BSA response to FCA Mortgages Market Study: Interim Report MS16/2

31st July 2018

Building Societies Association

Introduction

The Building Societies Association (BSA) represents all 44 UK building societies. Building societies have total assets of over £393 billion and, together with their subsidiaries, hold residential mortgages of over £302 billion, 22% of the total outstanding in the UK. They hold over £271 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for 36% of all cash ISA balances. They employ approximately 43,000 full and part-time staff and operate through approximately 1,500 branches

This response has been prepared by the BSA in consultation with its members. We have provided responses to only those questions that are directly relevant to our members.

General Comments

1 It is pleasing that the Financial Conduct Authority (FCA) recognises that there are high levels of customer engagement in the mortgage market and that the commercial relationships between lenders and mortgage brokers broadly work. It is also clear that the mortgage market works well for the overwhelming majority of consumers. There has been much regulatory change over recent years, lenders have now settled into this environment and we have seen a period of stability. This stability is now enabling rapid development and innovation with many of our members investing heavily in these areas.

2 We are disappointed with the theme throughout the paper, which seems to suggest that price is the most important or only factor when selecting a mortgage. Price is important, but there are a range of other factors to consider when choosing a mortgage. The only winners in a price driven, commoditised market would be those lenders with the deepest pockets and effectively competition, innovation and much needed specialist mortgage products would be eroded.

3 We are confident that building societies are making use of the transitional arrangements set out by the regulator to help existing borrowers. However we strongly agree that all existing customers should be treated fairly, in this spirit the BSA in collaboration with UK Finance and the Intermediary Mortgage Lenders Association (IMLA) present an industry-wide agreement in this area.

4 The more pressing concern is the number of borrowers that are unable to switch their mortgage once it is sold to a non-active, often unregulated entity. There are many regulatory barriers which make it difficult to help these customers and without understanding the profile of these mortgagors it is difficult to assess lender appetite. The BSA and its members will continue to work closely with the FCA to try and identify ways in which these barriers can be overcome.

5 Ultimately, the mortgage market is a highly competitive environment which is working in favour of borrowers, enabling them to find the mortgage that best suits their needs at a competitive rate. Building societies provide real competition in the market by offering niche mortgages alongside standard products. First-time buyers, the retired,

the self-employed or those with more complex needs will find a mortgage to suit them at a building society.

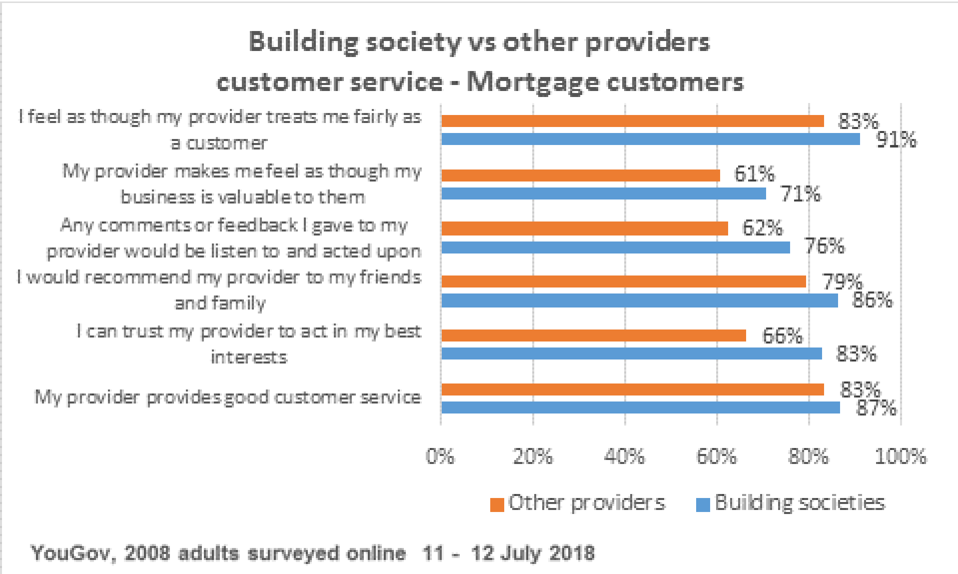
Questions for discussion

<u>Vision for the market and principles for potential remedies</u>

Q1: Do you have any views on our vision for the market?

6 As mentioned in our general comments the market has now settled after a period of significant regulatory change. This type of settled environment will naturally accelerate innovation, we strongly believe the regulator should allow the market to develop organically as market forces are a natural driver. Regulatory intervention could have the opposite of the desired effect and slow down innovation and development.

7 The study focuses on increasing consumer choice early in the process and we agree that more work is required in this area as some of the current solutions such as Price Comparison Websites (PCWs) are not fit for purpose in their current form. We are disappointed in the theme around the cheapest rate being the best solution for the customer. Many factors will determine the choice of lender including; speed and quality of service. Building Societies pride themselves on the service they offer their members and evidence suggests our members have a higher level of customer satisfaction than competitors. We certainly should not downplay the value this holds for customers when making a decision in selecting a mortgage lender.



8 The study suggests that providing more information up front both to intermediaries and consumers directly would be of benefit. In respect of intermediaries, there are a number of technology solutions that are developing rapidly in this space and our members will work closely with intermediaries to improve this process further. However, we are more cautious on very detailed criteria information being provided in the public domain as this could lead to an increase in fraudulent activity and gaming of the system.

9 Advice remains the most suitable method of transacting a mortgage for the majority of customers. However, there are certainly many customers who do not require advice when taking a mortgage and have by default been forced down this route as a consequence of the changes introduced by the Mortgage Market Review (MMR).

10 Rather than undoing some of the work of MMR, we feel a better approach would be to extend the existing execution-only provisions within the Mortgage Conduct of Business (MCOB). Lenders and intermediaries should be able to offer factual information and guidance through an execution-only process if the customer requires it.

11 It is critical that borrowers fully understand the services that intermediaries provide, and the breadth of the market they cover. A broker comparison tool could be a viable solution, but to make such a tool fit for purpose, and simple to navigate for consumers, further work and analysis is required. The MMR originally proposed to extend the approved persons regime to intermediaries, with the aim of bringing transparency and responsibility to the sector. Ultimately, the Financial Services Authority (FSA) decided against this approach based on budgetary constraints. In retrospect, the FCA Register is a technical record of regulatory compliance gained by firms and individuals and is difficult to navigate for consumers. We look forward to finding out more information about the FCA's recent announcement[1] of a public Directory that would encompass mortgage advisers. The aim of the Directory is to help consumers find an adviser by location – if specialisms could be added to the Directory this could be a way of providing the raw data by which a future broker comparison tool could draw upon.

12 We agree that any barriers to switching for existing customers with active lenders should be removed. The BSA has worked closely with the FCA as well as UK Finance and IMLA to present an industry wide agreement as a solution. Customers with inactive lenders are more of a concern as it is difficult to understand how the majority of these customers can be helped under current rules. The BSA and our members will continue to work with the regulator to explore a possible solution for these customers.

Making it easier for consumers to find the right mortgage

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https://www.fca.org.uk/news/press-releases/fca-proposes-new-directory-financial-services-workers

Q2: Do you think tools of the kind outlined could help consumers find more easily the best mortgage for them?

13 We certainly welcome any efforts that help improve consumers' ability to make effective choices by utilising technology further. We have previously stated (Barriers to competition in the UK mortgage market response) our concern that price comparison websites (PCWs) are causing customers to simply choose the lender with the lowest headline rate with customers being limited to the products only available from that lender and, therefore, missing out on an alternative product that may better suit their needs. The way products are presented on these sites could also increase bias as a result of sponsored lines that push consumers to a specific outcome.

14 It must be noted that the market has moved a long way in terms of innovation since the data was collected in the report. We are aware of current technology solutions that provide intermediaries with detailed criteria in a simple format on one platform, many of our members are providing these companies detailed criteria information already. In view of these new entrants coming into the market, mortgage sourcing systems are looking to improve their own propositions' by including more criteria within their platforms. We are also aware of the development of multi-Decision In Principle (DIP) platforms which should help intermediaries and customers to gain a quicker and more accurate view of the lending choices available. Industry will continue to innovate and developments around open banking will enhance this further. We strongly believe this process should remain market led and be allowed to continue at its own pace.

15 We also understand that a range of other firms are looking to use fintech to draw upon data to assess criteria. There remains a risk that a solution based solely on fintech could compound the problem, if the only firms plugged into the system are large high street banks. It is likely to favour only the incumbents that benefit from the current process.

Q3: What do you think would be necessary for this approach to work and what do you see as the main challenge?

16 As mentioned earlier we believe any solution should be market led. Many of our members are already providing additional criteria to intermediaries via criteria platforms, but this is subject to commercial arrangements. It is unclear how much criteria information the FCA would feel is sufficient and the format it should be presented in. We firmly believe that this is something that the market should provide.

17 Our members would draw a line at information that is commercially sensitive such as affordability modelling or credit score cut offs. We will continue our dialogue with the regulator and the wider industry to understand if this area could be improved.

18 Many of our members support customers with more complex needs. This relies on manual underwriting and looking at each case on its individual merits. It would be very difficult to provide much more upfront information that would add value as much of the work is done at the underwriting stage.

19 Technology solutions mean the provision of this real time information as mortgage criteria is constantly evolving this could prove challenging and costly for our members.

Q4: Could there be any unintended consequences?

20 Detailed criteria in the public domain could increase the likelihood of fraud and individuals gaming the system to their benefit.

21 Mortgages are a complex product area and difficult to compare to other financial products for a number of reasons; a mortgage tends to be a consumers most significant financial commitment over the longest term, the loan is secured against a property which again is a complex area depending on type of property such as leasehold, freehold, older properties, new builds etc. More customers are now self-employed, on zero-hour contracts etc. with income and expenditure becoming more complicated to assess. A standard one size fits all approach is not relevant as it could discourage much needed niche lending which relies on manual underwriting and case by case analysis of customers' circumstances rather than automated approaches which are more suitable for the simple mainstream lending favoured by the larger lenders.

22 The FCA needs to be mindful not to champion a solution which encourages standardised criteria and discourages lenders who are providing valuable solutions for the large and growing cohort of customers who have more complex needs. Building societies have led the way in innovative lending policies to help first-time buyers, self-build, lending to older borrowers, shared ownership and the self-employed. This type of product innovation to meet evolving customer needs is valuable and certainly in line with government vision and must be encouraged.

23 In many cases our members' approach to treating customers on a case by case basis and manually underwriting cases enables them to have some flexibility within criteria. It is impossible to capture this flexibility within standardised criteria available in the public domain. These type of cases usually become apparent through interaction directly with the lender or provision of more detailed information from a broker therefore would not lend well to current execution only regulation.

24 As mentioned earlier the industry is rapidly developing in this area and working well. If the regulator was to suggest some form of intervention this would inevitably mean those investing in innovation would slow down and wait until they are certain of the FCA position and direction.

25 Any solutions that could prove costly could force lenders to review their pricing.

<u>A wider range of tools giving consumers more choice about the support (including advice) that they need and offering greater convenience.</u>

Q5: Do you think consumers would benefit from more choice on the tools they use (including advice) and support they receive in the way outlined above?

26 Current guidelines around execution-only (MCOB 4.8A) where any form of spoken or interactive dialogue between the firm and the customer necessitate advice having to be provided understandably mean consumers by default opt for the advice process as they are uncomfortable with execution-only in its current form.

27 Radical changes to the provision of advice are not welcome as advice remains the most suitable option for the majority of customers. We believe that MCOB rules around execution-only should be revisited to allow customers to have a guided execution-only option. Lenders or intermediaries should be able to provide factual information and support through the application process.

28 It is difficult to accurately categorise the types of customer who would benefit from execution-only with any certainty, and equally difficult to determine this through transactional type. We therefore believe providing clarity and building on the existing rules would be the best solution. It would be prudent to ensure where advice is required it is the only option available therefore existing exceptions to accessing execution-only as outlined in MCOB should be maintained.

29 It is important that any update to MCOB be explicit as without this clarity lenders and intermediaries will understandably take a cautious approach. In order for any change to be successful the rules around steering customers to execution-only need to be clarified to enable firms to openly market execution-only options.

30 Customer convenience and changing consumer habits should be considered. Providing customer protections are not eroded as a result, we would be supportive of encouraging the development of online advice. More testing and analysis of technology solutions is needed to ensure the technology is fit for purpose and the advice standards are equal to that of a face-to-face or telephony interactions.

31 Lessons need to be learnt from the issues seen in online financial advice and technology solutions needed to be tested and fully scrutinised before rushing down this avenue hopefully the FCA's Innovate department can provide this support. The BSA has been involved in conversations between the FCA's Sandbox Unit and a fintech firm, with the latter looking to partner with building societies to pilot a robo-advice project. The Sandbox Unit ultimately decided against accepting the pilot into the Sandbox. However, there was no additional communication within the FCA to let supervision teams know about the pilot work being undertaken by societies looking at robo-advice. Building societies and fintechs are keen to work with the FCA where they are developing new functions. However the high bar for the Sandbox Unit has

made this difficult and better engagement within the rest of the FCA to help monitor innovations could be beneficial to all concerned.

Q6: What do you think would be necessary for this approach to work and what do you see as the main challenges?

32 MCOB 4.8A.17 sets out the amount of business the firm reasonably expects to transact by way of execution-only and the steps to be taken by the firm if that business exceeds the expected levels. This requirement should be removed as it would be very difficult to understand the number of customers who would elect execution-only.

33 As mentioned earlier execution-only rules should be extended to allow for guidance of suitable customers through the process. This will ensure customers who are comfortable without full advice have the support and comfort of a guided process.

34 It would be necessary to understand what additional support customers who would be suitable for execution-only would require via consumer engagement and study. This would ensure any changes to regulation are fit for purpose and also determine if more customers would opt for this solution rather than advice.

Q7: Could there be any unintended consequences?

35 There is a delicate balance required to ensure customers who require advice do not opt for execution-only therefore losing regulatory protection.

<u>Helping Consumers choose an intermediary on an informed basis</u>

Q8: Do you think consumers should be given more help to assess intermediaries' strengths and weaknesses in the way outlined above?

36 We would be supportive of a comparison tool, which helps consumers make an informed choice when selecting a broker. More work would have to be done to understand the relevant metrics they should be assessed on and there would need to be oversight of these types of tools to ensure accuracy and fairness to all intermediaries.

Q9: **What do you think is necessary for this approach to work and what do you see as the main challenges?**

37 It would be important for consumers to understand the services offered including fees and some form of quality measure such as getting the right information first time. Customer satisfaction or net promoter scores are also useful measures.

38 We would welcome some form of analysis on concentration of business with particular lenders, which would hopefully encourage use of a wider range of lenders ensuring the customer gets the best possible product available to them. However we are mindful that some intermediaries operate in a specialist space where there are limited lender options, this should be considered in order to treat them fairly.

39 It is unclear how this tool would be funded and maintained it would need some form of regulatory oversight to ensure fairness and accuracy.

Q10: Could there be any unintended consequences?

40 Smaller firms with a limited capacity if scoring highly on the comparison tool may see business levels increase beyond their capacity impacting the customer experience or outcome. The tool has a danger of being anti-competitive if the metrics used to rate intermediaries discriminates against some firms or gives an advantage to others.

41 If intermediaries are to be required to fund this tool they may look to increase revenue elsewhere which could mean an increase in costs for the consumer.

Reducing barriers for those consumers who do not or cannot switch

Q11: Do you think it should be made easier for consumers with active regulated lenders to switch?

42 Yes and to this end the BSA, UK Finance and IMLA have facilitated an industry wide agreement which many of members have signed up to with the expectation that more will follow.

43 Members have signed up to a principles based voluntary agreement which applies to customers who are:

- first charge owner-occupiers; and
- an existing borrower of an active lender, and
- on a reversion rate; and
- are looking to for a like-for-like mortgage; and
- where there are no material breaches of contract,
- are up to date with payments,
- still a residential property/loan and has a minimum term remaining of 2 years; and
- has a minimum outstanding amount of £10,000 and where the customer may benefit from switching.

By the end of 2018 all qualifying borrowers will be contacted if the firm has not already communicated with them in 2018.

Q12: Which consumers should be covered in our approach?

44 We do not feel there should be any customers excluded on the basis of when they took out the original mortgage contract. There will be some exceptions to the voluntary agreement:-

- Any change to the terms of the mortgage which is likely to be material to affordability would be excluded.
- Overseas properties, only mortgages on properties in the UK are included in this agreement.
- Arrears – customers who have aggregate arrears of more than one monthly payment in the past 12 months are not eligible.
- Discontinued products – firms do not need to replicate like for like e.g. if firms no longer certain product types.
- Permissions for commercial lets – the agreement will not apply where consent to let has been given.
- Securitisation – while not a total bar on moving borrowers to a new rate, some active lenders may not be able to offer new products immediately due to regulatory and/or legal constraints.

45 In terms of those in financial difficulty or outside the above criteria we feel the payment shortfall rules and guidance in MCOB 13 are adequate in ensuring customers are treated fairly and therefore remain within bespoke forbearance processes that suit their individual circumstances.

Q13: What do you think is necessary for this approach to work, and what do you see as the main challenges?

46 Working groups have been established with our fellow trade associations to reach this agreement, this group will continue to take this forward working closely with the FCA.

47 This agreement will be released to the press and included on the BSA, UK Finance and IMLA Websites.

Q14: Could there be any unintended consequences?

48 We believe our members are already helping the majority of these customers as the relatively low figure of 10,000 customers highlights, we therefore do not anticipate any negative consequences to the solution we will propose.

Long-term inactive customers

Q15: Do you think we should do more to encourage long-term inactive customers to switch in the way outlined above?

49 The FCA's recently published Strategic Review of Retail Banking Business Models show the number of customers on SVR has halved from 35% in 2013 to 17% in 2018. This is clear evidence of lenders having positive contact strategies to ensure customers are aware of their options when existing deal expires. In addition brokers clearly have a vested interest in ensuring any of their customers are contacted at the end of an existing deal to explore the option of switching internally or moving lender via a remortgage.

50 Regarding the 20,000 customers identified within the report who sit with regulated but inactive lenders, more could certainly be done to communicate with these customers to ensure they are aware it may be possible to move their mortgage to an active lender. This could be done via adding a message to annual mortgage statements directing them to intermediaries as well as engaging with consumer groups and government to raise awareness.

51 We do not feel our members create any barriers for customers to switch products, all have contact strategies where they write to customers prior to the deal expiring, many then follow up with phone calls and further letters. There are numerous examples of good practice such as offering discounted Standard Variable Rates (SVR).

52 We should not forget many customers are actively making the decision to remain on a reversion rate because of the flexibility offered. For those not engaged after numerous attempts from a lender we need to accept that the onus should ultimately fall on the customer to manage their own financial affairs. Our members strongly support financial education in the community and put a lot of time and investment into this. Our sector looks forward to the creation of the Single Financial Guidance Body (SFGB) and engaging with the SFGB to offer our continued support for financial education.

53 Our members are more than happy to help those customers who meet existing new borrowing criteria. The 120,000 customers who sit with unregulated owners will prove more challenging.

Q16: What do you think is necessary for this approach to work in the mortgages sector and what do you see as the main challenges?

54 The Mortgage Credit Directive (MCD) in its current form does not allow our members to provide mortgages to the customers of other lenders who do not meet current criteria.

55 As mentioned above, customers should firstly be directed to intermediaries who can ascertain if there are any lenders in the market that could lend to them. For example, in the wake of the financial crisis, a number of nationalised banks worked with intermediary groups to remortgage customers elsewhere. This could be done via engagement with existing mortgage lender or unregulated entity via a message on their mortgage statement and engagement with consumer groups to publically raise awareness.

56 Even if a solution could be found for the inability to act with MCD in its current form there are a number of further issues. There is a need to balance the risk of taking on loans that do not meet todays accepted criteria standards. We feel government engagement is key, particularly for those customers whose mortgages are now held by unregulated entities.

57 Lenders would have many barriers in helping these customers such as capital requirements, the nature of these loans would also have an effect on mortgage books.

58 We will continue to work with the FCA in order to find a possible solution and also feel there is also a role for government in this process.

Q17: Could there be any unintended consequences?

59 If a solution is found as long as taking on the customers is a commercial decision taken by the lender and there is some form of government assurance there should be no effect to pricing. Engaging with the unregulated entities who have a vested interest in these customers remaining on their books on high interest rates will be the biggest challenge.

60 However if large numbers of customer suddenly moved from reversion rates to core products internally some lenders may be required to revisit their pricing to make up for this shortfall.

<u>Remedies – timeline and general questions</u>

Q18: Do you have any comments on our timelines?

61 It is difficult to see definitive timelines within this paper. Once we have firm proposals it would be easier to determine whether any timelines are suitable against the proposals.

Q19: Do you have any views on the relevance of our findings on first-charge residential mortgages to other mortgage markets that we regulate and which were not within the scope of the market study?

62 We believe that any changes to the first-charge market should be reflected in the second charge market.

Q20: Do you have any views on the extent to which these potential remedies (with further enhancement or refinement) are relevant to lifetime mortgages?

63 The remedies discussed within the study would broadly apply to the lifetime mortgages market. Our views expressed throughout our response would equally apply apart from a few areas of difference. There should not be an execution-only option in this area as reflected in current guidelines.

64 Generally the majority of these customers would transact via specialist intermediaries some form of comparison tool would be useful for customers, however this would have to consider the concentrated nature of the market and not unfairly penalise these firms.

65 Online solutions may not be as applicable for this segment of the market where transactions tend to be complex and there is a more likely that customers are vulnerable.

66 Barriers to switching would not really be a concern due to the nature of the lifetime products.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.