, a firm must provide the customer with information, including:

- the name of the insurance undertaking and its legal form;
- address of its head office;
- the definition of each benefit and option;
- contract term;
- the means of terminating the contract;
- means of payment and duration of premiums;
- tax arrangement for benefits under the policy;
- cancellation information;
- arrangements for handling complaints.

6A: Product-specific rules

Applies to firms that sell guaranteed asset protection (GAP) contracts to customers in connection with the sale of a vehicle.

A GAP contract is insurance covering a policyholder in the event of total loss to a vehicle, and it is the difference between:

- the amount claimed under the policyholder’s vehicle policy in respect of the loss; and
- an amount calculated in accordance with the GAP contract.

ICOBS 7: Cancellation

States that a consumer has the right to cancel without penalty, and without giving a reason, within:

- 30 days for a contract of insurance which is, or has elements of, pure protection (eg critical illness) or payment protection;
- 14 days for any other contract of insurance or distance contract (such as home insurance).

Firms are free to offer more generous cancellation terms than this, provided they are favourable to the consumer.

The right to cancel does not apply to the following:

- travel policies of less than one month;
- policies the performance of which has been fully completed;
- pure protection policies of six months or less, which are not distance contracts;
- pure protection policies effected by trustees of an occupational pension scheme, or employers (or partners) for the benefit of employees (or partners);
- general insurance (which is not a distance contract or payment protection contract) sold by an intermediary who is an unauthorised person; and
- a connected contract which is not a distance contract.

On receipt of the cancellation notice, the insurance company must return all premiums paid within 30 days, and the contract is terminated.

ICOBS 8: Claims handling

If claims are handled by an intermediary, the insurance company must ensure that the rules are complied with, ensuring no conflict of interest. Claims must be handled promptly and fairly, and the firm must provide reasonable guidance to help the policyholder make a claim. The firm must not unreasonably reject a claim.

Rejection of a claim is considered unreasonable if it is for:

- non-disclosure of a material fact which the policyholder could not reasonably have expected to have disclosed;
- non-negligent misrepresentation of a material fact;
- breach of a condition of the contract unless the circumstances of the claim are connected to the breach.

FACTFIND

Full details of ICOBS are available at:

www.handbook.fca.org.uk/handbook/icobs/

21.5 What are the Banking: Conduct of Business rules?

The Banking: Conduct of Business Sourcebook (BCOBS) applies to firms accepting deposits from UK banking customers in the UK, for example by providing savings and current accounts.

BCOBS complements the Payment Services Regulations, which prescribe the way that payments are to be undertaken within the European Economic Area (EEA). The BCOBS rules are designed in such a way as not to overlap with the provisions of the Payment Services Regulations. Those areas of the Payment Services Regulations not covered by BCOBS are addressed by the Standards of Lending Practice (see section 21.7), overseen by the Lending Code Standards Board.

BCOBS has eight chapters, which are summarised here.

BCOBS 1: Application

BCOBS applies to firms that accept deposits from banking customers, if such activities are carried on from an establishment maintained by the firm in the UK, and activities connected with accepting such deposits.

BCOBS 2: Communications with banking customers and financial promotions

Requires a firm to pay regard to the information needs of banking customers when communicating with, or making a financial promotion to them, and to communicate information in a way that is clear, fair and not misleading.

BCOBS 2A: Restriction on marketing or providing an optional product for which a fee is payable

Details the rules applying to marketing or providing an optional product (linked to a current account or savings account) for which a fee is payable.

BCOBS 3: Distance communications and e-commerce

Applies to a firm that carries on any distance marketing activity from an establishment in the UK, with or for a consumer in the UK.

BCOBS 4: Information to be communicated to banking customers and statements of account

Details how a firm must provide or make available to banking customers appropriate information about a retail banking service and any deposit made in relation to that retail banking service.

BCOBS 5: Post-sale requirements

A firm must provide a service in relation to a retail banking service that is prompt, efficient and fair to a banking customer and which has regard to any communications or financial promotion made by the firm to the banking customer from time to time. This includes dealing with customers in financial difficulty, those that wish to move bank accounts, and lost and dormant accounts.

BCOBS 6: Cancellation

Sets out a customer's rights to cancel in various circumstances, and when there are no rights to cancellation.

BCOBS 7: Information about current account services

Requires a firm to publish information about its provision of personal current accounts and business accounts.

BCOBS 8: Tools for personal current account customers

Requires a firm to make available a cost calculator tool and an overdraft eligibility tool either online or via an app and to provide alerts to personal current account customers about their personal current account usage.

FACTFIND

Full details of BCOBS are available at:

www.handbook.fca.org.uk/handbook/bcobs/

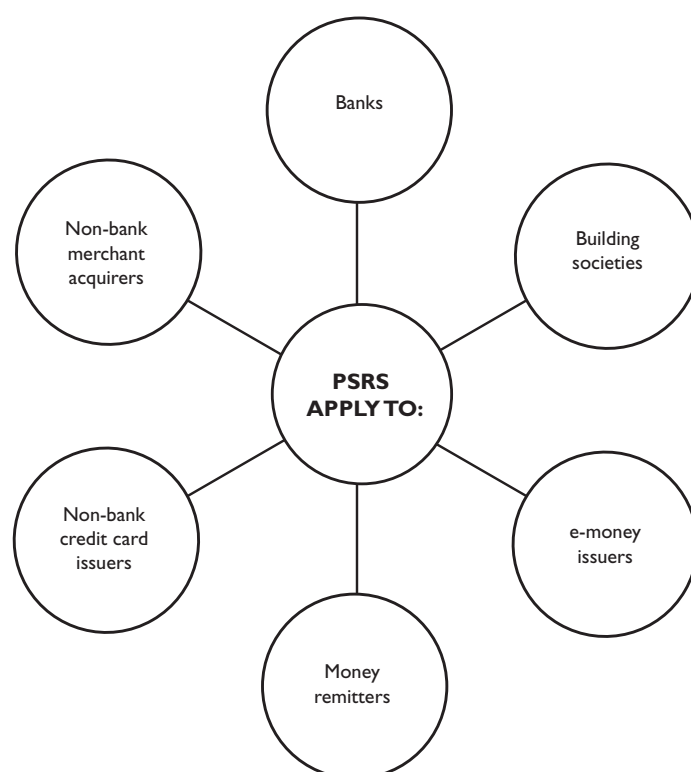
21.6 What are the Payment Services Regulations?

The Payment Services Regulations (PSRs) cover most payment services, including the provision and operation of 'payment accounts'. Payment accounts are accounts on which payment transactions may be made and where access to funds is not restricted (a fixed-term deposit is an example of a restricted account). The regulations extend from the information that is to be provided before a payment is made to the remedial action a firm must take if a payment goes wrong.

The PSRs' conduct of business provisions only apply to payment services made in euros or sterling, so primarily to sterling and euro-denominated accounts.

The PSRs affect firms providing payment services, and their customers (see Figure 21.2).

FIGURE 21.2 FIRMS COVERED BY PSRs



The PSRs introduced a new class of regulated firms known as payment institutions (PIs). These are businesses authorised to process payments by card, credit transfer or direct debit, to issue or acquire payment instruments and to remit money. If not exempt, a PI must either be authorised or registered by the regulator. Authorised PIs are subject to prudential requirements. Conduct of business requirements apply to all payment service providers, including banks, building societies, e-money issuers and PIs.

KEY TERMS**MONEY REMITTER**

A payment services provider that accepts funds for payment without necessarily holding an account with either the payee or payer. It enables one party to send money to another using its services to get the money to the required destination.

NON-BANK MERCHANT ACQUIRERS

A financial institution other than a bank that processes credit or debit card payments.

21.6.1 Payment Services Directive (PSD2)

PSD2 came into effect on 13 January 2018 and is a significant evolution of existing regulation for the payments industry. It aims to increase competition in the payments industry, brings into scope new types of payment services, enhance customer protection and security, and extend the reach of the Directive.

Even though the UK left the EU, PSD2 continues to apply to financial service providers in the UK.

The key changes introduced by PSD2 can be grouped into four main themes: market efficiency and integration; consumer protection; competition and choice; and security.

PSD2 increases consumers' rights in a number of ways. For example:

- Payments sent or received where one of the payment service providers (PSPs) is located outside the EEA are covered, as are payments in non-EEA currencies.
- The amount a payer can be obliged to pay in an unauthorised payment scenario has reduced from €150 to €50, except in cases of fraud or gross negligence by the payer.
- PSD2 bans surcharging for the use of payment instruments covered by the Interchange Fee Regulation and payment services covered by the SEPA Regulation.
- PSPs must put in place dispute resolution procedures and are required to respond to payment complaints within 15 business days of receipt. In exceptional circumstances, a holding reply can be provided, explaining the reasons for the delay, with the final response being received within 35 business days.

To facilitate competition, banks must give third-party providers access to their account in order to carry out the transactions. There are two key types of

organisation involved in providing the services, often referred to collectively as third-party providers or TPPs:

- An account information service provider (AISP) is defined in PSD2 Article (16) as an “online service to provide consolidated information on one or more payment accounts held by the payment service user”.
- Payment Initiation Service Providers (PISPs) are service providers that carry out transactions for the account holder, which could include person to person (P2P) transfers – an online technology that allows customers to transfer funds from their bank account or credit card to another person’s account via a mobile device using the internet – and general bill payments.
- In addition, PSD2 introduces another new definition: “account servicing payment service provider” (AS PSP) to distinguish the provider where the customer’s payment account is held. The PSD2 text makes it clear that customers have a right to use PIS and AIS where the payment account is accessible online and where they have given their explicit consent.

There are further technical standards relating to strong customer authentication, and common and secure communication.

21.6.2 Payment Systems Regulator

The Payment Systems Regulator (PSR) is a subsidiary of the Financial Conduct Authority (FCA). It oversees all domestic payment systems that are brought into the regulator’s scope by HM Treasury. The PSR has authority:

- over requirements regarding system rules; and
- to give directions to participants in designated payment systems.

It has further specific powers to:

- require access to designated payment systems for a payment services provider;
- vary agreements relating to designated payment systems (including fees and charges); and
- require owners of payment systems to dispose of their interests in them, subject to the satisfaction of certain preconditions and subject to HM Treasury approval.

FACTFIND

You can find further information about the Payment Services Regulations at:

www.fca.org.uk/firms/electronic-money-payment-institutions

21.7 The Standards of Lending Practice

Lending is not covered by BCOBS. Although the FCA's CONC sourcebook applies, there is also a degree of self-regulation by the industry in this area. The Lending Standards Board (LSB) publishes standards to which firms that are registered with the LSB must adhere.

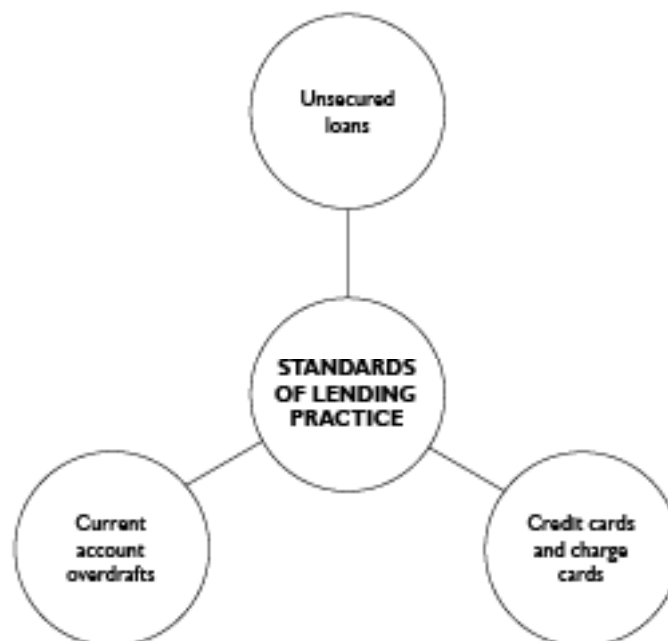
The Standards of Lending Practice for personal customers set out a number of principles, covering:

- product and service design;
- product sale;
- account management and servicing;
- money management;
- financial difficulty;
- consumer vulnerability; and
- governance and oversight.

The key requirements are shown in Figure 21.4.

A separate set of Standards apply to business customers.

FIGURE 21.3 PRODUCTS COVERED BY THE STANDARDS OF LENDING PRACTICE



Registered firms must at all times comply with the Consumer Credit Act 1974, the Consumer Credit (EU Directive) Regulations 2010, the FCA's Consumer Credit Sourcebook (CONC), the Equality Act 2010 and other relevant legislation. Compliance is monitored and enforced by the Lending Standards Board.



CHECK YOUR UNDERSTANDING 2

The Standards of Lending Practice do not apply to mortgages. What is the regulation that covers mortgages?

FIGURE 21.4 KEY REQUIREMENTS OF THE STANDARDS OF LENDING PRACTICE

Product and service design	Customers will have access to products and services which have been designed to take into account the range of customer circumstances and needs throughout the customer journey.
Product sale	Customers will only be provided with a product that is affordable and meets their needs.
Account maintenance and servicing	Customer requests will be dealt with in a timely, secure and accurate manner. Information provided will be clear and detail any action required by the customer.
Money management	Customers will be helped to manage their finances through proactive and reactive measures designed to identify signs of financial stress and help avoid financial difficulties.
Financial difficulty	Customers in financial difficulty will receive appropriate support and fair treatment.
Consumer vulnerability	Firms are expected to provide inclusive products and services that take account of the broad range of customers and are flexible enough to meet the needs of customers who are classed as vulnerable. Firms are expected to have a formal strategy for dealing with vulnerable customers.
Governance and oversight	Firms are expected to put in place policies and procedures that ensure customers receive a fair outcome when taking out a consumer credit product and throughout all their dealings with the firm.

21.8 What are the other categories of advice?

We looked earlier in this topic and in the previous topic at the principles and regulations governing the provision of advice on regulated products such as mortgages and insurance contracts. There are a number of other categories of advice that apply in certain limited circumstances:

- basic advice;
- generic advice;
- focused advice;
- simplified advice;
- robo advice.

Following the Financial Advice Market Review (FAMR) in 2016, which was launched by HM Treasury and the FCA to explore ways in which the government, the industry and regulators could stimulate the development of a market delivering affordable and accessible financial advice and guidance to consumers, the FCA published guidance to help firms to provide ‘streamlined advice’.

Streamlined advice is defined as “a personal recommendation which is limited to one or more of a client’s specific needs and does not involve analysis of the client’s circumstances that are not directly relevant to those needs” (FCA, 2016). The FCA has produced guidance on streamlined advice services, which it notes might include robo advice services (see section 21.8.3) or more traditional face-to-face or telephone-based models.

21.8.1 Basic advice

Basic advice is a limited form of advice that applies to stakeholder products. It is focused on one or more specific client needs; it does not involve an analysis of the client’s circumstances that are not directly relevant to those needs. It involves the use of a set of scripted questions to establish whether a stakeholder product within the firm’s range is suitable for the customer.

STAKEHOLDER PRODUCTS

We looked at stakeholder pensions and the reasons for their introduction in Topic 10. When first introduced in 2001, stakeholder pensions were a popular option, and this encouraged the government to extend the range of savings and investments products. As with the stakeholder pension, the idea was that customers who might be deterred from making appropriate savings provision through a lack of confidence, lack of understanding or concerns about risk and cost would be attracted by a simple, low-risk product with transparent charges.

A suite of products was introduced, covering short- and medium-term investment needs, along with the stakeholder pension and a Child Trust Fund. Charges were capped: the maximum permitted annual charge for the investment products is now 1.5 per cent for the first ten years of the life of a product and 1 per cent thereafter. For stakeholder pensions arranged prior to 6 April 2005, charges are capped at 1 per cent throughout.

As stakeholder products were designed to be simple, the expectation was that they would be straightforward to sell and regulation could therefore be less complex. The 'basic advice' process was less costly for providers to deliver and it was hoped that that would encourage take-up.

When a firm first has contact with a client with a view to giving basic advice on a stakeholder product, the client must be provided with the basic advice initial disclosure information in a durable format together with an explanation of the information.

When giving basic advice, the firm must do so using a sales process that includes putting scripted questions to the client.

A stakeholder product can only be recommended if:

- reasonable steps have been taken to assess the client's answers to the scripted questions and any other facts disclosed by the client during the basic sales process;
- there are reasonable grounds for believing that the stakeholder product is suitable for the client; and
- the firm reasonably believes the client understands the basis upon which the advice has been provided.

**IN
BRIEF****WHEN IS BASIC ADVICE APPROPRIATE?**

Basic advice is appropriate for clients who:

- have their priority needs met (ie they do not need to reduce existing debt, have adequate access to liquid cash, and have their core protection needs met);
- have some disposable income or capital that they wish to invest;
- do not want a holistic assessment of their financial situation, just advice on a specific investment need.

The client must be provided with enough information about the nature of the stakeholder product, including its aims, commitment and risks, to make an informed decision about the recommendation being made to them. While a full suitability report is not required, a recommendation summary is. The client must be provided with a copy of the completed questions and answers as soon as possible after concluding the sale.

A record must be kept of the fact that the firm has chosen to give basic advice to a particular client, including the range of stakeholder products used. This record must be retained for five years.

21.8.2 Generic, focused and simplified advice

Figure 21.5 describes generic, focused and simplified advice and when they may be used. Note the key difference between focused and simplified advice: for focused advice, the customer determines the boundaries within which the advice is to be focused; with simplified advice, it is the firm that sets out the parameters of the advice that it is providing.

Where a customer has been provided with information about a product or products, or has had technical terms explained to them, then it is likely they have received guidance rather than advice. This is also referred to as an 'information only' service. Such an approach can be contrasted with the provision of advice, which involves a recommendation to take, or avoid taking, a particular course of action.

FIGURE 21.5 GENERIC, FOCUSED AND SIMPLIFIED ADVICE

<p>Generic advice</p> <ul style="list-style-type: none"> • Advice or information that does not relate to a particular product or investment and does not meet the characteristics of regulated advice • For example, 'for most people it is sensible to have adequate financial protection in place'
<p>Focused advice</p> <ul style="list-style-type: none"> • Where, at the request of the customer, advice and recommendations relate to specific needs or investments • Also referred to as limited advice
<p>Simplified advice</p> <ul style="list-style-type: none"> • Advice that is limited, by the firm providing it, to one or more of a customer's needs • Does not involve analysis of the customer's circumstances that are not directly relevant to those needs • This type of advice may be provided face to face, over the phone or online

FACTFIND

Advice Guidance Boundary Review – proposals for closing the advice gap

The FCA has released a discussion paper, DP23/5, with the purpose of encouraging discussions on how advice and support can be delivered to consumers and how new and emerging technologies can be utilised to improve consumer experiences and outcomes. The goal is to create a regulatory framework that allows for commercially viable models of advice and support so that consumers can make informed financial decisions.

For further information you can visit: www.fca.org.uk/publications/discussion-papers/dp23-5-advice-guidance-boundary-review-proposals-closing-advice-gap.

21.8.3 Robo advice

Robo-advisers are a class of financial adviser that provide financial advice or portfolio management online with minimal human intervention. They provide digital financial advice based on mathematical rules or algorithms. This innovation is intended to provide a low-cost alternative to face-to-face advice and go some way to address the advice gap left by the cost of the traditional

advice model. The Treasury and FCA have been monitoring the development of this approach and in April 2017 published guidelines, making it clear that any funds offered to investors by robo-advisers offering ‘streamlined advice’ are to be suitable for customers’ risk tolerance and investment objectives. The guidelines advise companies on the information they need to collect about investors, and warn on the importance of forming “clearly worded” risk questionnaires that do not assume “a high level of financial capability”. The FCA has suggested that robo-advice companies could use consumer testing and web analytics to monitor how long customers spend on each page of their websites.



THINK AGAIN ...

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

For instance, can you:

- explain the situations in which MCOB rules apply to mortgage transactions?
- define categories of advice that apply in limited circumstances?
- explain how ‘buy to let’ differs from ‘consumer buy to let’?
- outline the main areas covered by MCOB?
- describe the rules relating to affordability and verification of income for mortgage purposes?
- outline the main areas covered by ICOBS and BCOBS?
- state the firms covered by the Payment Services Regulations?
- list the key requirements of the Standards of Lending Practice?
- describe the key differences between generic, focused and simplified advice?

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.

References

FCA (2016) *Financial advice market review: Final report* [pdf]. Available at: www.fca.org.uk/publication/corporate/famr-final-report.pdf



Test your knowledge

Use these questions to assess your learning for Topic 21. Review the text if necessary.

Answers can be found at the end of this book.

- 1) A mortgage arranged for which of the following mortgagors would not be a regulated mortgage?
 - a) Terry and Angel, who are joint borrowers buying their first home.
 - b) Laszlo and Yuri, who are creating a mortgage in their capacity as trustees.
 - c) John, who is a sole borrower, trading up to a bigger property.
 - d) Décor Plus, which is a public limited company.
- 2) Which of the following methods of obtaining new business is not permitted for a regulated mortgage?
 - a) Cold calling.
 - b) Mortgage introducers.
 - c) Radio advertising.
 - d) TV advertising.
- 3) Maurice wants to use the equity in his property by arranging a lifetime mortgage. He wants exactly the same product that his brother has and does not want to waste time considering other options. Why would it not normally be possible for Maurice to proceed on an execution-only basis, even though he knows exactly what he wants?
- 4) Which of the following statements is **untrue** in relation to the offer document that is produced following a mortgage application?
 - a) It must contain details of the monthly payments.
 - b) It must state how long the offer is valid for.
 - c) It must explain how the customer can withdraw from the contract once the mortgage is completed.
 - d) It must be accompanied by an up-to-date tariff of charges.

- 5) When assessing affordability for a mortgage application, which of the following is regarded as committed expenditure?
 - a) Repayments on a personal loan.
 - b) Council tax.
 - c) Water bills.
 - d) Costs of travel to work.
- 6) To ensure that there is no danger of misrepresenting the policy benefits, an adviser must always allow the customer to make their purchasing decision on the basis of information published by the product provider. True or false?
- 7) Eva has just taken out an income protection policy. If she changes her mind and decides she no longer wants this policy, what cancellation rights does she have?
- 8) The Standards of Lending Practice are an example of self-regulation. True or false?
- 9) A customer who wishes to buy a stakeholder pension product may receive:
 - a) focused advice.
 - b) generic advice.
 - c) information only.
 - d) basic advice.
- 10) What is the key difference between focused advice and simplified advice?

