Policy briefing

July 2015

FCA Thematic Review on Embedding the Mortgage Market Review: Advice & Distribution

On 9 July 2015, the FCA published the results of a thematic investigation into the implementation of the advice and distribution provisions in its Mortgage Market Review (MMR) which went into force in April 2014.

The study went into detail on various aspects of the consumer advice process. The overall findings were as follows:

- Many lenders have taken significant steps to provide advice for the first time. These firms, and those that have always provided advice, should now focus on delivering consistently good outcomes for customers.
- There was no evidence of systemic customer detriment.
- Some firms were failing to take reasonable steps to obtain sufficient, relevant information about customers' needs and circumstances before making recommendations. Although 59% of advice provided to customers was assessed as suitable (with only a small number of cases assessed as demonstrably unsuitable), the basis for 38% of recommendations was unclear.
- The consumer research highlighted that some customers place the greatest importance on the initial monthly payment to the detriment of other factors. This can dictate whether they think a mortgage is a 'good deal' or not.

Next steps: the FCA are communicating these findings with the market, and taking action with firms in cases where the findings suggested a need for this. The FCA will begin a wider assessment of barriers to competition in the mortgage market this Autumn, with a view to launching a market study in early 2016 on those aspects of the mortgage market that are not working to the benefit of consumers.

Background

On 9 July 2015, the FCA published the results of a thematic investigation into the implementation of its Mortgage Market Review (MMR) in April 2014.[1] The investigation involved an assessment of the quality and suitability of mortgage advice provided by firms using a range of tools, including mystery shopping, file reviews, on-site visits and qualitative consumer research. They also assessed a small number of examples of more complex or specialist advice.

Mortgage Market Review in force April 2014

The MMR saw major changes to the regulator's rules governing the selling and approval of mortgages to residential consumers, mainly set out in its Mortgage Conduct of Business (MCOB) sourcebook, but also related sourcebooks such as Training & Competence (TC). The changes can be summarised as follows:[2]

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[1] Financial Conduct Authority Thematic Review TR15/9: Embedding the Mortgage Market Review: Advice and Distribution, 9 July 2015. www.fca.org.uk/news/tr15-09-embedding-the-mortgage-market-review-advice-and-distribution

[2] For a more detailed summary of the final MMR changes, see The Chartered Insurance Institute Policy Briefing, *The Mortgage Market Review: The Final Score*, 14 Nov 2012 www.cii.co.uk/22944

- **Advised versus execution-only:** an advised sale is now defined as any sale that stems from any sort of consumer-seller interaction, in which case the seller will have to assess suitability. Execution-only is only be possible in limited situations, such as if there is no interaction, if the customer is High Net Worth, or in some situations if the customer does not wish to take the advice. The confusing "non-advised" regime was effectively scrapped.
- **Professional standards:** all those selling mortgages, supervising call centre staff that do this, or designing scripted questions for unadvised sales, will need to hold a mortgage qualification at QCF Level 3 Certificate (such as the CII Certificate of Mortgage Advice). Those mortgage sellers in the market not at QCF Level 3 on 26 April 2014, and new staff joining since, have until **26 October 2016** to attain this.
- **Vulnerable customers:** the rules are stricter for vulnerable applicants to protect them from unknowingly making unsustainable commitments. These have to receive advice, and (in sale & rent-back situations) will have to take it.
- **Affordability assessment:** overall approach: mortgages could only be sold to customers who can afford them. Self-certification mortgages have been banned and income will have to be verified in every mortgage application. In assessing affordability, lenders will have to stress-test interest rate changes and consider major outgoings such as heating and council tax.
- **Interest-only mortgages:** are still allowed but lenders now have to be stricter about assessing repayment vehicles. Relying on rising property values has been severely restricted.

FCA thematic investigation: overview and main findings

The report outlines the findings of the regulator's thematic review of the quality and suitability of mortgage advice provided by firms following MMR implementation. The investigation also employed a consumer research study to explore customers' experience of receiving advice and the extent to which firms are recommending mortgages which are suitable for customers' individual needs and circumstances.

The main findings were as follows:

- 59% of mystery shops and files reviewed resulted in suitable mortgage recommendations to customers;
- Although only 3% of cases were assessed as demonstrably unsuitable, there were many situations in which firms failed to take reasonable steps to obtain sufficient relevant information about customers' needs and circumstances before making recommendations. This resulted in a high number of cases (38%) where the FCA were unable to determine whether the mortgage recommended was suitable; and
- Shoppers did not receive advice in 19% of mystery shops commissioned despite the shopper believing they had received a recommendation.

Report details

The report looked into firm performance across the following areas: what customers expected from mortgage advice, initial inquiry and information provision, suitability assessment, how firms were providing advice, consumer communication, and culture governance and oversight.

Customers expectations from mortgage advice

Customers did not have a good understanding of the role of mortgage advice and found it difficult to distinguish it from other aspects of the mortgage application process, in particular the lending decision.

- Some customers regarded discussions with advisers in lenders as mandatory to facilitate their access to a loan or simply to validate the appropriateness of a product which they had already identified.
- Others also believed the mortgage adviser was only responsible for giving 'support' and 'guidance' rather than advice.

- The research also confirmed that customers often bring their own biases to advice discussions which may affect their ability to assess product risks or mortgage features objectively and rationally.

Initial inquiry and information provision

Consumers participating in the commissioned research reported they were keen to educate themselves about mortgage repayment methods, features and risks, and that they had tried to gather information from several different sources before approaching a specific firm or adviser or beginning to apply for a mortgage. In response, there was a range of approaches to dealing with initial customer enquiries.

- Some firms had strict controls on the boundaries between providing advice or information – in some cases this made it difficult for customers to obtain mortgage information without advice.
- Others were more receptive to the information needs of customers but advisers were often unclear as to whether or not they were providing advice.
- Others had adopted a cautious approach to providing information to customers, to mitigate risks of unqualified staff providing regulated advice. In some cases this prevented customers from accessing information about products, or mortgages, unless they spoke to an adviser or accessed information online.
- The FCA explained in response to these strategies that "there is a risk that these policies will frustrate customers seeking information and discourage them from shopping around."

Suitability assessment

When a firm assesses whether the regulated mortgage contract is appropriate to the needs and circumstances of a customer the factors it must consider include the following non-exhaustive list, insofar as relevant:

- whether the customer's requirements appear to be within the mortgage lender's known eligibility criteria for the regulated mortgage contract,
- whether it is appropriate for the customer to take out a regulated mortgage contract for a particular term,
- whether the regulated mortgage contract is appropriate, based on the information provided by the customer as to his credit history, and
- whether it is appropriate for the customer to pay any fees or charges in relation to the regulated mortgage contract up front, rather than adding them to the sum advanced.

The thematic review found that most advisers took reasonable steps to collect relevant information about customers' needs and circumstances, but did not always fully consider that information, or draw on it when assessing suitability.

How firms were providing advice

The regulator identified significant differences in the approach taken by firms in providing and assessing advice, resulting in a range of outcomes. Many firms had highly structured advice systems with significant investment in systems, front line staff and operational capability, and some major points of note were as follows. For standardised or linear advice processes and systems, there was a trade-off between control and flexibility:

- the positive features of good control, clear guidance, informative policies to assist decision-making; however
- there were issues about limited flexibility to suit customer needs and circumstances. In some cases, advisers had difficulty gathering and managing information on non-standard circumstances, and in some isolated cases, advisers were even deliberately misrepresenting customer circumstances to circumvent internal policies and procedures.

Other firms such as appointed representatives of large retail intermediary networks had little or no structure. While this was more flexible, they risked missing vital process features and the quality of the advice depended on the expertise and experience of advisers.

Consumer communication

According to the investigation, most participating customers still did not appear to fully understand the product features or risks even after advice was received. The FCA believe this reflects the focus to ensure customers receive a product suitable to their needs over the need for the customers to understand.

- Verbal: the FCA did not identify any one advice channel (face-to-face, telephone or video) that provided better outcomes, issues were raised about the length of disclosures where vital details were sometimes missed, extent to which technical jargon was avoided, and some cases of misleading disclosures. In the latter case, the FCA is taking action with those firms found to be making such disclosures
- Written: although there is no requirement for advisers to write to a customer explaining the reason for their recommendations, most firms choose to do this.

Culture governance and oversight

Management and Boards need to provide leadership and direction to create an environment that enables capable front-line staff to make informed judgements:

- one lender was able to provide clear examples of issues it had identified and changes it had made to the way it delivered advice in the interests of customers.
- another lender demonstrated how different components of its control environment, including its quality assurance (QA) function, played important roles in identifying root causes of issues and making continual improvements.
- some other firms were well-intentioned but focused solely on assessing compliance with processes and did not also consider customer outcomes.

Next steps

The review of advice and distribution forms part of the FCA's overall mortgage programme. Its thematic review into responsible lending commenced in April 2015 and from autumn this year, the FCA will begin a wider assessment of barriers to competition, with a view to launching a market study in early 2016 on those aspects of the mortgage market that are not working in consumers' interests.

In relation to implementing this review, the FCA have already provided individual feedback to firms visited as part of our assessment, setting out any actions required as a result of their findings. The regulator is also sharing findings with the industry and more widely so that firms can consider to what extent our findings are relevant to their business and what changes they may need to make as a result. In particular they expect:

- Firms to consider whether they need to take steps to improve how they communicate with customers when providing mortgage advice or information.
- Advisers to take steps to establish customers' needs/circumstances when offering advice or recommendations.
- Firms to review whether their practices have the potential to create unattractive unintended consequences.
- Where appropriate, senior managers and board members to ensure the firm has appropriate controls and reporting mechanisms to demonstrate it acts in accordance with the best interests of its customers.

Laurence Baxter
CII Group Policy & Public Affairs
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