AN INTERMEDIARIES 360 DEGREE GUIDE TO SECOND CHARGE MORTGAGES

AND WHY THEY SHOULD BE PART OF YOUR TOOLKIT

SHAWBROOK BANK

THIS GUIDE IS FOR INTERMEDIARY USE ONLY AND IS NOT SUITABLE FOR CONSUMERS

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If you're new to second charge mortgages, now is the time to become involved in the market – it's growing and evolving. There is a plethora of finance options available to your customers and, naturally, finding them the most suitable option remains your focus. Intermediaries and their customers often opt for the familiar remortgage, but this is not necessarily always the best option for your customer's personal circumstances. This is where a second charge may just be the solution.

Second charge mortgages can suit a variety of customers and since the Mortgage Credit Directive (MCD) applies equally to first and second charge mortgages, far from being daunting, this incoming legislation will make the second charge market more accessible as the advice process becomes aligned and fee structures become more flexible.

On the 21st March 2016 second charge mortgages will become regulated mortgage contracts as the MCD rules take effect. This will provide added security to customers and raise awareness of the product generally within the market as the intermediary will be obliged to disclose that second charge mortgages may be a more appropriate option, where their customers are increasing their borrowing. Furthermore, this will underpin the future growth of the market and ensure that customers are better informed. Now is the time to add second charge mortgages to your toolbox and we hope this guide will be a useful first step.

This guide to second charges is intended to be a taster, an introduction to familiarise you, the intermediary with this loan type and show how intermediaries who are already dealing with first charge mortgages are perfectly placed to start working with second charge. Contrary to popular belief the majority of advisers will come across potential second charge mortgage customers daily – they just don't realise it. Find it hard to believe? Read on to find out.

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Overview

As a starting point, we will take you through a brief history of the market and a glimpse into the future, an exciting new era heralded by the MCD. We will then outline why second charge mortgages are an important string to your bow – and help you to make the most of every opportunity.

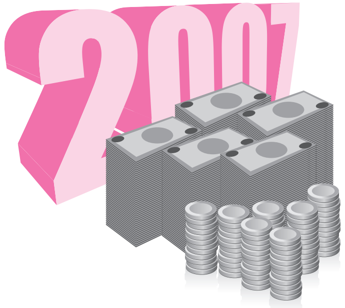
Signposting

To help you spot the opportunities for a second charge when they present themselves, we've detailed flags to look out for, as well as real life examples of where second charges have been used. We've also broken down elements of the MCD to highlight some of its implications, as well as the current factors which should make you and your customers comfortable with choosing a second charge mortgage.

If you would like to find out more, please get in touch at ***secured@shawbrook.co.uk*** or call **0845 600 7861** and we'd be glad to tell you all about second charges.

THE SECOND CHARGE MARKET PAST, PRESENT AND FUTURE

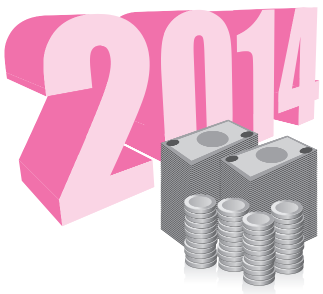
The second charge industry has seen significant changes over the last few years. Here is an overview of the evolution in the market since 2007 and how, with the correct behaviours, we can continue to grow this vibrant and exciting sector.



Looking back

The second charge market reached its peak in 2007 when gross lending figures stretched to £7bn[1] – a significant figure but unfortunately one which was symptomatic of various poor practices which contributed to a riskier sector overall.

Unsurprisingly then, these practices were unsustainable. When the global credit crisis hit, second charge lending figures plummeted; the Finance and Leasing Association (FLA) reported a decrease in gross lending of 84% between 2008/2009 and in 2010 the market hit an all-time low where the FLA reported only £16m in second charge lending for the month of December (source: www.fla.org.uk).



We're glad to say, however, that it's not all doom and gloom; since 2011 the market has been recovering. In fact, in March 2015 alone £75.5m in second charge mortgages were taken out by homeowners - a five year high for the sector (www.loantalk.co.uk). Since 1st April 2014 it has been under the FCA's supervisory regime; which is paramount to the sectors continued sustainable growth thus ensuring past poor practices cannot re-emerge.

It is for this reason that intermediaries and customers can, and should be, absolutely confident in considering a second charge mortgage as a genuine alternative to a remortgage.

[1] CP14/20 2.33 pg 15

Looking forward

The industry is gearing itself up for a fundamental change – on the 21st March 2016, the MCD will bring second charges into line with first charge mortgages, as regulated mortgage contracts, in order to provide consistency across the mortgage market and appropriate customer protection.[2]

To ensure customers are better informed "all customers considering taking out a first or second charge mortgage [will be] made aware that alternative finance options may be available."[3] By means of new disclosure requirements, the directive also requires lenders and intermediaries to provide an adequate explanation of the disclosures made by the firm, the essential features of the product, any ancillary products and the impact on the customer (including consequences of default).[1]

The implementation of the Mortgage Credit Directive and the new second charge regime is set to be one of the biggest changes in the market in 2016; with less than 12 months until the new second charge regime comes into effect and to help support intermediaries with their new obligations, summer 2015 will mark the launch of our Second Charge Mortgage Academies - dedicated to helping intermediaries learn more about the second charge mortgage market.

The academy sessions are formatted to help you identify some key points from the Mortgage Credit Directive (MCD) and the new regulatory regime for second charge mortgages; we will provide relevant information, to help you understand the impact that the new rules will have on the market.

We also recognise that the new disclosure obligations may be a prompt for clients to ask you for further information. Our sessions are therefore designed to build your knowledge and confidence in this sector, brush up on the essential features of the products, their unique selling points, helpful hints, tips, case studies, how to source and process a second charge mortgage and generally help you build a deeper knowledge of the wider market.

If you would like to register for an Academy, visit us at ***www.shawbrook.co.uk/secured-lending/academy***

[2] FCA PS15/9

[3] 5.1 Consultation Paper; Implementation of the Mortgage Credit Directive and the new regime for second charge mortgages; September 2014

WHY DO SECOND CHARGE BUSINESS?

Intermediaries are becoming increasingly aware of the alternative options available for their customers

Whilst a remortgage or a further advance can also offer attractive rates, it may be that a second charge mortgage offers a more bespoke solution. Reasons you may wish to explore an alternative solution for your customers include:

- When you, the intermediary, have determined that it is in your customer's best interest to remain on their existing interest-only mortgage; a second charge mortgage can allow the customer to borrow additional money without the need to disturb their existing mortgage.
- Early redemption charges may apply on the existing mortgage – in particular since 5 and 10 year fixed rates have become commonplace over the past couple of years
- Customers who have run into difficulty over the course of their existing mortgage may be declined a remortgage due to an increased risk profile
- Customers may find themselves 'trapped' as a result of lenders tightening criteria after the MMR
- Customers who are looking to consolidate debt may run into similar difficulties obtaining a remortgage
- Customers who are looking to consolidate debt may need to reduce their outgoings but this doesn't mean that they should drag out the repayments over the length of their existing mortgage term

Second charge mortgages on the other hand mean that:

- Customers keep their existing mortgage – the second charge sits behind the customer's existing first charge mortgage – and there are no exit fees or changes to the existing mortgage terms and conditions
- Customers can pay back when they like
- Second charges are assessed on their own individual merits
- Second charges allow the customers to consolidate debts over a longer term than an unsecured loan but also allow them the flexibility to have a shorter term than their first charge mortgage, potentially saving them thousands in interest

Who would a second charge mortgage benefit?

Second charge mortgages can help a variety of people so there isn't a 'typical' second charge customer.
It's not just those who have fallen victim to circumstance and need to rebuild their credit rating. Increasingly, high-net-worth individuals are looking to raise more finance than they would be able to access through a personal loan.
When Shawbrook brought its popular Platinum range to the market, it opened the eyes of the industry to the fact that second charge mortgages are not just for subprime customers but for your average 'high street' customer too.

A note to consider

We are seeing increasing interest, not only from new lenders and intermediaries, but also affiliate sites like Moneysupermarket.com. Being able to introduce these products to customers, before they discover them online, will mean you're best placed to retain their business. If not, you could miss out on their additional requirements for other financial products such as insurance. So in any case, the time spent learning why they could be a great option for your customer is worthwhile.

SPOTTING SECOND CHARGE OPPORTUNITIES

Here are some circumstances when a second charge may be a better option for a customer:

The customer wishes to *retain* their existing mortgage

For example, when you have already determined that it is in your customer's best interest to retain their existing interest only mortgage or lifetime tracker.

The customer wants *flexibility* in the repayment of the loan

A Shawbrook second charge mortgage does not have early repayment charges and also allows for overpayments so the borrower is able to repay the loan at the pace that suits them.

They want to use the money for reasons *not permitted* by other forms of finance

Examples can include business purposes – a cash injection, to buy machinery and equipment, to pay a tax bill – or to fund a wedding.

They need a *higher Loan to Value (LTV)* than is otherwise available

We can offer second charge mortgages up to 95% LTV, and yes, first charge lenders consent to this.

They want to use a *buy-to-let* (BTL) property as the security

The loan itself can be used in relation to that property, for example to do works, or for a completely different purpose, including putting down a deposit on a further property.

Here are some reasons that a customer may be declined elsewhere but still fit with a second charge mortgage:

If the lender has not counted *all of the customer's income*

A lender will look at all income including foster care income and BTL rental yield.

If the customer has an *Individual Voluntary Arrangement (IVA)*

Many high street banks look negatively on borrowers with an IVA. We take the view that having an IVA that has been consistently repaid for at least three years is a sign of financial responsibility.

If they have *recently changed jobs*

We will consider a customer if they have been in employment for at least two months.

If the customer has recently started trading either as a *sole trader* or *limited company*

Customers are eligible for a second charge mortgage with us after six months of self-employment.

If they have a *poor credit rating*

We look at the customer's credit score but we don't dismiss them if it doesn't quite reach our minimum requirements. We look at each case on its own merits and take a holistic view, as opposed to a tick box approach.

WHERE A SECOND CHARGE MORTGAGE CAN WORK FOR YOUR CUSTOMERS

High net worth

In one of the largest ever second charge deals in the UK, last summer Shawbrook helped a high-net-worth customer raise £2m to make improvements on their second home.

Since the second home was abroad, but the customers live and work in the UK, their financial advisor recommended raising the money against their primary residence in the UK.

It was clear from the outset that a remortgage wasn't going to be the best option for this customer's particular circumstances since six months prior, the financial advisor had remortgaged their main residence on to a fixed rate deal which they were tied into and would have had incurred hefty early repayment charges to redeem.

The customer's financial advisor therefore recommended a second charge mortgage as the most appropriate solution and Shawbrook were the obvious option based on our flexibility and ability to assess a case on its individual merits.

Did you know?

We can also lend on a second home or a buy-to-let property in the UK.

Consolidation

Consolidation of credit is probably one of the most common reasons that intermediaries approach us for a second charge loan for their customers' and a fantastic example of how a second charge mortgage can be used effectively.

Through recommending a second charge mortgage, one of our intermediaries saved their customer £2,135 per month by consolidating various pieces of outstanding credit.

In addition to the monthly saving, the customer's benefitted by saving on interest overall because the financial advisor took the time to craft a bespoke solution and didn't just lump all of the unsecured debt into the 20 years' remaining on the customer's existing mortgage. Rather, he assessed what the customer could comfortably afford (not just the lowest monthly payment possible) then worked out the lowest term for their budget, compared it with a remortgage and found that a second charge worked better for his customer's individual circumstances.

Did you know?

The term of the second charge mortgage can be shorter than the existing first charge mortgage

- Ideal flexibility if customers need to reduce their outgoings but don't want to drag the payments out over the full term of the mortgage

The term of the second charge mortgage can also be longer than the existing first charge mortgage

- Ideal flexibility if customers only have a few years left to run on their existing mortgage and are looking to raise money over a longer period than the remaining term.

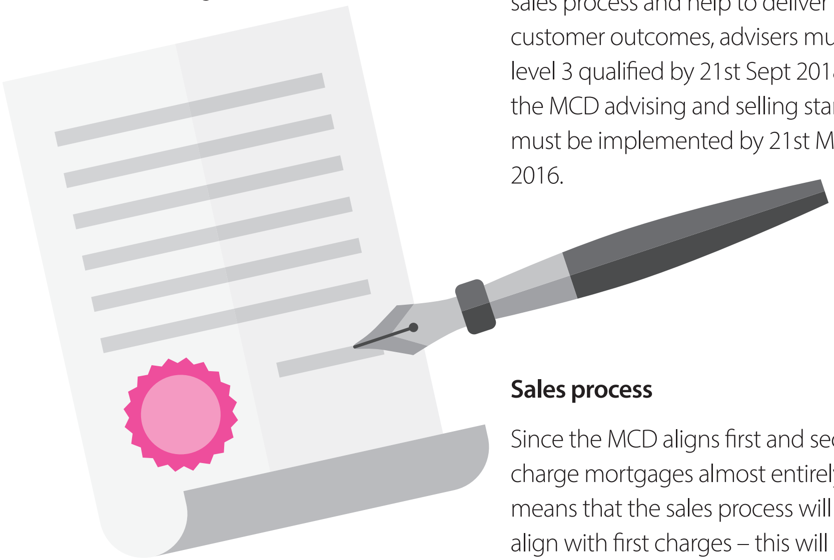
THINGS INTERMEDIARIES NEED TO KNOW ABOUT THE MORTGAGE CREDIT DIRECTIVE

The Mortgage Credit Directive applies equally to first and second charges

This means that first and second charge mortgages completely align

Obligated disclosure of alternative finance options

The Financial Conduct Authority (FCA) believes that customers should be made aware of a wider range of alternative finance options when looking to increase their borrowing secured on their home.[4]



Adequate explanation

The directive requires lenders and intermediaries to provide an adequate explanation of the disclosures made by the firm, the essential features of the product, any ancillary products and the impact on the customer.[5]

Advising and selling standards

To ensure that properly qualified individuals are an integral part of the sales process and help to deliver good customer outcomes, advisers must be level 3 qualified by 21st Sept 2018 but the MCD advising and selling standards must be implemented by 21st March 2016.

Sales process

Since the MCD aligns first and second charge mortgages almost entirely this means that the sales process will also align with first charges – this will provide an opportunity for intermediaries to submit their second charge mortgage applications directly to the lender or continue to use a specialist second charge mortgage intermediary.

[4] CP14/20 5.5 &5.6 pg50
[5] CP14/20 2.33 pg15

THE REASONS WHY YOU AND YOUR CUSTOMERS SHOULD BE COMFORTABLE WITH A SECOND CHARGE MORTGAGE

We hope that this guide has made you feel more at ease with second charges. As a takeaway we wanted to give you five reasons why we believe you and your customers should consider second charge lending as part of your toolkit.

1. The market is currently regulated by the FCA and the loans themselves will become regulated mortgage contracts on the 21st March 2016 – meaning greater customer protection and more consistent standards across the market

2. The entire process, including the sales process will be aligned with the first charge mortgage market – making it easier to identify and compare second charges against first charges

3. In line with first charge mortgages, all income declared is verified – we ensure the loan is affordable for your customer by checking all income and expenditure and stress testing all loans to protect against future interest rate rises

4. Lenders (as well as intermediaries) must adhere to a stricter regulatory regime which sets high standards, offering your customers peace of mind

5. A second charge is a flexible option and can provide a genuine alternative to a remortgage, particularly where the customers don't want to disturb their first charge mortgage

If you'd like to find out more about how you can provide second charge mortgages to your customers, get in touch. You can call the sales team on **0845 600 7861** or email ***secured@shawbrook.co.uk***

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SHAWBROOK BANK ACADEMY

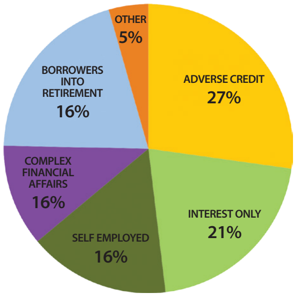
Dedicated to helping intermediaries learn about the second charge market.

The implementation of the Mortgage Credit Directive and the new second charge regime is set to be one of the biggest changes in the market in 2016.

To support advisers with their new obligations, our academy sessions aim to arm you with the practical knowledge to prepare for this new regulatory regime and to further your understanding of the second charge mortgage landscape post MCD.

Which customers do you find hardest to place?

A recent survey of advisers found that you find it difficult to place the following types of customer. Our Academies will show you how and why second charge mortgages could be a solution.



Source: Mortgage Solutions Survey May 2015

WHO

Mortgage advisers. Especially those not currently involved in second charge mortgages.

WHERE

Locations throughout the UK.

WHEN

Morning sessions throughout July – December 2015.

WHAT'S COVERED?

At the end of the Academy, you can expect to:

- Gain a more thorough understanding of the second charge market and how it's changing
- Understand how to recognise when a potential second charge mortgage may be appropriate for your customers
- Understand second charge products, criteria, essential features as well as their unique selling points
- Understand the opportunities to grow your business through second charge mortgages, the advice process and how to integrate them into your business.

REGISTER NOW

www.shawbrook.co.uk/secured-lending/academy