Financial Conduct Authority

Embedding the Mortgage Market Review: Advice and Distribution

July 2015

Thematic Review

TR15/9

Contents

1. Executive summary

Overview

1.1 This report summarises the key findings of our thematic review of the quality and suitability of mortgage advice provided by firms following implementation of the Mortgage Market Review (**MMR**). It should be read in conjunction with ESRO's independent customer research report '*Understanding consumer expectations of the mortgage sales process*'.[1]

1.2 The two publications consider customers' experience of receiving advice and the extent to which firms are recommending mortgages which are suitable for customers' individual needs and circumstances.

1.3 We also highlight areas where firms may need to take steps to improve practices including oversight arrangements to ensure that advisers treat customers fairly and act in their best interests when recommending suitable mortgages.

1.4 We assessed the quality and suitability of mortgage advice provided by firms using a range of tools, including mystery shopping, file reviews[2], on-site visits and qualitative consumer research. We also assessed a small number of examples of more complex or specialist advice.[3]

1.5 We found that:

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

1 www.fca.org.uk/your-fca/documents/research/understanding-consumer-expectations-of-the-mortgage-sales-process-esro
2 134 mystery shops (108 where advice was given); 34 file reviews
3 Debt consolidation, credit impairment and lifetime mortgage

1.6 Some firms were engaging customers in focused, relevant, discussions leading to suitable recommendations with good rationale. However, overall, the quality of advice in the mortgage market was mixed:

- Some firms delivered advice with little or no structure meaning advisers typically failed to ensure they had sufficient understanding of customers' needs and circumstances on which to base their recommendations.

- Other firms placed heavy reliance on completion of point-of-sale application systems, allowing little flexibility for advisers to apply judgement or adapt delivery to meet individual customers' needs.

1.7 Both approaches resulted in unintended consequences which impacted on the customer experience or the suitability of recommendations provided.

1.8 The best performing firms in our sample (both lenders and intermediaries) demonstrated that it is possible to strike an appropriate balance. These firms used structured processes that supported advisers to obtain relevant information about customers' needs and circumstances, but allowed sufficient flexibility for them to use their knowledge, skill and judgement to assess this information and tailor their services to individual customers. This enabled them to make consistently suitable recommendations and deliver a good customer experience.

What consumers told us

1.9 ESRO's consumer research indicates that 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. Customers may not engage properly with discussions where they are unsure about the purpose of certain questions designed to support them and identify mortgage products that meet their specific needs and circumstances.

1.10 The research also confirmed that customers can bring their own biases to advice discussions which may affect their ability to assess product risks or mortgage features objectively and rationally. This also influences how they engage with advisers.

1.11 Many also had a poor understanding of the mortgage recommended to them, and could not explain why it was suitable in light of their specific needs and circumstances.

Key message for firms

Although customers are responsible for their own decisions, advisers must assess each customer's needs and circumstances and use their judgement, knowledge and skill to recommend suitable mortgages.

This may include probing customers' stated preferences and exploring trade-offs with customers who express contradictory or conflicting needs.

Advisers must take reasonable steps to try to obtain all information which is likely to be relevant for this purpose.

What can firms and advisers do?

1.12 Our new rules were introduced in April 2014. We recognise that, over the last year, many firms have focused on delivering new processes to comply with our requirements. This report reflects on practices we have observed and identifies areas where firms may have opportunities to strengthen their approach to embed good practice and deliver better customer outcomes. Where examples of practice in this report include commentary by advisers or customers these are verbatim extracts from mystery shopping transcripts.

1.13 Some of the firms we assessed had identified issues with their advice processes and were making changes to improve their service to customers. We welcome these efforts and recognise that some firms were still embedding and improving new processes at the time of our assessment.

1.14 Other firms need to take further steps to put in place a culture which promotes and supports good customer outcomes. For example, firms should ensure that:

- Distribution strategies, governance and oversight arrangements focus on achieving good customer outcomes.
- Advisers take reasonable steps to take account of all relevant customer needs and circumstances and have flexibility to apply judgement when recommending mortgages.

1.15 Many advisers in our review could have done more to engage customers when providing advice. In particular, when assessing whether a mortgage is appropriate to a customer's needs and circumstances, advisers should assess the factors set out in MCOB 4.7A.6R in combination, rather than considering each component of suitability in isolation.

We are working with the industry to embed our new mortgage regime

1.16 Our review did not identify systemic customer detriment. However we are asking the firms that participated in our review to make specific improvements, where appropriate, and will act if we identify customer detriment.

1.17 We are working with firms and industry bodies to help them to take the next step towards consistently delivering suitable recommendations.

1.18 Our review of advice and distribution forms part of our wider programme of mortgages work. We commenced our review into responsible lending in April 2015 and will continue our assessment of how firms are implementing our post-MMR rules. Building on this, from autumn 2015 we 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 to the benefit of consumers.

Who will be interested in this report?

1.19 Our findings will primarily be of interest to mortgage lenders and intermediaries. Consumer groups and trade bodies will also be interested in the themes explored in this report.

2. What the MMR changed for firms distributing mortgages

2.1 Changes to our Mortgages Conduct of Business rules (MCOB) came into force on 26 April 2014 following the Mortgage Market Review (MMR). Our rules aim to deliver a mortgage market which works well for consumers and is sustainable for all participants.

2.2 Taking out a mortgage is one of the most important (and financially significant) decisions most consumers will make during their lifetime. But during the MMR, we observed that almost a third of customers were sold a mortgage without any assessment of whether that mortgage was appropriate for them, based on their particular needs and circumstances. In addition, the non-advised interactive sales process presented challenges to firms and consumers. To address these issues, we made the following changes to our sales standards:

- Ensured that the responsibility for assessing affordability rests squarely with the lender.
- Required firms to provide advice in interactive sales (e.g. face to face or telephone), with very limited exceptions.
- Introduced an execution-only sales channel without advice, for limited use in particular scenarios.
- Increased professional standards (all sales staff required to hold a Level 3 mortgage qualification).
- Removed the requirement for advisers to recommend the 'most suitable' mortgage product.
- Introduced a duty for firms to act honestly, fairly and professionally in the best interests of their customers.[4]

2.3 Our new mortgage advice regime means that most consumers receive advice, with the aim of ensuring they are only recommended mortgages which are appropriate and suitable for their needs.

4 MCOB 2.5A.1R

3.
What customers expect from mortgage advice

3.1 ESRO's consumer research indicates that 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.

3.2 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. Some customers also believed the mortgage adviser was only responsible for giving 'support' and 'guidance' rather than advice.

Customer research quote (Remortgagor, London)

'I know what I'm doing when it comes to remortgaging. I'm getting us a better deal. So having to take a day off work to go in to the bank and talk them through our family finances was pretty ridiculous. The deal would mean we pay less a month, so obviously we can afford it.'

Customer research quote (Home mover, Glasgow)

'I did the application over the phone and it was quite laborious. It was a good thing I already knew what I wanted.'

3.3 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.

3.4 As a result, customers may not properly engage with discussions where they are unsure about the process or the purpose of questions designed to support them and identify mortgage products that meet their specific needs and circumstances.

3.5 Although customers are responsible for their own decisions, advisers must assess each customer's needs and circumstances and use their judgement, knowledge and skill to recommend suitable mortgage products. This may or may not align with customers' initial views of what they want.

3.6 Firms may wish to consider whether there is more they can do to promote more transparent and effective engagement with customers to mitigate any risks of misunderstanding or poor customer outcomes.

4.
Initial enquiry and the provision of information

4.1 Consumers who took part in ESRO's research told us 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.

4.2 Firms had adopted contrasting 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. Other firms were more receptive to the information needs of customers but advisers were often unclear as to whether or not they were providing advice.

4.3 Some lenders 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. For example, some front-line staff insisted that customers speak to a mortgage adviser when they were only seeking product information. Some advisers refused to provide balanced and neutral product information when customers requested it.

Example

An adviser in a lender reflected that they were unable to provide information on a product:

'OK, because I had a chap phone up this morning you see and he said, "What's your five year fixed rate? Because I think that's the one for me." I said I'm not allowed to tell you that I said, because that would, could be construed as I'm giving you advice for that rate without having interviewed you properly.'

4.4 These policies appeared to be designed to minimise regulatory risk but firms need to be mindful of the possible unintended consequences. There is a risk that these policies will frustrate customers seeking information and discourage them from shopping around.

4.5 In other cases, firms asked customers to commit to an application before making a recommendation, or expected them to apply as soon as they provided a recommendation. Some scheduled appointments were deliberately designed to facilitate this.

Example

After obtaining information on a customer's needs and circumstances, an adviser asked the customer to commit to making an application at which point the adviser would recommend a mortgage:

Adviser: ***'OK, that's fine, that all passes affordability, there's no issues there at all, OK. So just to make you aware after we've issued you an offer of loan a withdrawal fee [of £] will be payable if your loan does not draw down before your offer of loan expires, OK?'***

Customer: ***'OK, I haven't even decided what mortgage type I want yet though.'***

Adviser: ***'What do you mean by mortgage type?'***

Customer: ***'Well fixed rate, variable.'***

Adviser: ***'Well we will be making a recommendation to you, so it's not, like we won't be doing this application on the basis that I go through everything with you and ask you what you'd prefer, like what do you want? I will be making a recommendation to you.'***

Customer: ***'OK.'***

Adviser: ***'OK, so we will, this application will take us around about two to three hours, in that space of time once I've gone through everything with you I should be in a position to make my recommendation to you, like explain, like find out from you what's more important.'***

Customer: ***'OK.'***

Adviser: ***'So you are sure that you want to proceed with this application?'***

4.6 Firms need to pay due regard to the interests of their customers and treat them fairly.[5] Firms should also pay due regard to information needs of customers[6] and ensure that processes are sufficiently flexible to accommodate them. In these examples firms expect customers to make significant decisions in the absence of full information: home buyers may feel unfairly pressurised into making an application to secure a mortgage.

Information or advice

4.7 Our mystery shoppers told us they thought they had received advice and a recommendation (from lenders as well as intermediaries) but reviews indicated advisers had only provided information. Although this sometimes related to specific mortgage products, the adviser did not advise the borrower as to the merits of taking out particular mortgages.

5 FCA's Principles for Businesses: Principle 6
6 FCA's Principles for Businesses: Principle 7

Example

A mystery shopper clearly asked for advice on the best product for their circumstances more than once, and was prepared to invest time to discuss needs and circumstances. However the adviser consistently ignored the prompts. They collected only basic details and said they would send information to the customer. They indicated that if this was acceptable they could proceed immediately. The adviser did not clearly tell the customer that they were not providing advice and our mystery shopper felt they had received advice and a recommendation. It was unclear whether the adviser would have undertaken an assessment of needs and circumstances before allowing the customer to proceed.

Customer: ***'I'm looking for some advice about a mortgage, please.'***

…….

Customer: ***'I'm trying to get the best advice I can.'***

……..

Customer: ***'I want…to get your best recommendation……'***

……..

Customer: ***'So there isn't one product that you think…. strongly you'd recommend today?'***

The adviser discussed products and the customer confirmed they would be ready to proceed.

Adviser: ***'I can email you some information about monthly payments, etc, with what we discussed…….I'll do you some figures for 15 years and 12 years…just to give you an indication, and if you're OK with that then I'll proceed in getting you agreed today.'***

4.8 In other cases we identified advisers giving advice and making specific product recommendations without first establishing the customer's needs and circumstances, in breach of our rules. We further consider the importance of assessing needs and circumstances later in this report.

Example

One intermediary collected basic details and offered to send information in the post. This sounded as though they were providing balanced and neutral information:

'…based on the info we took, I'll put in there some assumptive quotes.'

The adviser sent two key facts illustrations recommending a specific mortgage, one with and one without a fee, along with a separate note stating that they were suitable for the customer.

4.9 There is a risk that advisers do not recognise when they are giving regulated advice – and under what circumstances they need to undertake a full assessment of needs and circumstances. The consumer research indicates that customers sometimes seek initial 'advice' from intermediaries and then act on this by applying directly via execution-only.

4.10 Firms should ensure that they have adequate controls and training in place so that all customer-facing staff understand and maintain the boundary between provision of information and regulated advice. Further information on the activities which constitute regulated mortgage advice is in the FCA's Perimeter Guidance Manual (PERG).[7]

Obtaining relevant information from the customer

4.11 ESRO's consumer research indicates that customers often undertake their own research on rates, repayment methods and product terms before seeking mortgage advice.

4.12 A number of customers had formed an initial preference for fixed rate products before seeking advice. These customers thought that interest rates were likely to rise in the near future, and so perceived that fixed rates were the best option.

Consumer research quote (Home mover, Manchester)

'Of course I chose a fixed. Rates are so low now that you'd be silly not to. I don't think rates will go up straightaway, certainly not until after the election anyway, but at the moment fixed are as low as everything else, and why would you not want to lock it down?'

4.13 Customers often develop an early view about which type of mortgage product will best meet their needs – and often place strong emphasis on this initial choice throughout the advice process. Some also mistakenly believe the adviser's role is only to find a product which meets their initial preferences and initial target monthly payment, and do not expect advisers to challenge them, or to spend significant amounts of time discussing their needs, circumstances or priorities.

7 PERG 4.6 *Advising on regulated mortgage contracts*

4.14 The consumer research highlighted that some customers are short-termist, and place the greatest importance on the initial monthly payment to the detriment of other factors.

Consumer research quote (First time buyer, Bristol)

'I was happy to go with whatever term they said, 29, 30 years. I don't expect we'll actually be paying it that long, but we needed the monthly amounts to be what we can afford now.'

Accepting customer preferences at face value

4.15 Our mystery shopping indicates that many advisers place a great deal of weight on customer's initial preferences – and in some cases, allow these to determine the recommendation, rather than taking reasonable steps to obtain all relevant information and assess suitability in light of the customer's actual needs and circumstances.

4.16 Although customers' initial product preferences (e.g. for a fixed rate) are an important factor that an adviser should consider, they are not the only relevant factor to consider when assessing suitability and should not predetermine the outcome of the assessment. Advisers must still assess a customer's needs (e.g. for 'stability of payments' or 'low payments') and the appropriateness of this in light of their individual circumstances by applying judgement.

4.17 The research also highlighted that some customers confuse questions designed to support advice with those designed to assess creditworthiness, particularly when receiving advice from lenders. They worry that they may be 'caught out' or declined the finance they require if they answer a question 'incorrectly'. The research suggests that customers may not always volunteer all relevant information to the adviser, or may downplay information on their likely future circumstances, e.g. their intention to have a family.

Consumer research quote (Home mover, Brighton)

'We were worried that they were going to ask us about having another baby and if we said yes they wouldn't let us have the amount we wanted. We do definitely want another, but we weren't going to tell the bank that.'

4.18 Firms can rely on information provided by the customer unless, taking a common sense view of that information, they have a reason to doubt it. Although customers need to bear responsibility for their decisions and actions, we saw more instances of clearly suitable advice when advisers challenged or probed customers' needs and circumstances, particularly if certain views or assertions did not appear credible, or conflicted with other preferences or information disclosed.

4.19 Our research also highlights that customers struggle to make objective and rational assessments of the suitability of mortgage features for their own needs, and are optimistic about their future financial situation. Firms should be mindful of these customer biases. Some advisers took customers' initial preferences at face value or asked them to choose specific types of mortgage products without assessing their needs and circumstances.

Examples

Customer: ***'What would you think is best for me…?'***
Adviser: ***'To be honest it depends on your mindset because obviously we base our advice on what you think, it's not what we think.'***

Adviser: ***'What I can do is get some details from you and give you a couple of sample type mortgages… you can decide what type you want once you see the numbers and what appeals to you…'***

Adviser: ***'…the way we would do this is let you have a look at what's available and the interest rates and so on and then you tell us which way you want to go, fixed rates, variable rates and all this kind of thing.'***

Adviser: ***'Right…. you said you wanted another two year fix, so I'll see what's available and show you some options.'***

Effective information gathering

4.20 The rules do not require advisers to challenge everything customers tell them and a firm must base its determination of whether a regulated mortgage contract is suitable to a customer's needs and circumstances on the facts disclosed by the customer. But the adviser must consider all relevant facts about the customer which they are aware of, or should reasonably be aware of.[8]

4.21 The best performing firms in our sample (both lenders and intermediaries) asked sufficient questions of customers to objectively assess needs and circumstances. They probed and challenged customers when they expressed conflicting preferences or had conflicting needs, clearly considering and discussing potential trade-offs with customers and helping them to establish priorities and understand the consequences of decisions.

8 MCOB 4.7A.5R (2). See also MCOB 4.7A.4G (1)

Example

One customer expressed a number of conflicting preferences and views to an adviser. The adviser asked questions to establish why the customer felt they needed a fixed rate to help establish this was appropriate and to help determine whether a shorter or longer product term was suitable.

The customer's initial comments indicated that stability and certainty of payments was important – and they expressed an early preference for a short-term fixed rate product: ***'I think I want a fixed rate for the first few years to get me used to paying a mortgage…'***

They also indicated that they wanted to borrow as cheaply as possible for the term of the loan: ***'I've got quite a big deposit and that gives me a good LTV I think you call it… I should be able to get a good rate for that shouldn't I?…. yes, I definitely don't want to pay over the odds…'***

The adviser asked probing questions, gathering information to help them understand the customer's needs and circumstances. They initially explored the preference for stability:

'So you have touched on the fixed rate aspect. Why's it important that the mortgage is with fixed payment there for you?'

The customer said that they liked to know exactly how much was going out each month. The adviser then probed: ***'And why do you feel that this is important?'***

The customer then confirmed that they required stability of payments to ensure that they could meet other financial commitments and manage their wider affairs. They also expressed a preference to know exactly what their payments were: ***'I've got quite a few bills to pay and I'm not always that organised, so I like to know exactly what's what.'***

The adviser then explained the trade-offs they may need to make between monthly cost and length of initial rate:

'So just touching, then, on the initial rate period, so you said that you just want to fix it for the first few years to get used to paying a mortgage, so there is different periods that you can fix your rate for, OK? Now the shorter the initial rate period the lower the interest rate and monthly cost is going to be, and then the longer the initial rate period, it will come with a higher interest rate and monthly cost. However, you will be provided with a longer period of security, of understanding exactly what you're paying each month.'

They continued to ask questions of the customer, gathering information to assess whether it was a priority for the customer to have stability of payments or the lowest cost, and helped them to consider how long they might need this for (a discussion regarding interest rates had already taken place):

'So, thinking about it in that way, what would be most important to you? Do you think your situation will have changed in a couple of years and that you won't mind having more uncertainty?'

As a result of the discussion, the customer agreed that it would be appropriate to fix their rate for a longer period of time. ***'That makes a lot of sense – I think I'd feel better to go a bit longer.… Maybe 3 – 5 years.'***

This conversation enabled the adviser to make an informed judgement and recommend a suitable mortgage.

4.22 Our mystery shopping assessments indicated a tendency for intermediaries to source products at very early stages of the initial conversation with customers before establishing needs and circumstances. Some intermediaries steered the customer quickly towards one or a limited number of what appeared to be 'best buys' or 'favourite' products. Some invited customers to select products from shortlists, contributing to confusion about whether they were receiving advice.

4.23 Sourcing systems can be a useful aid to help intermediaries identify suitable products and support the advice process, but advisers still need to apply judgement, skill and knowledge to ensure that selected products are suitable for individual customers. Advisers should consider the limitations of sourcing tools and the risks of disregarding specific products from their evaluation until they have sufficient information to determine that they are not suitable for the customer. Firms need to be mindful of the risks of early product sourcing by advisers and have appropriate controls to mitigate the risk of poor customer outcomes arising from this.

Example

Some advisers do not ask enough questions, make assumptions or project their own biases when making recommendations.

One adviser asked a 59-year-old customer seeking a mortgage limited questions before making a recommendation. The adviser captured factual information about the customer's deposit, date of birth, occupation, marital status, basic salary, credit history and level of unsecured debts.

They then asked the customer a further closed question to determine a mortgage term aligned with retirement before steering the customer directly towards a fixed rate product:

'So potentially we're looking at a six year term, yeah?….. I think I would recommend that you took a mortgage, at least a five year fixed rate, I think rates are very, very low…..'

The adviser also asked the customer what they expected to pay each month. When the customer indicated a payment of £1,000, the adviser remarked that the customer would be ***'pleasantly surprised'***.

The adviser then immediately recommended a specific product: ***'looking at a longer term fixed rate which is what I'd recommend in this case, Lender A do a loan to value of anything under 50% on this particular product, which is fixed for five years…. there's no lender arrangement fee on this one but a fixed rate of 2.76% would give you a monthly repayment of £633.63 on a six year term.'***

The adviser then tried to cross-sell protection products and explained the fee that would be payable for their advice.

This adviser failed to take reasonable steps to assess the customer's needs and circumstances. For example, they did not explore whether the customer needed payment stability or flexibility to overpay. They did not explore whether the mortgage term or a capital repayment mortgage was suitable. In other words they did not gather enough information to assess whether the mortgage sourced was appropriate in light of the customer's specific needs and circumstances and the factors set out in MCOB 4.7A.6R.

5.
Assessing suitability

5.1 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, insofar as relevant:[9]

(1) whether the customer's requirements appear to be within the mortgage lender's known eligibility criteria for the regulated mortgage contract,

(2) whether it is appropriate for the customer to have an interest-only mortgage, a repayment mortgage, or a combination of the two,

(3) whether it is appropriate for the customer to take out a regulated mortgage contract for a particular term,

(4) whether it is appropriate for the customer to have stability in the amount of required payments, especially having regard to the impact on the customer of significant interest rate changes in the future,

(5) whether it is appropriate for the customer to have their payments minimised at the outset,

(6) whether it is appropriate for the customer to make early repayments,

(7) whether it is appropriate for the customer to have any other features of a regulated mortgage contract,

(8) whether the regulated mortgage contract is appropriate, based on the information provided by the customer as to his credit history, and

(9) 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.

5.2 This list is not exhaustive. For certain customers there may be additional considerations to explore.[10]

5.3 We 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.

5.4 We also identified examples of advisers:

- making assumptions or ignoring needs relating to factors in MCOB 4.7A.6R,

9 MCOB 4.7A.6R
10 MCOB 4.7A.7G

- assessing these factors in isolation, or putting undue weight/emphasis on some aspects of their assessment, rather than making a balanced recommendation based on the suitability of the mortgage in light of all the customer's specific needs and circumstances, and

- failing to consider trade-offs or establish a clear sense of the customer's priorities when presented with conflicting requirements or needs.

5.5 Advisers sometimes also placed significant weight on accommodating customers' preferences to minimise their payments at the outset[11] and identified products which allowed the desired stability in contractual monthly payments, but failed to have regard to the impact on the customer of significant interest rate changes in the future.[12] Although we did not identify significant detriment arising from this, the risk may become more significant in a more volatile interest rate environment.

Assessing repayment method

5.6 The standard of advice when considering repayment method was mixed. Some firms did a thorough job in assessing whether it was appropriate for the customer to have an interest-only mortgage, repayment mortgage or combination of the two.[13] Some lenders that did not offer interest-only mortgages ensured that this, along with other key eligibility criteria, was communicated to customers at an early stage.

Example

One adviser clearly told a customer early on that they didn't qualify for an interest-only mortgage but also clearly explained that they would still need to assess the appropriateness of different repayment methods given the customers' specific needs and circumstances.

'The first thing that I'll make you aware of is that here at Lender X we offer two mortgage products…. a capital repayment and an interest-only mortgage. In order to be eligible for the interest-only mortgage you need to earn an income of £XX or more…..'

Although the customer was not eligible for an interest-only mortgage with the lender the adviser confirmed they would still need to establish whether or not a interest-only mortgage would be suitable based on an assessment of the customer's needs and circumstances.

'That doesn't apply to you based on what you've told me – but I'd still need to assess whether this type of repayment method [interest-only] would best suit your needs…. if this is the best thing for you then I would need to advise you to look for this elsewhere.'

11 MCOB 4.7A.6R (5)
12 MCOB 4.7A.6R (4)
13 MCOB 4.7A.6R (2)

5.7 Other lenders who did not offer interest-only mortgages only raised the question of repayment method after extensive discussions and at a late stage of an advice discussion. This risked customers perceiving they had wasted their time or worse than this, could result in advisers shoehorning customers with credible interest-only repayment methods into taking less suitable repayment mortgages.

5.8 By contrast, intermediaries often assumed that interest-only mortgages would not be suitable for certain borrower groups. This appeared driven by the limited availability of interest-only mortgages, rather than establishing what was suitable for the individual customer. In a number of cases, the repayment method wasn't discussed at all.

Examples

Some advisers assumed a capital repayment mortgage was the only option and failed to explore whether an interest-only mortgage might be suitable.

'Then we look at the repayment method for your mortgage, which again is a very quick discussion because most people look at [a capital] repayment [mortgage].'

'With regards to the new mortgage, obviously it would have to be a repayment because it's a residential property.'

5.9 Some intermediaries relied solely on customers' initially stated preferences and were effectively 'order-taking' without taking sufficient steps to assess whether a repayment mortgage was appropriate in light of each customer's specific needs or circumstances.

Assessing mortgage term

5.10 Our mystery shops identified that mortgage repayment term is typically driven by eligibility and affordability criteria, with intermediaries conscious of the need to recommend a term that most lenders will consider. Advisers in the best firms in our sample assessed customers' individual needs and circumstances thoroughly and recommended mortgage terms that were suitable. They considered the trade-offs that needed to be made, helping customers to understand the impact of their decisions, for example taking a mortgage over a longer term.

Example

One adviser considered the suitability of different mortgage terms taking account of relevant factors.

A first time buyer initially expressed a preference for a 25-year mortgage term. They indicated that their monthly budget could extend as far as £490 per month to allow for this – but also expressed a preference to reduce monthly repayments if possible (‘***the maximum I could really go up to is £490, but it would be a bit of a stretch I think… I could definitely manage it though***’).

The customer was 36 years old and had no plans to retire until they were 65. The adviser asked probing questions of the customer to understand their initial preferences regarding term, objectively assessing whether there was a clear need or circumstances which justified this: ***’So just to look at the term – so why 25 years to start, then?’***

The customer revealed that they had suggested a 25 year term as this was ‘normal’: ***’it’s what people tend to go for, isn’t it?’***

Having identified that there may be potential to recommend a longer mortgage term if appropriate, the adviser explained that longer mortgage terms would result in a higher overall cost as they attracted interest for a longer period of time – and explored whether the customer would be happy to pay more in total to achieve a lower monthly repayment and maintain some disposable income. As the customer was a first time buyer, the adviser also challenged them to think about the wider costs associated with moving and maintaining a home, identifying that they had overestimated how much they were likely to be able to pay.

During the conversation the customer expressed an interest in shortening the mortgage term to pay less overall ***’(Interest) can really add up’***, but when this was explored with the adviser, decided that lower monthly repayments were more important.

The adviser eventually recommended a 29-year term, but coupled this with a product which permitted unlimited overpayments. This gave the customer a more comfortable initial monthly payment of £390, allowing them to maintain a level of disposable income – and allowed sufficient headroom to accommodate any unexpected costs associated with their move. The customer decided to set up a direct debit to overpay £50 per month to help offset any additional interest but retained flexibility to change this if their circumstances changed.

Recommendations to minimise mortgage term utilising a customer's maximum budget

5.11 Some firms appear to believe that it is 'best practice' to recommend a mortgage term that minimises a customer's total amount payable over the life of the loan. In these instances, advisers steered customers to a repayment term with initial payments that reflected their maximum budget even when customers needed to minimise their monthly payments or could borrow over a longer term. In some cases, advisers relied heavily on automated systems to drive this recommendation. Sometimes advisers applied significant pressure.

5.12 Recommending a shorter mortgage term can be in a customer's best interest. However the mortgage term needs to be considered alongside other factors including the product term and the impact of any significant interest rate changes in the future.[14]

5.13 For example, if a recommendation is tailored to a customer's maximum budget and the monthly mortgage payment rises sharply, they may experience unexpected financial pressure, or require compromises in future lifestyle choices to accommodate the increased monthly payment.

5.14 In some cases lenders' responsible lending stress tests may mitigate this risk and in other cases customers may be willing and able to make compromises in their lifestyle to maintain increases in their mortgage payments. However we saw little evidence of advisers considering these risks or potential trade-offs and whether a recommendation driven by a particularly short mortgage term was suitable in light of a customer's needs and circumstances.

Example

One adviser recommended a two year fixed rate product with an initial monthly repayment of £399 and interest rate of 2.39%. They reduced the customer's mortgage term to the minimum affordable level to use the customer's entire monthly budget.

'So the term that I'm recommending today is a term of 15 years and 10 months, now this term is suitable as it will ensure that the mortgage will be repaid well before you plan to retire at age 67. Now this is shorter than the initial 20 year term that you requested but the reason I've been able to reduce this is because you said you were happy to maximise your budget figure of £400 per month.'

The adviser then discussed two illustrations with the customer, highlighting the cost on reversion to the current SVR and at a further 1% stressed rate.

'After the two years have ended if you do nothing you will go onto a standard variable rate which at the moment is 3.69%. That would mean that your payments would change to £434.'

'Now I do have another figure here and this figure is just for information purposes, we do not know what our standard variable rate will be in two years' time, OK, so I've also done a comparison if our standard variable rate was to go up to 4.69%. That would give you a monthly repayment of £462, OK?'

14 MCOB 4.7A.6R(4)

The customer was not expecting any increase in their income, and was not contributing to a pension or making regular savings. They also had very little disposable income. The recommendation utilised the customer's entire monthly budget, leaving a risk of insufficient headroom to maintain expenditure and lifestyle on reversion to standard variable rate. Although the adviser showed the customer clear examples of the potential future cost of borrowing, they did not explore with the customer what the impact would be of these higher costs.

Although the recommended product permitted overpayments, the adviser did not discuss the possibility of taking a longer term to reduce monthly repayments and retain flexibility to make overpayments.

Impact of significant future interest rate changes on customers

5.15 Customers who participated in our research understood that interest rates were at an historic low and likely to rise – and had formed an early preference for fixed rate products to provide payment stability.

5.16 However, despite expressing a need for stability, customers appeared to be reluctant to commit to longer product terms because of concerns about early repayment charges and the risk of retrospectively paying over the odds.

Consumer research quote (Home mover, Leeds)

'We do want the stability of knowing what our costs will be each month, but 5 years is a really long time. We don't quite know what our situation will be then and I wouldn't want to be trying to move around or change within a 5 year, I'd rather just be free earlier to find another good deal.'

5.17 The customer research also suggests that customers may not be best placed to identify the most appropriate mortgage for their needs and circumstances. This is because they tend to place excessive focus on short-term costs and have a potentially over-optimistic view of what the mortgage market and their financial situation might look like in two years' time. Such short-termism conflicts with the long-term commitments and risks associated with a mortgage.

5.18 Advisers must base their assessment of whether a product is appropriate for the customer's current circumstances and any reasonably foreseeable changes to these.[15] Although it is important for advisers to take account of customers' preferences, advisers have a responsibility to consider a customer's needs and circumstances objectively and make a judgement and recommendation which is suitable for that customer, even if this is in conflict with a customer's initial preferences. The rules do not require an adviser to predict the future but to make an objective and rational judgement based on the relevant factors.

15 MCOB 4.7A.19R

Example

One adviser explored the customer's attitude to a shorter and longer initial product term by discussing the advantages and disadvantages.

Adviser: ***'You could take a two year fix and you're going to save £50 a month for the next two years, but we could have the same conversation two years on and if interest rates have gone up, then we could be looking at a deal that would be more expensive. Within a short space of time that saving that you've made is wiped out and you are facing higher payments.'***

Customer: ***'I hadn't thought about it that way. That's actually quite a big risk to take to save £600 per year – maybe I should fix for a bit longer… I'll need to think about it.'***

Adviser: ***'There may also be fees to pay again and sooner if you go for a shorter deal…. But then again, if interest rates don't go up, or they go down, you may be on a higher rate.'***

5.19 Some advisers steered customers towards short-term fixed rates based on their popularity and without first identifying and assessing a customer's needs and circumstances and assessing whether such products were suitable.

Example

One adviser steered the customer to a fixed rate purely because they were a first time buyer rather than establishing whether this was suitable in light of their specific needs and circumstances.

Adviser: ***'Because you are a first time buyer, I would definitely suggest, strongly suggest that you have a fixed rate mortgage.'***

Speculation on interest rate rises

5.20 MCOB 4.7A.6R(4) requires firms to assess the impact on the customer of significant interest rate changes in the future. Many firms appear to be interpreting this incorrectly as a requirement to gather information on a customer's view on future interest rate movements, resulting in a number of confusing questions and frustrating exchanges between customers and advisers.

Example

Adviser: ***'I said what are your thoughts on what the, I suppose, the interest rates will do? Because unfortunately I don't have that magic crystal ball and I can't tell you.'***

5.21 Some advisers also provided their own predictions as to the future movement of Bank of England base lending rates.

Example

Adviser: ***'Interest rates are likely to go up.... we are expecting them to come up by anything between, I'd say, 2.5% to 3.5% over the next five years.'***

5.22 Others took this a step further and speculated on the rate that customers would be paying on reversion to standard variable rate at the end of their product term without using an illustration, or confirming the cost of borrowing if base rates went up.

Example

Adviser: ***'Again, the chances of you getting another five year fixed rate after your five years at 2.89% will be incredibly slim, you're probably looking at about 7 or 8%, I'd imagine, by the end of that.'***

5.23 We have already told firms that conduct of this nature is inappropriate as advisers cannot predict future interest rate changes.[16] There is a risk of unsuitable advice, or a poor customer outcome, if an adviser's personal opinion on rate movements forms part of their assessment of a customer's needs and circumstances, or unduly influences their recommendation. Advisers may also inadvertently mislead the customer into applying for a product which does not subsequently perform as they have been led to expect, or result in them making an ill-informed selection when a range of products is recommended.

5.24 Conversely, some advisers helped customers to understand the risks and benefits associated with different types of mortgages, and considered the impact on individual customers of a rise in interest rates. This was used to inform their recommendation. They engaged the customer fully in the decision making process by assessing the level of risk that they felt willing and able to take.

16 FCA Final Notice 2014: Royal Bank of Scotland plc and National Westminster Bank Plc (page 17)

Example

Adviser: ***'How would you feel if they announced that interest rates are going up, and then the following month you've got to find another £100/£200 out of your salary, so I suppose it's really trying to get your thoughts on that?'***

Consideration of how other features of a mortgage can meet customer needs

5.25 A number of advisers considered the appropriateness of mortgage features such as the ability to make overpayments or the benefits of an offset mortgage.

Example

One customer held £25,000 in savings with the lender. The adviser identified that the customer was a high rate taxpayer who was receiving a relatively low rate of interest, and confirmed that the customer had no plans to use the funds during the mortgage term. They explained the benefits of an offset product to the customer and calculated the specific costs savings that applied if the customer chose to opt for this product, factoring in the customer's tax position. This met the customer's preference to obtain the cheapest possible mortgage, whilst also being suitable for their wider needs and circumstances.

5.26 However we also identified examples where advisers discounted products with flexible features early in the process, because they were deemed too complex or perceived to be higher risk, despite these being potentially more suitable for the customer's needs.

Product fees and charges

5.27 In the consumer research, customers told us they struggled to compare fees, charges and interest rates across a range of products, and found it difficult to understand how much these factors were likely to impact on the overall costs of their loan. A small number of customers who had opted to defer payment of fees also underestimated the extent of additional interest they would pay – and were surprised when this was explained to them in cash terms.

5.28 When an adviser assesses whether a regulated mortgage contract is appropriate to the needs and circumstances of the customer, it must consider whether it is appropriate for the customer to pay any mortgage fees and/or charges up front, rather than adding them to the sum advanced.[17]

17 MCOB 4.7A.6R (9)

5.29 Most advisers, once they identified a suitable product, or range of products, did a good job of considering trade-off of fees and interest rates, for example whether to pay a fee and take a lower rate or not – and whether to add the fee to the mortgage.

Example

One adviser drew clear comparisons between a product with a fee and one without to help the customer to understand which one was most cost effective given the amount borrowed.

'So the difference is £8.80 per month. So £8.80 times 24 is £211.20 but you would need to pay an extra £500 in fees to save £211. That one's not cost effective.'

Expressing the amounts in cash terms helped the customer to understand exactly how much they would be paying in either case. The adviser helped the customer to understand the consequences of the decision and work through the trade-offs which needed to be made.

5.30 We also identified cases where lenders and intermediaries clearly acted in the best interests of their customers by advising it would be cheaper for them to arrange a product switch with their existing lender than to pay fees to remortgage.

A joined-up approach

5.31 Our mystery shops indicate that advisers sometimes make recommendations on each aspect of a mortgage in isolation. For example, as highlighted above, advisers may recommend a particular mortgage term without considering the initial product type or term or mortgage features (e.g. ability to overpay), rather than considering the appropriateness of all aspects of the mortgage as a whole (i.e. the mortgage term combined with the product type, term and features).

5.32 Our examples in this report and our mystery shops show that advisers are more likely to achieve good customer outcomes when they take a joined-up approach to the overall mortgage recommendation, and explore priorities and any necessary trade-offs. The best advisers in our sample considered the potential advantages and disadvantages of shorter and longer term products, coupled with a shorter or longer mortgage term, and/or flexible features, such as the ability to make overpayments.[18]

18 MCOB 4.7A.6R (3) (4) (6) & (7)

Example

Adviser: ***'A happy medium to getting the mortgage term reduced further could be, accept £539 as your new contractual payment, but after you've completed and everything's settled down, you could use your overpayment feature to pay more – and set it on direct debit if you want to discipline yourself to pay…. then if something unforeseen happens you could strip your payments back.'***

Risk of 'shoehorning' customers into an unsuitable product

5.33 No advice must be given to a customer to enter into a regulated mortgage contract if there is no regulated mortgage contract which is suitable from the product range offered by the firm.[19]

Example

One mystery shopper's income included a significant element of commission and discretionary bonuses. The customer told the adviser that they wanted to commit to an affordable contractual monthly payment amount but retain the ability to overpay (which they had successfully been doing for the duration of their existing mortgage).

The adviser confirmed that the lenders mortgage products did not allow for regular overpayments. Instead, the adviser recommended that the customer commit to a higher contractual monthly repayment amount and shorter mortgage term, and seek to extend their mortgage term at a later stage if needed.

Adviser: ***'We don't actually have an overpayment service but you can change your term whenever you like…. You can change at any point without any charges. However if we extend the term of a mortgage we just need to prove that you can afford it.'***

The recommended mortgage term was not appropriate for the customer in light of their needs and circumstances. The adviser also failed to consider whether it was appropriate for the customer to make early repayments, or whether they should have any other features of a regulated mortgage contract, in breach of MCOB 4.7A.6R (6) and (7).

5.34 An adviser must not recommend the 'least worst' product if they do not have access to products which are appropriate to the customer's needs and circumstances.

19 MCOB 4.7A.5R (3)

More complex advice to more vulnerable customers

Debt consolidation

5.35 Where the main purpose of a remortgage is the consolidation of existing debts MCOB 4.7A.15R requires the adviser to take account of:

- any costs associated with increasing the period over which the debt is to be repaid,
- whether it is appropriate for the customer to secure a previously unsecured loan, and
- where the customer is known to have payment difficulties, whether it would be appropriate for the customer to negotiate an arrangement with his creditors rather than to take out a regulated mortgage contract.

5.36 We reviewed the extent to which a small number of firms considered these factors when a customer was looking to consolidate unsecured debts. We identified little evidence of advisers collecting information on the interest rates payable on existing loans or making any effort to work out the costs associated with increasing the period over which the debt is to be repaid. As a result there was insufficient evidence to clearly justify advisers' recommendations to secure unsecured debts against a customer's property.

5.37 Some firms have weak policies and controls in this area. In one firm the advice process failed to recognise the potential additional requirements in cases where debt consolidation is the main purpose of the loan. Another firm was unable to identify debt consolidation cases.

5.38 Our findings indicate a poor understanding of the requirements where the main purpose of a remortgage is to consolidate debts. We expect firms to take action to ensure that they and their advisers understand their responsibilities when advising this customer segment. In particular advisers need to make judgements as to the suitability or otherwise of consolidating debt in relevant cases – and not rely solely on risk warnings or disclosures to justify a recommendation. Firms also need to have appropriate management information that is able to record debt consolidation cases. Firms need to improve oversight arrangements to ensure they properly monitor and mitigate the risk of unsuitable customer recommendations in more complex cases.

Lifetime mortgages

5.39 As part of our work we reviewed a small number of lifetime mortgage cases and mystery shops, assessing them against MCOB 8.5A. Our findings mirrored a number of the issues we identified in the mainstream market – with advisers not probing sufficiently or taking reasonable steps to gather relevant information to determine whether the lifetime mortgage was suitable for the customer and appropriate in light of their needs and circumstances. This included:

- Failing to gather sufficient information to assess the impact of a lifetime mortgage on a customer's tax or benefit position or considering their health and life expectancy.[20]
- Not considering the impact of equity erosion arising from interest roll-up, for example, relating to the customer's preferences for their estate.[21]

20 MCOB 8.5A.6R (1) & (5)
21 MCOB 8.5A.6R (4)

- Poorly explaining the costs associated with the transaction. In some cases, it was not clear what the transaction costs were or whether the adviser had considered whether it was more appropriate to pay fees or charges up front or add them to the sum advanced.[22]

5.40 In addition, explanations about the potential benefit of making interest payments on a lifetime mortgage were sometimes misleading. For example, where an adviser told a customer that it only benefits their beneficiaries to make interest payments. This will depend on the individual circumstances of the customer e.g. the customer's future plans may include selling their property to move to another property.[23]

22 MCOB 8.5A.6R (9)
23 MCOB 8.5A.6R (6)

6.
How firms were providing advice

6.1 We identified significant differences in the way lenders and larger intermediary firms delivered, controlled and gained assurance that advisers were providing suitable mortgage recommendations.

Highly structured, system-driven advice strategy

6.2 Many lenders had made a significant effort to deliver advice for the first time, investing in systems, front-line staff and operational capability.

6.3 A number of larger lenders relied on advisers following highly structured and linear advice processes supported by integrated application systems. They had introduced common advice standards that were designed to help advisers to identify suitable mortgage products for customers, based on input of their needs and circumstances, and lending criteria.

6.4 Standardising the way that advisers gather the necessary information from the customer about their needs and circumstances alongside clear guidance, policies or frameworks that help inform advisers' decisions ensures they are provided with adequate support to make judgements. It also provides firms with greater control over recommendations. However there is a downside if advisers have little or no flexibility to apply judgement to take account of a customer's individual needs and circumstances.

Consumer research quote (Home mover, London)

'They would not stop asking why I wasn't putting more money down, because I had it. I just didn't want to, and I was downsizing! Eventually I made up that my daughter was getting married and I'd use the money for that. She isn't, but it's none of their business what I use my money for.'

6.5 We also identified isolated examples of mystery shops where advisers in lenders, despite good intentions, appeared deliberately to misrepresent customers' needs and circumstances, or manipulated systems to circumvent internal policies or controls, because the system otherwise prevented them from presenting what they believed to be suitable options to the customer. In some cases advisers in lenders appeared to rely entirely on systems to drive their recommendation.

Examples

Adviser: ***'It's a computer system with an algorithm that comes up with a minimum affordable term, so we tend to go with that.'***

Adviser: ***'So, I've put all your information into the system and, based on your answers, it is telling me that the best product for you is XX.'***

6.6 System driven approaches often resulted in lengthy, stilted and repetitive conversations which limited advisers' ability to engage effectively with customers, and impeded their ability to assess needs and circumstances properly.

6.7 We also identified numerous examples of advisers in lenders asking circular or unnecessary questions, or failing to draw on information which had already been provided.

6.8 Some advisers also struggled to gather information from customers with non-standard circumstances (for example, those who were self-employed or in receipt of rental income), or advise them effectively, due to apparent systems limitations.

Impact of multiple hand-offs and mandatory process

6.9 Some large lenders required customers to repeat large amounts of factual information more than once during multiple interviews with different members of staff. Processes in these firms often required a member of staff to assess whether the customer met lending criteria and provide a separate mandatory lending decision-in-principle, before allowing them to speak to an adviser to obtain a recommendation. Information did not appear to be carried forward from the previous meetings, resulting in a disjointed, repetitive and extended process.

Example

Customer: ***'Haven't I been through all of this with someone?'***

Adviser: ***'I know, I do apologise for this, we have to go through it for each stage of the system just to make sure that by the time you get to an adviser nothing's changed.'***

Customer: ***'Well nothing has changed in the last week.'***

6.10 Customers who participated in our external research described their experience of navigating some firms' advice processes as '*time consuming*' and '*inefficient*'. They also reported becoming disengaged if they found it '*unnecessarily convoluted*'.

6.11 Although advisers should, when appropriate, check that a customer's circumstances have not changed, firms should be mindful of processes that risk confusing or frustrating customers and which can lead them to disengage with conversations about needs.

6.12 Many lenders had recognised these issues at the time of our review and were taking positive and timely steps to address them.

But having insufficient structure or process brings different risks

6.13 By contrast, appointed representatives of many large retail intermediary networks are delivering advice with little or no structure. This, coupled with limited oversight and controls in many of these networks, resulted in variable and inconsistent quality of advice and a higher propensity for unclear or unsuitable recommendations. Needs and circumstances were often assumed or missed. The quality of advice and recommendations depended on the skill, knowledge and approach of individual advisers, with mixed results arising from advisers adopting different approaches.

6.14 These networks had been delivering advice prior to implementation of our new regime and many appeared not to have adequately considered the potential risks of poor outcomes posed by their advice models. We recognise the challenges posed when delivering advice through a network of appointed representative firms, and the advantages of allowing advisers flexibility in the way they provide advice. However, we are concerned that weaknesses in oversight and controls may prevent these firms from identifying and mitigating the risks of poor customer outcomes arising from this business model.

Getting the right balance

6.15 The best performing firms in our sample (both lenders and intermediaries) demonstrated that it is possible to use structured processes that enable advisers to obtain information about a customer's needs and circumstances but allow sufficient flexibility for them to use their knowledge, skill and judgement to assess this information and make a suitable recommendation.

Example

In one firm, advisers were able to navigate around the firm's systems with ease, avoiding repetitive questioning. Without asking irrelevant or circular questions, advisers probed and challenged the customer's preferences and needs, gathering all information necessary to assess needs and circumstances. The advisers linked information together, ensuring that the customer remained engaged.

Advisers also reflected key pieces of information back to the customer throughout the process and encouraged them to ask questions, making sure that they understood and engaged with the areas discussed.

Suitable recommendations for non-complex, mainstream, cases were delivered to customers efficiently. The whole process, depending on whether the customer opted for a lending decision in principle, generally consisted of one discussion lasting between 60 and 80 minutes.

7. Communicating effectively with customers

7.1 Despite receiving advice, customers who participated in our consumer research did not appear fully to understand the features or risks of mortgages they had been recommended – and most were unable to explain why they were suitable for their specific needs and circumstances. In particular, customers did not always appear to grasp the implications of the trade-offs which may have been made when they discussed their needs and circumstances with their adviser.

7.2 The rules focus on ensuring that customers obtain a mortgage suitable for their needs and circumstances. They do not require firms to ensure customers understand the advice they receive or the reasons for recommendations made to them – and it is not clear that such a requirement would necessarily deliver better customer outcomes. However firms must pay due regard to the information needs of their customers and ensure that they communicate with them in a way which is fair, clear and not misleading.[24]

7.3 This report has already highlighted the risk of not explaining clearly the scope of service the adviser is providing. Although we did not specifically test disclosure in our assessments, we identified practices which risked disengaging, misleading or confusing customers.

Verbal communication

7.4 We reviewed advice provided face to face, by telephone and by video link but didn't identify any one channel as more likely to provide a better outcome for customers. However, our mystery shopping exercise indicated that some firms are adopting lengthy standard form disclaimers, covering the Data Protection Act and other regulatory requirements. We acknowledge that a number of these are required by our rules – and the challenges to delivering these in an engaging manner. Where disclosures are over-long and introduced or delivered apologetically, with their importance downplayed or using technical language and jargon, customers may 'switch off' and fail to engage.

> Consumer research quote (Home mover, Bristol)
>
> ***'They did talk me through the 'T&Cs', as I would call them. I do my best to listen but you just start to drift off after a little while. It all sounds so meaningless.'***

24 FCA's Principles for Businesses: Principle 7

7.5 Where firms delivered these disclosures in bite-size chunks, reflecting on what they meant for individual customers, these customers were less likely to miss important information such as whether or not the firm was providing advice and a recommendation.

7.6 Some firms took the time to check customer understanding at key stages of the advice process. Technical language and jargon was avoided or explained, and extra care was taken with customers who were less experienced or indicated a lower level of financial capability. Rather than making the discussions longer, it enabled more focused decision-making.

7.7 We also identified isolated instances of advisers making misleading disclosures.

Examples

Referring to a request for advice on debt consolidation the adviser said: ***'…the government, in their wisdom, decided that it's not something that they want to be recommended to people to do.'***

'By regulation, in connection with the Financial Conduct Authority, we have to make sure that your mortgage is fully protected, or, if it's not, that you're aware it's not and you're happy with it.'

'Now our fee structure works out that we can charge up to 1% of the mortgage amount, but we avoid this by looking at your protection, so if we do any protection…. we reduce the fee and then our standard fee becomes £125 on application and £399 on completion, so you'll have to factor that in to the actual deal itself.' The 1% charge, which was not quoted in monetary terms, equated to £500 which was less than the supposedly cheaper option with protection.

7.8 These practices are not acceptable. We will take action where we identify firms that encourage advisers to make misleading statements to maximise sales, or do not take reasonable steps to manage the risk of advisers systematically misleading or pressurising customers to cross-sell products at the expense of customers' best interests.

Written communications

7.9 Although there is no requirement for advisers to write to a customer explaining the reason for their recommendations, most firms choose to do this. In cases we saw, the written explanations of the reasons why recommendations met the needs and circumstances of customers were poor, relying heavily on scripted text or generic comments which were irrelevant or had not been discussed. Letters were not tailored to a customer's individual circumstances and as such customers felt they added little value.

Consumer research quote (Remortgagor, London)

'The strangest bit of all of it was having this letter afterwards with her interpretation of events outlined. It felt a bit accusatory – you said this, you said that. I felt like she was just getting rid of all responsibility for everything.'

7.10 Where firms choose to issue these communications they need to ensure they are fair, clear and not misleading.

8. Culture, governance and oversight

8.1 We expect senior management in firms to promote a culture which focuses on delivering outcomes aligned with the best interests of customers. Management and Boards need to provide leadership and direction to create an environment that enables capable front-line staff to make informed judgements and deliver suitable recommendations which are in the customer's best interests.

8.2 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.

8.3 A number of lenders proactively tested their sales process following the introduction of the new advice rules.

Example

One firm commissioned mystery shopping and identified shortfalls in the customer experience after shifting to an advised model. The firm's root cause analysis revealed that an extensive approval-in-principle process, multiple hand-offs and detailed systems-driven 'fact-finding' were resulting in an excessively long, disengaging process. Front-line staff also noted that the system prompted numerous unnecessary questions and required them to issue long disclaimers, impacting their ability to build rapport with customers and collect relevant information effectively.

The firm's senior management team took steps to address key weaknesses in the advice process and made improvements to ensure better commercial and consumer outcomes. The system-driven advice process was reviewed, and unnecessary questions and process were removed. Advisers received further training to help them to assess outcomes confidently and quickly, and use systems effectively. Staff were also encouraged to continue raising ideas for improvements, driving a continuous feedback loop and ongoing improvement within the business. The firm also scheduled a further programme of mystery shopping to confirm whether changes had been effective and were resulting in a better customer experience.

8.4 Although, at the time of our review firms were still embedding changes, the culture is not sufficiently challenging in many firms, particularly large intermediary firms, with senior management often taking false assurance from:

- limited management information which is insufficiently granular to identify poor customer outcomes or conduct risks arising from providing mortgage advice, and
- limited, insufficiently robust quality assurance which did not assess or challenge advisers or outcomes for individual customers.

8.5 Oversight typically focused on checking compliance with processes, such as checking the 'fact-find' document and any customer letter had been completed correctly (including appropriate risk warnings), with little focus on identifying, challenging and mitigating the risk of poor customer outcomes. The previous chapter highlighted potential shortfalls in written communications provided to customers. There is a risk where firms rely too much on these communications to assure themselves that advisers have made suitable recommendations.

8.6 Intermediaries have strengthened controls since MMR to check lending criteria and ensure they present well-packaged applications to lenders (e.g. by sourcing information to support the lender's affordability assessment). These firms are particularly cognisant of the need to manage and mitigate the risks of mortgage fraud. Although we welcome efforts to detect and prevent financial crime and ensure that customers are likely to meet lending criteria, this needs to be balanced with an appropriate consideration of suitability of recommendations for customers. Firms were failing to identify weaknesses in the suitability of recommendations made by advisers, or the root causes of poor advice.

8.7 Many firms were not well placed to assess the suitability or quality of advice delivered to their customers and did not have an accurate view of the customer experience. Senior management was often unaware of poor customer experiences and there was no opportunity for advisers to learn from good or poor practice.

8.8 Most firms we looked at, both intermediaries and lenders, had scope to take a more customer-focused approach to giving mortgage advice including better gathering of information about needs and circumstances. Based on the firms we assessed, larger retail intermediary networks have most work to do to strengthen governance and oversight arrangements to identify, manage and mitigate the risks of poor customer outcomes.

Example

One firm's QA process focused solely on the quality of business submitted to lenders, ensuring that all necessary paperwork had been completed by advisers and uploaded to the firm's central systems.

The firm placed strong emphasis on financial crime prevention and meeting lender requirements e.g. documenting affordability (for lenders' purposes), with a forensic analysis of documentation and cross referencing of bank statements and pay slips taking place. However, the QA team did not consider whether the recommendation met the customer needs, or resulted in a good customer outcome. The firm reported a 100% pass rate (once missing documents or information had been requested from advisers and placed on file).

Example

One firm applied what it told us was a 'risk based approach' to quality assurance but failed to capture appropriately granular management information to identify poor customer outcomes or mortgage conduct risks.

MI did not include useful metrics including those related to mortgage term, initial product term, repayment method or customer age. Data was predominantly focused on sales, preventing senior management from identifying potential issues with adviser competence, product bias or unexpected trends relating to the suitability of advice.

The firm was also unable to easily identify more complex cases such as those including debt consolidation, impeding its ability to ensure that advisers were complying with the additional suitability requirements which might apply to this higher risk business.[25]

25 MCOB 4.7A.15R

9. Next steps

9.1 Further to undertaking this review and reporting our findings we will continue to engage with the industry to address the issues identified. We have provided individual feedback to firms visited as part of our assessment, setting out any actions required as a result of our findings.

9.2 Some of the firms we assessed had themselves identified issues with their advice processes and were making changes to improve their service to customers. We welcome these efforts and recognise that some firms were still embedding and improving new processes at the time of our assessment.

9.3 We are sharing these 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 we 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 reasonable steps to establish customers' needs and circumstances when giving advice and making recommendations.
- Firms to review whether their practices have the potential to create unintended consequences that can lead to poor customer outcomes.
- 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.

9.4 We will continue to work with firms and industry trade bodies to help them to take the next step towards consistently delivering suitable recommendations and good customer outcomes.

9.5 Our review of advice and distribution forms part of our wider programme of mortgages work. We commenced our review into responsible lending in April 2015 and will continue our assessment of how firms are implementing our post-MMR rules.

9.6 Building on this, from autumn 2015 we 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 to the benefit of consumers.

Annex 1
Assessment methodology

Consumer research

1. Consumer research was carried out by ESRO, an award-winning independent research agency. The objective was to understand consumer expectations and experiences of the mortgage sales process since the introduction of the MMR reforms in April 2014.

2. The methodology was qualitative in nature and consisted of 40 investigative in-home interviews (2-3 hours each) and 6 focus groups (1.5 – 2 hours each).

3. Interviews and focus groups were split out across first time buyers, home movers and remortgagors, as well as those who had made their application directly with their lender, via an intermediary or via an execution-only route. All respondents had successfully applied for a residential mortgage since 26 April 2014.

Mystery shopping

4. Mystery shopping was carried out by GfK Mystery Shopping, an independent market research firm. The objective of the mystery shopping exercise was to obtain examples of advice practices across a range of firms to assess how the market is complying with the mortgage rules and whether this is delivering good outcomes for customers. In assessing whether advisers made suitable recommendations we did not assess whether advisers, having identified a suitable mortgage, recommended a product with the lowest cost (e.g. initial interest rate or fees).

5. The mystery shops included a range of business models and sought to reflect the split of intermediated and direct to lender business in the market today. As such our shoppers sought advice from larger and smaller banks, building societies and smaller and large intermediaries. Our mystery shoppers obtained advice through a range of distribution channels: face-to-face, telephone and via video-link.

6. The mystery shops covered first time buyer, home mover and remortgage scenarios. Shoppers reflected their own needs, circumstances, preferences and opinions. The FCA assessed audio recordings, transcripts of discussions and supporting documents (emails, illustrations, etc.) provided for each shop.

7. We carried out 134 shops across 35 firms. A small number of our shoppers sought advice to consolidate unsecured debt, were credit impaired or sought lifetime mortgages. However the vast majority of shoppers sought advice on non-complex mainstream mortgages.

8. Our shoppers were briefed to ask for advice and a recommendation. They were briefed only to consider the shop complete once they received a recommendation. They did not proceed to make applications but told advisers they were willing to proceed immediately e.g. they purported to have had offers to buy property accepted.

9. A number of shoppers struggled to obtain advice and a recommendation despite asking for this numerous times, sometimes across more than one discussion. In some cases the agency attempted to complete additional mystery shops using different shoppers to meet its quota of advice shops. In a number of shops we assessed we consider the adviser only provided information despite our shoppers confirming that they thought they had received a recommendation on one or more specific products or mortgages.

Firm visits and file reviews

10. We carried out 11 on-site visits across a range of firms with different business models including: banks, building societies, intermediary networks, intermediaries with direct sales forces, and intermediaries advising through estate agencies. This included visits to firms (both lenders and intermediaries) that provided advice by telephone only. We also mystery shopped these firms.

11. Given the challenges in completing more complex mystery shops, we also assessed the suitability of 34 actual recommendations of more complex business (case files) in five firms.[26]

26 Debt consolidation, credit impairment and lifetime mortgage

Financial Conduct Authority

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25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk