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

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By email: MortgagesMarketStudy@fca.org.uk

Dear Sir / Madam,

Mortgages Market Study – Interim Report

The Financial Services Consumer Panel welcomes the opportunity to respond to the FCA's *Mortgages Market Study – Interim Report.*

The Panel supports the FCA's vision for the mortgage market and our responses to the questions are provided below. Our main points are:

- The FCA should do more to protect current and future mortgage prisoners. As many borrowers are unable to switch, lenders can exploit them. As well as being a conduct issue this is a market failure which has implications for competition and the FCA needs to address it. As part of this, the FCA should consider limiting the 'follow-on' rate which mortgage lenders charge after the initial period expires. This would help guarantee that mortgage prisoners would not be exploited even if their loan was sold on to a company not authorised for mortgage lending.
- Innovative tools have the potential to help many consumers find a more suitable mortgage but consumers should have easy access to additional information or advice, if required.
- Not all consumers require advice when choosing a mortgage. However, the provision of advice is the one point where protection insurance is currently raised with consumers. If the requirement for advice is diluted it could lead to consumers not buying protection insurance when it would be in their interests to do so. The FCA should take account of this risk.
- Any consumer for whom there is a cheaper deal available with their current lender should be able to switch, whether or not they are in arrears.
- We agree that long-term inactive customers should be able to get a better deal, but the FCA must recognise that the decision to switch is based on a number of factors, not simply a desire to reduce monthly repayments. Demand-side remedies have limited effectiveness, and the FCA should consider whether more interventionist approaches may deliver better outcomes for disengaged consumers.
- Intermediaries need to be able to consider the full range of later life decumulation products to offer best advice to consumers. The FCA should consider how to encourage more holistic advice about decumulation products, including reviewing the different regulatory rules which apply. The proposed broker tool should provide greater clarity to consumers about the products which an intermediary is able to advise on.

Answers to questions are provided below. These are grouped together, mirroring the FCA's approach in its consultation paper.

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

The FCA's vision should include the principle that all captive customers – sometimes referred to as 'mortgage prisoners' - should be treated fairly. The FCA refers to mortgage prisoners as a 'legacy issue'. This ignores the fact that large numbers of mortgage prisoners will re-emerge the next time there is a sharp swing in the economic environment, house prices or lending standards. There is no clear evidence that any of the policies put forward by the FCA or PRA will prevent the re-emergence of mortgage prisoners – indeed, regulators appear to be overconfident in their own ability to prevent risks from occurring. Greater Government participation in the mortgage market and the subsequent withdrawal of the help-to-buy mortgage guarantee could cause new generations of mortgage prisoners to emerge.

We are also concerned that around a third of both the stock and the flow of consumers with mortgages are not getting products that meet their needs and circumstances.

While the study found no evidence of conflicts of interest in the value chain we still think that applying Mortgage Market Review (MMR) principles in this market would help, particularly given the potential incentive for intermediaries to encourage churn through short-term fixed-rate products with customers then reverting onto higher Standard Variable Rates.

We also believe that mortgage providers should not be able to refer people to specific intermediaries due to potential conflicts of interest. Consumers should be advised to find a suitable intermediary themselves, something which should be easier if the intermediary comparison tools work as intended.

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

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

Q4: Could there be any unintended consequences?

We support the development of innovative tools to make it easier for consumers to make comparisons between products both in the short-term and the expected end term. At present, it can be difficult for consumers to assess whether they would be better off switching their mortgage due to the range of product rates and fees which can be levied when re-mortgaging, let alone the potential impact of interest rate changes or changes in personal circumstances.

However, mortgage eligibility can vary by geography, property type, employment status of borrower, age of borrower, loan to value and potential portability. It is difficult for digital tools to reflect these variations and the combinations between them. The interplay between fees and interest rates is also complex and can be difficult to convey in a clear and readily understandable format via digital tools. Moreover, as the FCA interim report acknowledges, tools might not be right for every consumer.

To address the limitations of any tools, no matter how well-designed, it will be important for consumers to have easy access to an intermediary to get additional information or advice, either over the telephone, via a section of the intermediary website or via webchat. The online responses could form the starting point of the conversation with an intermediary.

Eligibility criteria are not transparent, so consumers face protracted questioning with very little understanding of whether their application is likely to be successful. Making eligibility criteria more transparent upfront would be very helpful so consumers do not waste time applying for mortgages which they have no realistic prospect of being accepted for.

Now, the best deals offered to some atypical borrowers are individually underwritten; digital tools offered by Price Comparison Websites (PCWs) and mortgage sourcing systems are not capable of reflecting individual underwriting. The FCA needs to take account of this in developing solutions.

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

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

Q7: Could there be any unintended consequences?

The Panel recognises that certain types of consumers (e.g. those with stable incomes who have standard mortgage needs) may not require advice, and should not have to pay for it, even if the costs are not apparent as they are bundled into the overall charges. This is particularly the case where they are remortgaging with an existing lender and are not increasing the amount borrowed or moving to a new property.

However, advice provides an opportunity for a consumer to be encouraged to consider their financial circumstances in the round; it is the one point where protection insurance is raised with consumers. The Panel's recent research found that most holders of protection products had bought them at the suggestion of an intermediary, financial adviser or lender. It had not occurred to them independently. If the requirement for advice is diluted, it may mean that consumers don't buy protection insurance when it would be in their interests to do so. The FCA should consider whether there are alternative prompts or ways to ensure that consumers give adequate consideration to protection insurance when taking out a mortgage.

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

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

Q10: Could there be any unintended consequences?

Yes. The choice of intermediary is often critical in finding an appropriate mortgage, since intermediaries vary in the extent to which they access different providers and their ability to deal adequately with people with more complex circumstances.

The FCA should ensure that the specialist expertise that some intermediaries offer is displayed clearly and is easily searchable. Information available to consumers should also include the number of lenders the intermediary deals with, as the FCA has found links between more expensive mortgages and intermediaries that typically place business with fewer lenders.

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

Q12: Which consumers should be covered in our approach?

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

Q14: Could there be any unintended consequences?

The Panel supports efforts to make it easier for consumers with active lenders to switch. However, we are more concerned about borrowers who are trapped in mortgages with lenders who are no longer active, or who have never been active and only purchase mortgages on the secondary market. We recommend that any consumer for whom there is a cheaper deal available with the same lender should be able to switch, whether or not they are in arrears. Denying customers in arrears the ability to switch is deeply unfair - some consumers are only in arrears because they are currently being charged an excessive rate and could afford a cheaper deal, while others are technically in arrears because they have negotiated a repayment holiday, or reduced payments for a while (e.g. due to illness or job loss). The effect of excluding customers in arrears would allow lenders to single out customers who were in financial difficulty and leave them stranded on excessive standard variable rates.

The protections that allow existing customers of active lenders to switch to a better deal with the same lender without a full affordability test only apply to loans that originated pre-crisis. It is not clear why people who took out loans post-crisis – even if these make up only a relatively small proportion of the total number of those with active lenders who are unable to switch - are treated worse than people in similar circumstances who took out their loans earlier. There will be new generations of mortgage prisoners which will emerge the next time there is a sharp swing in the economic environment, lending standards or house prices. The low interest rate environment could also mean that customers reaching the end of fixed-rate deals and who are unable to switch will see significant rises in payments. For example, a consumer taking out a deal with a two-year fixed rate of 1.7% now could see their rate increase to between 4% and 5% if they are unable to switch at the end of the deal. The absolute gap between base rates and SVRs has increased significantly and in the future customers stuck paying the SVR will be unlikely to benefit from cuts in interest rates as base rates are already much lower than prior to the financial crisis.

For customers with firms that are no longer lending, or where a mortgage book has been sold to a company that is not authorised for mortgage lending, we recognise that the FCA's ability to take action is limited. It is not right that consumers can find themselves with a lower level of protection, and unable to switch to a better mortgage deal, because of decisions made by a firm to sell on or move a mortgage book outside of the regulatory perimeter. While the FCA's regulatory remit is for Parliament to decide we would expect the FCA to press for changes, given the negative consequences for consumers of the current regulatory framework.

We would also expect the FCA to evaluate whether to use the full range of its powers to limit the 'go-to' or 'follow-on' rate which mortgage lenders should be able to charge after the initial period expires. This would help guarantee that mortgage prisoners would not be exploited even if their loan was sold on to a company not authorised for mortgage lending.

The FCA should learn the lesson from the very successful CAT standard mortgage initiative. CAT standard mortgages included a term which required the variable rate of the mortgage to be no more than 2% above the Bank of England base rate. Two major mortgage providers (Nationwide and Lloyds TSB) continued to include this term in their mortgage agreements in the run-up to the financial crisis. The result has been that these two lenders were required to pass on in full the cuts in Bank of England base rates to their Standard Variable Rates. Other lenders have used cuts in the base rate to widen their margins at the expense of their customers. Nationwide estimated that the benefit of the CAT standard had been £300 million in the six months to

November 2010.[1] Assuming that borrowers at Lloyds TSB have enjoyed a commensurate benefit in line with their market share means that consumers with those mortgages benefited from the CAT standard mortgage initiative by over £1 billion each year in the aftermath of the financial crisis.

As part of the market study the FCA should also review the pricing decisions on SVRs that lenders made following the financial crisis. For example, banks justified increasing SVRs following the financial crisis as they said that their funding costs had increased. One bank said in 2012: "*The increase to the rate reflects the fact that raising money through retail savings and in the wholesale markets is currently very expensive by historical standards*." Over 1 million mortgage holders were hit by mortgage rates increases, costing them over £300 million a year.[2] When bank funding costs were significantly reduced in subsequent years as they received Government subsidies through funding for lending banks failed to reverse the increases. The FCA should also review whether lenders complied with requirements to consider reducing the caps on their SVR.[3]

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

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?

Q17: Could there be any unintended consequences? (e.g. any impact this could have on prices for new customers)

While switching may lower monthly repayments, interest rates are not the only factor to consider. Others include:

- the costs of switching (e.g. new surveys, additional fees) which mean that the cumulative cost of regular switching might outweigh the benefits of lower interest rates over a 25 or 30-year period;
- consumers may be ineligible under current criteria for non-obvious reasons (e.g. health problems);
- customers may value their relationship with their existing lender;
- customers may not want to face the disruption and hassle of transferring their mortgage to another product or lender.

The FCA should also recognise the limits of demand-side remedies that put the onus on consumers to take action, and consider whether more interventionist approaches may deliver better outcomes where consumers are not engaging with the market.

Q18: Do you have any comments on our timelines?

Mortgage prisoners have been trapped, paying higher rates than necessary, for a long time. For example, a customer of Northern Rock who had a £200,000 mortgage in 2007 is already more than £15,000 worse off than customers who paid the average SVR at other lenders.[4] The FCA should take swift action to enable all customers to access more competitive deals and should make it clear to the Government where the regulatory perimeter needs to change to enable the regulator to protect consumers.

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[1] Nationwide Building Society, Half year financial report for the period ended 30 September 2010, Page 4

[2] https://www.todaysconveyancer.co.uk/main-news/increase-in-svr-will-affect-more-than-1-million-mortgage-customers/

[3] http://www.fsa.gov.uk/pubs/other/vvop.pdf

[4] https://newcityagenda.co.uk/northernrock/

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 – for example, second charge?

Second charge mortgages tend to be sold either direct or through specialist intermediaries. We question whether consumers should be encouraged to go into this market without first exploring the possibility of increasing their main mortgage (either with their existing lender, or with another lender). Second charge mortgages should have the same advice requirement as first charge mortgages. This will make it more likely that consumers will be able to explore a wider range of options.

Q20: Do you have any views on the extent to which these potential remedies (with further enhancement or refinement) are relevant to lifetime mortgages (in light of our assessment of lifetime mortgages in Annex 5)

When a consumer first considers taking out a later life decumulation product, they may not know which product is the most appropriate for them. Yet they are forced to follow a customer journey which unhelpfully and prematurely limits their options. Intermediaries need to be able to consider the full range of later life decumulation products to offer best advice to consumers. The FCA should consider how to encourage more holistic advice about later life decumulation products, including reviewing the different regulatory rules which apply. At the very least, we would expect the FCA to provide greater clarity about the products which an intermediary is able to advise on in the proposed broker choice tool.

The number of providers of lifetime mortgages is limited, as is the number of intermediaries. This makes for a thin market. The prudential rules make it particularly expensive for consumers to escape as providers must unwind the matching products they hold to offset the risks of lifetime mortgages (usually an annuity book). This means that for all practical purposes there is no switching within the lifetime mortgage market. Many of the remedies discussed in the interim report focus on switching, or enhancing the ability to switch. In the lifetime mortgage market, it is vital that consumers get the best possible deal first time.

Q21.Do you have any views on these options or any other alternatives?

No.

Yours faithfully

Sue Lewis
Chair, Financial Services Consumer Panel