Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Mortgages Call for Inputs
Strategy & Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

18 December 2015

Dear Sir/Madam,

Call for inputs on competition in the mortgage sector

The Financial Services Consumer Panel welcomes the opportunity to respond to the mortgage market call for input.

Whilst for many consumers, the mortgage market appears to operate well, with good choice and competitive headline rates, there are some segments of the market for whom there is less choice, for example older borrowers and the self-employed.

However, finding the best deal can be difficult for all consumers as a very low headline rate may not be the cheapest over a two- or five-year period, or even the lifetime of the mortgage, once fees and charges are taken into account. In recent years there has been a proliferation of different types of, and gradual increase in, mortgage fees. The recent Which? and Council of Mortgage Lenders report[1] aimed to introduce a common approach by lenders to make their "tariff" of fees and charges available to customers to avoid confusion and make it easier to find information about mortgage costs. However, this will not help consumers find the best deal. Whilst a standard format for lenders' tariff of charges would increase transparency, it would not help consumers understand the total cost of the credit over a set term, in comparison to another deal with a different fee and headline rate combination, nor to compare the total cost over different durations.

While there are high levels of switching from mortgage customers, it is less clear whether consumers are actually switching to a product which best suits their needs.

Mortgages are incomplete contracts in that their value is determined by the behaviour of suppliers after the point of purchase.[2] After the initial deal period, consumers can be put on a longer-term "variable rate" with no control placed over its level. For those consumers unable to move to a new deal, due to new affordability criteria introduced by the 2014 Mortgage Market Review (MMR), these potentially excessive prices can cause detriment and can distort competition if the largest firms have significant back-books which they can use to gain additional revenue.

The Panel believes that simpler pricing, comparative charges, and non-product fees which reflect their actual costs would be far more transparent and ensure that

[1] http://www.cml.org.uk/policy/policy-updates/all/transparency-of-mortgage-fees-and-charges/
[2] Llewellyn (1999), The Economic Rationale for Financial Regulation

competition was working in the interests of consumers. Mortgage prisoners – those trapped with their existing lender – should be protected from excessive rate rises and offered reasonable deals allowing them to gain certainty over their mortgage payments.

We have observed that there seems to be an increasing emphasis on demand-side solutions to fix all sorts of market problems, amounting to "more disclosure plus a bit of consumer education". This takes responsibility away from firms for designing straightforward products and explaining them in a way that is readily understood by consumers. We know more disclosure doesn't lead to better consumer outcomes, just greater consumer confusion. We hope the FCA will resist the temptation to follow this trend if it does commence a mortgage market study.

The Panel believes that all financial services providers should have a duty of care towards their customers. It follows that this should also be the case for mortgage advisers and brokers as well as mortgage providers themselves. Such a duty would oblige advisers and providers to avoid conflicts of interest and act with the best interests of the customer in mind.

We believe that having a duty of care would mean advisers, brokers and intermediaries, who are acting as the agent of the customer, and yet benefit from commission payments or procuration fees (proc fees) each time they arrange a new mortgage product, would not automatically suggest short term fixes when they were not in the consumers' best interests.

Particular areas of the mortgage market where the Panel wishes to comment:

<u>Mortgage Prisoners</u>

Consumers can become mortgage prisoners for a variety of reasons including changes to circumstances (such as their house value/income); changes to underwriting practices at their lender/across the market or changes to regulation (such as the introduction of new affordability checks or macro-prudential rules). Normal market forces do not apply to these groups of consumers. Lenders are not compelled to offer reasonable fixed rates to mortgage prisoners – which could result in consumers becoming vulnerable to financial difficulties when interest rates increase. Lenders which fail to use the transitional provisions for mortgage prisoners may not be treating customers fairly. Although some lenders are using an existing customer's payment track record as evidence of affordability (which is a reasonable and permissible approach) other lenders are not.
In addition, there are consumers who have taken out their mortgages post-MMR, who are therefore not covered by the transitional provisions, and whose circumstances have changed and they find themselves trapped. This group of borrowers are at particular risk of unfair treatment.

It also appears that changes to SVRs can be asymmetric. In 2012 a number of different lenders raised their SVRs, citing increases in funding costs or other issues. Over 1 million consumers saw their mortgage rates increase. The FSA/FCA allowed lenders to amend the "caps" which they had told consumers were in place on their SVRs. Despite the significant reduction in bank funding costs since the introduction of the Funding for Lending Scheme (FLS) these SVRs have remained at these elevated levels. In 2013, Bank of Ireland increased rates for some of its customers who were on "lifetime" tracker deals.

Consumers are also vulnerable to changes in their mortgage costs if their mortgage is sold on to an alternative lender or subject to a securitisation arrangement. The agreement for the securitisation of mortgages sold by UK Asset Resolution appears to include a provision that, after an initial period, the rate paid by customers will be linked to LIBOR.[3] This seems to contradict the assurances given by UKAR that there would be no changes to the terms and conditions of the mortgages.[4]

Lending into retirement and equity release

The Panel is concerned that three main providers and three main adviser networks have a stranglehold over the lifetime mortgage market, which is pricing out smaller more innovative players. Lifetime mortgages and equity release products are very different to mainstream mortgages and should be treated as such. We believe the FCA should also examine the impact of large and non-transparent mark-to-market[5] early repayment charges for lifetime mortgages. We recognise that this practice arises out of prudential requirements which mean that lenders match their loan book with an annuity book, but the consequences for consumers whose circumstances change, including the death of a partner, the move to a care home, or a house move to be closer to family members, can be serious.

There is a need to create a liquid market in slices of housing equity without threatening security of tenure, while at the same time not restricting people's ability to sell or downsize should they want to or need to at any point. The capital required to make an offer rules out many possible companies to provide this.

We also believe there is a missing market in interest-only mortgages for older people. Again, the capital required to be held against the loan is often prohibitive.

Associated fees and charges

There are also problems with deals fees for services associated with the mortgage, such as valuation fees and legal fees. Firms have refused to reveal how the cost of valuation fees are distributed between the valuer, the panel manager (who manages the allocation of the valuations to individual surveyors) and the surveyor.[6] The cost of a valuation can vary widely between banks, with some adding on administration fees on top of the valuation. The tied and exclusive supply of valuation surveys as a condition to provision of a mortgage by lenders, and the fees arising from this, was referred to the Monopolies and Mergers Commission in 1993. The MMC determined that a 'complex monopoly' existed, with harms considered to be: refusing to accept valuations from competent surveyors; setting national prices (not reflecting local conditions); paying external valuers a set national fee; and requiring borrowers to pay fees that do not separately identify valuation administration charges. It concluded, however, these did not act against the public interest but proposed: "that where lenders refer to valuation fees in their promotional material, including that made available in response to initial enquiries, and in mortgage application forms, they should be required to specify separately and clearly the valuation fee and any administration charges levied in connection with this valuation fee." It is not clear if this recommendation is still followed or enforced by the FCA.

There are also practices including lenders operating conveyancing panels and offering the consumer the choice of selecting from one of their panel of solicitors, or levying a fixed charge if they choose to use an outside firm. It is not clear whether banks are charging a fee to professionals for appearing on these panels.

[3] See Slate No. 1 Plc, Final Prospectus, Arranged by JP Morgan Securities plc
[4] http://www.n-ram.co.uk/corporate/media/latest-news/2014/2014-10-14
[5] The level of the Early Repayment Charge is based on the market price of a particular gilt
[6] http://www.rics.org/Global/RICS-Balancing-Risk-Reward-Sustainable-Valuation-Report.pdf

Commission

Since the introduction of the new mortgage rules in 2014, there has been a requirement for most interactive mortgage sales (eg face to face or telephone) to be advised.

As a result, the Panel believes it would now be appropriate to align the mortgage advice rules with the advice rules across the rest of the financial services industry. Consumers should know from the outset whether their adviser is truly independent and acting as their agent, providing advice that reflects the customers' interests; or offering a restricted service which is limited in scope in terms of the number of providers or products included within the adviser's range of business.

In addition, it is not always clear how advisers and sales staff are remunerated. Commission in the form of proc fees is often unclear. The elimination of commission in the mortgage advice sector would increase transparency of fees for consumers. It would also remove the current scope for bias from advisers in favour of particular products or providers that generate higher levels of commission.

Porting

There are some uncertainties over porting a mortgage to a new property. Some consumers who have porting clauses in their mortgage contracts find that they are unable to move them to a new property in practice, either because the new property is in an area or is of a type that the lender does not lend on, or because the lender treats a ported mortgage as a new contract and the consumer does not fit the criteria for the new contract. It is possible that some porting clauses are misleading consumers who are intending to move during the lifetime of the contract and who choose a particular product because they think it is portable.

Buy-To-Let

Over the past few years the Buy-To-Let mortgage market has grown strongly. Almost all of this lending currently takes place through intermediaries and is on an interest-only basis. There are concerns about the possible impact on financial stability from BTL mortgages. It is also worrying that the vast majority of BTL mortgages are not subject to conduct regulation.

Lenders seem to be not conducting the same stress tests to examine mortgage affordability in an environment where interest rates increase. A number of lenders currently require that rental income can be as low as 125% of mortgage interest payments when using an interest rate of 5%.[7] The FCA should examine the sales practices for BTL mortgages and ensure that it gathers comprehensive data on the market. It should also examine how intermediaries and lenders verify the rent being charged on the property when setting the Interest Coverage Ratio.

Financial Promotions

The FCA should also ensure that financial promotions for mortgages include the total fees payable and any statements made about how much consumers could save by switching include the impact of fees.

Higher mortgage fees combined with regular switching at the end of relatively short fixed terms can also mean that mortgage fees could represent an increasing proportion of

[7] https://www.gov.uk/government/consultations/consultation-on-financial-policy-committee-powers-of-direction-in-the-buy-to-let-market/financial-policy-committee-powers-of-direction-in-the-buy-to-let-market

overall mortgage costs. This combined with the fact that most lenders offer initial deals combined with moving to a higher long-term rate means that APR as a method of comparison is useless to many consumers.

Lending to the Self-Employed

While the Panel understands that most mortgage products are in theory available for the self-employed and micro-enterprises, these consumers do find it much harder to take out a mortgage. Brokers and intermediaries' sourcing systems cannot always cope with 'non-vanilla' applications. As a result, for those who pay themselves in dividends, rather than a salary, or for those who receive income from several sources, the actual choice of mortgage advice and products can be limited.

Yours sincerely

Sue Lewis
Chair
Financial Services Consumer Panel