MORE HOMES DIVISION GUIDANCE NOTE	
To:	**All Registered Social Landlords copied to SFHA**
Subject:	**Guidance on requirement for Financial Conduct Authority (FCA) authorisation in relation to managing and enforcing past and future shared equity agreements.**
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This Guidance Note is for those registered social landlords and their wholly-owned subsidiaries which act as administering agents in relation to Scottish Government's shared equity schemes, including the Low-Cost Initiative for First Time Buyers and Help to Buy (Scotland) schemes. It provides information for registered social landlords and their wholly-owned subsidiaries to help them to determine whether they require Financial Conduct Authority (FCA) authorisation in relation to managing and enforcing past and future shared equity agreements.

It is not intended to be definitive legal advice on whether any particular registered social landlord or its wholly-owned subsidiary requires authorisation from the Financial Conduct Authority in relation to consumer credit and mortgage contracts.

Registered social landlords and their wholly-owned subsidiaries are encouraged to seek independent legal advice on whether they require to be authorised by the Financial Conduct Authority, particularly since some registered social landlords and their wholly-owned subsidiaries may well undertake other consumer credit or mortgage contract activity out with the shared equity schemes for which authorisation is required.

Background

RSLs and their wholly-owned subsidiaries who administer shared equity transactions and post-sale work for the Scottish Government's Low Cost Initiatives for First Time Buyers (LIFT) and Help to Buy shared equity schemes must ensure that they have appropriate authorisation from the FCA to undertake such activities.

Under the Homestake scheme which operated from 2005-2008 (before being re-branded the LIFT schemes) registered social landlords or their wholly-owned subsidiaries entered into a shared equity agreement direct with the homeowner as a 'lender' or 'creditor'. Registered Social Landlords and their wholly-owned subsidiaries managed and enforced these Homestake shared equity agreements in their role as lender.

From April 2008, under the LIFT shared equity schemes (which included the Open Market Shared Equity (OMSE) and New Supply Shared Equity Schemes (NSSE)), Scottish Ministers entered into shared equity agreements with homeowners. The Help to Buy (Scotland) Schemes which have operated since 2013 operate a similar

approach. RSLs and their wholly-owned subsidiaries continued to manage and enforce these shared equity agreements in their role as an administering agent for Scottish Ministers (on receipt of payment of reasonable administrative costs from the shared equity owner) rather than as lender.

Many NSSE loans were partially exempt from the consumer credit legislation on the basis that registered social landlords and their wholly-owned subsidiaries could potentially have taken advantage of the 'supplier exemption'. This exemption meant that a registered social landlord and their wholly-owned subsidiary did not need authorisation from the FCA to undertake debt-collecting or debt administration for NSSE agreements in relation to properties which were sold by that same administering agent direct to the shared equity owner, i.e. where the registered social landlord and their wholly-owned subsidiary was the 'supplier' of the NSSE property.

The supplier exemption did not apply if the registered social landlord and their wholly-owned subsidiary arranged for its parent, subsidiary or a third party organisation to undertake the administration of the NSSE agreements, since the 'supplier' of the property and the organisation managing and enforcing the agreements were then two separate organisations.

The NSSE supplier exemption did not apply to credit broking, so a Category C licence may still have been required by the registered social landlord and their wholly-owned subsidiary in relation to NSSE shared equity agreements.

The Scottish Government's administrative procedures for its shared equity schemes make clear to participating registered social landlords and their wholly-owned subsidiaries that they must ensure that they have all appropriate authorisations for consumer credit purposes in relation to their role in the shared equity schemes. It is a matter for each administering agent to determine whether they require authorisation from the FCA and, if so, to obtain that authorisation.

Changes to Regulation of the Consumer Credit Regime

There have been several changes over the years to the legislation relating to, and the regulation of, the consumer credit regime. Most registered social landlords and their wholly-owned subsidiaries originally held a consumer credit licence from the Office of Fair Trading (OFT). The FCA took over the OFT's role as regulator of the consumer credit regime on 1 April 2014. Many registered social landlords and their wholly-owned subsidiaries obtained interim permission from the FCA to undertake consumer credit activities under the new regime and have since obtained full permission from the FCA to continue to do so.

Credit broking exemption for housing authority loans

Following changes to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) on 27 June 2014, it was no longer the case that promoting and introducing potential customers to exempt 'housing authority' schemes was considered to be credit broking. As a result, registered social landlords and their wholly-owned subsidiaries no longer need FCA authorisation for credit broking in relation to the shared equity schemes.

Mortgage Credit Directive Order

In implementation of the Mortgage Credit Directive 2014/17/EU published by the European Commission, the FCA's rules on second charge lending changed on 21 March 2016 by virtue of the Mortgage Credit Directive Order 2015 (MCD Order). There is now a distinction between secured (second charge) lending and unsecured lending under the FCA's regulatory regime for consumer credit.

Authorisation from the FCA post-21 March 2016

The effect of the MCD Order is that registered social landlords and their wholly-owned subsidiaries will no longer require FCA authorisation in relation to shared equity agreements entered into with homeowners, or varied, on or after 21 March 2016.

However, the MCD Order does not backdate this exemption to apply to shared equity agreements entered into before 21 March 2016. That means that registered social landlords and their whole owned subsidiaries may still require FCA authorisation for consumer credit related activities carried on in relation to shared equity agreements entered into before 21 March 2016.

Whether or not FCA authorisation is now required for shared equity activity, and the type of authorisation required, depends upon the date on which the shared equity agreement was entered into with the homeowner, or the date on which the agreement was varied (whichever is later). The general rule is that, if you needed permission to enter into the agreement at the time it was entered into, then you will probably still need permission now, and vice versa.

Business Test

Registered social landlords and their wholly-owned subsidiaries will only need to be authorised by the FCA if they are carrying on the regulated activity 'by way of business' (section 22 of the Financial Services and Markets Act 2000).

The FCA's Handbook provides guidance on what is meant by 'by way of business'. This states that "whether or not an activity is carried on by way of business is ultimately a question of judgement that takes account of several factors (none of which is likely to be conclusive)". These factors include:

- the degree of continuity;
- the existence of a commercial element;
- the scale of the activity and the proportion which the activity bears to other activities carried on by the same organisation but which are not regulated; and
- the nature of the particular regulated activity that is carried on.

Registered Social Landlords or their wholly-owned subsidiaries will want to consider whether they meet the 'by way of business' test. If their conclusion is that the regulated activities are not carried on by way of business, then FCA authorisation may not required. The Scottish Government recommends that registered social landlord do not take such a decision without first seeking legal advice or discussing this with the FCA.

SCENARIOS FOR REGISTERED SOCIAL LANDLORDS OR THEIR WHOLLY-OWNED SUBSIDIARIES TO CONSIDER

1. Homestake agreements entered into by Registered Social Landlords or their wholly-owned subsidiaries before 6 April 2008

From 1 May 1998 to 5 April 2008, the Consumer Credit Act 1974 applied an upper credit limit of £25,000 to the definition of consumer credit agreements. Where the amount of credit granted to a homeowner by the registered social landlord or their wholly-owned subsidiary, under the scheme was over £25,000, the Homestake agreement was not classed as a consumer credit agreement.

It is likely that most of the Homestake agreements entered into by a registered social landlord or their wholly-owned subsidiary were for credit over £25,000 and would therefore not have fallen within the definition of a consumer credit agreement pre-6 April 2008. This means that registered the social landlord or their wholly-owned subsidiary did not need permission to enter into these agreements at the time and do not now need permission.

However, those Homestake agreements which were entered into pre-6 April 2008 for credit below £25,000 would have been consumer credit agreements, unless one of the exemptions in the Consumer Credit Act applied.

The 'housing authority' exemption contained in section 16(6A) of the Consumer Credit Act did not apply to registered social landlords or their wholly-owned subsidiary. However, there are potentially other exemptions, such as the 'four payments exemption' contained in article 3(1)(b) of the Consumer Credit (Exempt Agreements) Order 1989, which could have applied to these Homestake consumer credit agreements.

The registered social landlord or its wholly-owned subsidiary ought to have obtained a consumer credit licence from the OFT at the time it entered into the Homestake consumer credit agreements which were not exempt. They should then have determined whether they needed to apply to the FCA for full permission to exercise or enforce their rights as lender under article 60B of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) in respect of the Homestake consumer credit agreements.

The registered social landlord or their wholly-owned subsidiary would have had to consider whether they met the 'by way of business test' in relation to these Homestake consumer credit agreements and did not therefore need authorisation to exercise or enforce their rights as lender. Key factors in this decision could include:

- the volume of outstanding regulated Homestake agreements (i.e. those outstanding loans for credit over £25,000 to which the four payments exemption does not apply);
- the frequency with which the RSL exercises or enforces its rights as lender under the regulated Homestake agreements;
- the financial remuneration received by the RSL for the regulated Homestake agreements;

- how integral the Homestake scheme is to the RSL's activities; and
- the proportion of the regulated Homestake agreements balanced against the RSL's other, non-regulated activities, such as housing management.

As from 21 March 2016, the Homestake agreements which were consumer credit agreements now fall within the definition of 'second charge back book mortgage contracts'. RSLs and their subsidiaries should inform the FCA of any second charge back book mortgage contracts which they continue to manage and enforce, and ensure that they have appropriate authorisation in place, if required.

2. Homestake agreements entered into by RSLs or their wholly-subsidiaries post-6 April 2008

The upper credit limit of £25,000 for consumer credit agreements in the Consumer Credit Act was removed from 6 April 2008.

This meant that all the Homestake agreements which the registered social landlord or their wholly-owned subsidiary entered into with homeowners after that date would have been deemed to be consumer credit agreements – regardless of whether they were for more than £25,000.

In terms of authorisations, if the organisation which made the equity loan is managing and enforcing the Homestake consumer credit agreements itself then it may need to be authorised under article 60B of the RAO to exercise or enforce its rights as lender.

Alternatively, if the lender outsources the management and enforcement of the Homestake agreements to its parent, subsidiary or other third party organisation then that other organisation may need to be authorised under articles 36A (credit broking), 39F (debt collecting) and 39G (debt administration) of the RAO to undertake Ancillary Activities[1].

There are likely to be very few Homestake agreements entered into by registered social landlords or their wholly-owned subsidiary post-6 April 2008. However, the registered social landlord or their wholly-owned subsidiary should consider whether FCA authorisation is now required in relation the management and enforcement of those outstanding Homestake consumer credit agreements.

3. Shared Equity Agreements entered into by Scottish Ministers between 6 April 2008 and 31 March 2014

Since 6 April 2008, under the LIFT shared equity schemes (which included the OMSE and NSSE Schemes), Scottish Ministers has entered into shared equity agreements with homeowners. This was because the Scottish Ministers, unlike registered social landlords, did not require a consumer credit licence from the OFT to enter into the shared equity agreements as 'lender', by virtue of section 16(6A) of the Consumer Credit Act.

[1] means the regulated activities of credit broking, debt administration and debt collecting in relation to credit agreements, as defined in articles 36A, 39G and 39F, respectively, of the RAO (formerly credit brokerage, exercising creditor's rights and duties and debt-collecting under a credit agreement in terms of the Consumer Credit Act

However, registered social landlords or their wholly-owned subsidiary still required to obtain a consumer credit licence from the OFT to undertake any Ancillary Activities in relation to shared equity agreements. Scottish Government guidance at the time recommended that Administering Agents should hold a consumer credit licence under Categories C (credit brokerage), F (debt-collecting) and G (debt administration).

4. Shared Equity Agreements entered into by Scottish Ministers between 1 April 2014 and 20 March 2016

When the consumer credit regulatory regime moved from the OFT to the FCA on 1 April 2014, parts of the Consumer Credit Act were repealed and the Financial Services and Markets Act 2000 and RAO (and related FCA legislation) then became applicable to consumer credit agreements.

Shared equity agreements were 'exempt agreements' by virtue of article 60E(5) of the RAO, on the basis that (a) they were secured by a standard security against the shared equity property, (b) the property is a dwelling and (c) the 'lender' is the Scottish Ministers. This means that Scottish Ministers continued to not require authorisation to enter into shared equity agreements.

However, the RAO was drafted in such a way that, even though the shared equity agreements are exempt, the registered social landlord and their wholly-owned subsidiary which administer the exempt agreements on behalf of the Scottish Ministers still require authorisation to undertake debt administration and debt collecting (if carried on by way of business). That is, unless the NSSE supplier exemption set out above applied.

5. Shared equity agreements entered into by Scottish Ministers, or varied, on or after 21 March 2016

As from 21 March 2016, shared equity agreements are deemed to be 'mortgage contracts', rather than 'consumer credit agreements', by virtue of the MCD Order, which implements the terms of the Mortgage Credit Directive in relation to second charge lending to consumers.

The broad structure of the FCA legislation as it stood pre-21 March 2016 has not changed.

However the RAO has been amended so that shared equity agreements which are entered into or varied after 21 March 2016 are no longer regulated consumer credit agreements. This is on the basis that the shared equity agreements meet the definition of an 'exempt housing authority loan'.

The Scottish Government has made some changes to its shared equity documentation which is issued to prospective shared equity owners to make clear that shared equity agreements meet the criteria of exempt housing authority loans under the new legislation.

Undertaking debt administration and debt collection (or indeed, credit broking) in relation to exempt housing authority loans are not regulated activities. This means that registered social landlords and their wholly-owned subsidiaries will not need to be authorised for any Ancillary Activity carried on in relation to shared equity agreements entered into or varied on or after 21 March 2016.

ADDITIONAL AREAS FOR WHOLLY-OWNED SUBSIDIARIES TO CONSIDER

1. RSL wholly-owned subsidiaries acting as agent for RSL lender under Homestake scheme

The consumer credit legislation in relation to Homestake agreements applies equally to RSLs and their wholly-owned subsidiaries - the same law applies to both. However, where a registered social landlord entered into Homestake consumer credit agreements as lender and then arranged for its wholly-owned subsidiary to manage and enforce the terms of those agreements, or vice versa (i.e. the wholly-owned subsidiary was the 'lender' and the registered social landlord manages and enforces the agreements) then it may be that only the non-lender organisation which is actually managing and enforcing the agreements needs to be authorised by the FCA to undertake Ancillary Activities, such as credit broking, debt administration and debt collecting.

2. Wholly-owned Subsidiaries acting as Administering Agent from 6 April 2008 to 20 March 2016

The consumer credit legislation in relation to registered social landlords or their wholly-owned subsidiaries undertaking Ancillary Activities in relation to the LIFT and Help To Buy (Scotland) schemes is the same – there is no distinction. The determinative factor in working out whether the shared equity agreements entered into between 6 April 2008 and 20 March 2016 are exempt is the identity of the 'lender', which will have been the Scottish Ministers (who were exempt).

The FCA will generally only require the organisation which is actually undertaking the debt administration and debt-collecting in relation to the shared equity agreements to be authorised. We recommend registered social landlords and their wholly-owned subsidiary to discuss this point further with the FCA and seeking legal advice, where appropriate.

Although, as explained above, the NSSE supplier exemption will only apply where the organisation which sold the NSSE property to the sharing owner is the same organisation which is undertaking the debt administration and debt-collecting. So, if the registered social landlord sold the property and its wholly-owned subsidiary manages and enforces the NSSE shared equity agreements then the subsidiary will likely require authorisation from the FCA for debt administration and debt-collecting.

Scottish Ministers require to ensure that appropriate arrangements are in place between registered social landlords and their wholly-owned subsidiary and any third party which is managing and enforcing shared equity agreements on their behalf. However, the appointed administering agents will still themselves be ultimately responsible to the Scottish Ministers in respect of their obligations under the LIFT and Help to Buy (Scotland) schemes.

3. Wholly-Owned Subsidiaries acting as Administering Agent from 21 March 2016

There is also no difference between registered social landlords and their wholly-owned subsidiaries in the latest legislation on mortgage contracts as it applies to the LIFT and Help to Buy (Scotland) schemes post-21 March 2016. On the basis that the Scottish Minister is the 'lender' and the shared equity agreement meets the criteria of a 'exempt housing authority loan', then neither a registered social landlord

and their wholly-owned subsidiary requires authorisation to undertake Ancillary Activities in relation to that shared equity agreement.