



The Association of Mortgage Intermediaries response to: FSA – Regulating Sale and Rent Back: an interim regime

Introduction

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI). AMI is the trade association representing over 75% of UK mortgage intermediaries. Over 70% of all mortgage transactions are originated by the mortgage intermediary community, including 58% of regulated contracts.

Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product from within their panel to meet the individual consumer's mortgage requirements. Our members also provide access to associated protection products.

Our members are authorised by the Financial Services Authority (FSA) to carry out mortgage and insurance mediation activities. Firms range from sole-traders through to national firms and networks with thousands of advisers.

Summary

AMI agree that a robust regulatory framework is required within the Sale and Rent Back (SRB) market, to offer quality and assurances for consumers entering into these arrangements. This must include assurances of the kind of security of tenure they are going to get, what they are paying and what protection they get against things going wrong.

We agree that inappropriate and unethical activities as referred to in both the HM Treasury and OFT consultations, have been evidenced and require addressing. We are however concerned that the purpose of authorisation under any regulatory regime, is to provide assurance to consumers, the industry and its regulator, that the individuals held within it are competent, and where applicable are appropriately qualified. The regulatory regime must provide absolute clarity of whether a firm is the "agent of the client" or "agent of the provider". Unclear motivations have damaged trust and AMI's own work on why consumers do not engage fully with Financial Services Institutions (FSIs) has shown that they do not know who to trust.

Trust and trustworthiness are crucial to any exchange relationship, and nowhere is this more apparent than in financial services. The long-term nature of many financial products, their complexity, and the importance of financial assets to individual well being, mean that customers perceive high levels of risk when making purchase decisions. They

typically lack specialist knowledge and may have difficulty in judging product performance. The costs of making a mistake are considerable.

Faced with such risk and uncertainty, many customers are dependent on FSIs to offer advice and products of an appropriate type and quality - and must trust them to do so. However, there is a growing concern about the extent to which FSIs are trustworthy and the extent to which consumers feel able to trust them.

The proposals – as outlined – to implement an interim regime, hold significant potential to damage this confidence further, offering seemingly appropriate regulatory protection without the appropriate regulatory scrutiny of its market participants.

AMI believe this is further exacerbated by current authorisation processes, which in itself carries insufficient checks, enabling firms to be sanctioned and later reprovved by the same regulatory regime. We would call for a full review of FSA's authorisation process, increasing the level of due diligence undertaken when considering the authorisation of new firms. Enabling a greater emphasis to be placed on fitness and propriety tests of those who lead, and have senior management influence in, firms.

This test would examine more about the individual's past behaviour, their business affairs and the way in which they have managed other, similar firms. It must be made a matter of some note to be authorised. The mortgage market does not benefit from the same strength of authorisation as that of the investment market. Authorisation is granted on a firm basis not individual, enabling some unscrupulous intermediary's activities to go relatively unnoticed. We would therefore call for FSA to implement individual authorisation within the mortgage market. Further, there may be the possibility of a period of "provisional authorisation" during which firms' performance against regulatory standards would be reviewed within a twelve-month period.

While we accept this policy will add to FSA's processes, we believe it will result in higher standards, where firms will be willing to accept this new barrier to entry, if it keeps unscrupulous ones out of the market.

AMI feel that the frequent comparison to home reversion plans is inappropriate. The reasons and objectives of these transactions are far removed from that of a SRB. Whilst from a legal perspective these may appear similar, their origins and drivers are very different and this should be reflected in any new regulatory regime.

Finally, it is the opinion of AMI that the incorporation of SRB within the regulatory remit of the FSA further reinforces the requirement for FSA to be the lead regulator within the mortgage market. Firms in the second charge market must also pay due attention to the Office of Fair Trading (OFT) guidance. This duopoly of regulation has surrounded the market in confusion, for both firms and consumers.

We recommend that it is of paramount importance that a "level playingfield" is created between all types of secured credit products as these current structures have led to evident gaps in consumer protection. AMI would call for the regulation of the second charge market to fall within the remit of the FSA.

Q1: Are there any other forms of sale and rent back (existing or planned) not captured here?

We are not aware of any other forms of SRB, other than those already captured within the consultation paper.

Q2: Are there any other business models in the SRB market?

We are not aware of any other business models in the SRB market, other than those already captured in the consultation paper.

Q3: Do you agree with our proposal to create a bespoke regulatory regime for SRB?

AMI agrees with the FSA's proposals to introduce a bespoke regulatory regime for the SRB market, due to the unique characteristics of the product, its market and the potential for significant consumer risk. The existing structure used within the mortgage conduct of business (MCOB) sourcebook, provides an appropriate framework for regulating SRB firms. A bespoke version of this will allow the creation of a more appropriate framework, designed specifically for regulating SRB firms, with the scope to create or modify existing rules, where risk is identified.

AMI would however caution that the quality of service from SRB firms can differ widely, between firms and market participants. The more established operators will seek to protect their reputations, offering certain guarantees, where others will focus on the monetary rewards offered by such schemes.

FSA must recognise the difference between these market participants and the differing funding lines and systems and controls within them. This can be most appropriately assessed, by FSA, at the point of authorisation. Firms must be appropriately appraised with greater emphasis placed on the firms fitness and propriety, including individual tests of those who lead, and have senior management or significant influence on a firm.

Q4: Do you agree that the risks of the proposed interim regulatory approach are outweighed by the benefits of putting in place consumer protections as quickly as possible?

Many SRB firms previously in operation would have relied heavily on funding from the buy to let market. The current economic conditions have brought about the decline of this market¹, subsequently for many, funding has been limited or removed all together. This in turn, has resulted in many firms ceasing to operate. While AMI recognise the potential consumer detriment posed by the SRB market, it is our belief that the potential for immediate consumer detriment has not increased over recent months. We therefore disagree with the FSA's comments and approach that the risks of implementation are outweighed by the potential benefits gained. We would caution that a more robust approach should be adopted, which would only authorise firms once a bespoke regulatory regime had been implemented.

AMI are concerned with the FSA comments that "this interim regime is necessary, even if the protections are not as complete as the full regime will provide". AMI would caution

¹ FSA – MLAR data: March 2009

the FSA against their proposals to only allow those firms carrying on SRB activities to apply for interim permissions. Such actions may result in unintended consequences for consumers, in that, firms may rush to complete applications, or form new businesses, active in this market, in order to qualify for the appropriate authorisation. Unscrupulous firms may use this as a “window of opportunity” to offer advice to consumers on inappropriate deals.

There is also the associated risk of firms not active in the market, cementing their presence post interim authorisation by purchasing an operational company which will have already sought authorisation and received the relevant sanctions to operate within this market place.

Q5: Do you have any comments on the proposed interim permissions regime?

FSA's consultation suggests that firms currently authorised for regulated activities under FSA will be able to seek permission to undertake SRB transactions irrespective of their activity within that market. What is unclear is whether these firms will be subject to the full authorisation requirements, as intended to be implemented in 2010.

We also believe that the total number of current SRB providers has been overstated within the HM Treasury consultation this may have a considerable impact on the overall costs for those who will be authorised in full in 2010.

Q6: Do you have any comments on the proposed interim Variation of Permission regime?

Please refer to our response as outlined in Q4.

Q7: Do you have any comments on the proposed status disclosure requirements?

We believe that the key fault of the current status disclosure regime is that it fails to help consumers recognise the motivation of the person they are dealing with: are they the agent of the client or the agent of the lender. We would like to see similar distinctions applied to the SRB market and subsequently the mortgage market, as are being discussed in the Retail Distribution Review i.e. an Independent Adviser or Sales person.

In order to support consumers to understand this distinction between agent of the client and agent of the provider more clearly, as well as the services they are being offered, all forms of disclosure to consumers, both written and oral, should be based on everyday language which moves away from industry jargon. It is crucial that the labels used to describe the FSI make absolutely clear to consumers the distinction between the various business models and what they can deliver.

When reviewing such processes, due attention should be paid to the fact that the UK's average reading age is 12, and many consumers are unfamiliar with industry terminology. This may be especially prevalent in the SRB market which FSA themselves identified within their consultation, as a complex deal to evaluate, especially for consumers already in stressful and difficult financial and emotional situations.

The current regime allows firms to state what they offer, but insufficiently protects consumers, as it does not insist firms explain the limits of their services. This is coupled

with a process that discourages active engagement with the clients due to the emphasis placed on its associated paperwork, and reinforces the view that disclosure is something “to get through” rather than to help the client understand the service being offered

Q8: Do you have any comments on the proposed reporting requirements?

None

Q9: Do you have any comments on our proposed approach to supervision of SRB firms?

None

Q10: Do you agree with our proposal to apply the Principles for Businesses to SRB?

We would agree with the FSA’s approach to apply the Principles for Business to SRB.

Q11: Do you agree with our proposal to apply part of SYSC 4, as well as SYSC 5 and SYSC 9?

We feel that firms should be subject to the full authorisation procedures and an appropriate regulatory regime from the first day of transacting business.

Q12: Do you agree with our proposals to apply the Training and Competence sourcebook to:

- a) Advising on SRB agreements; and**
- b) Overseeing non-advised sales of such agreements on a day-to-day basis but without imposing the appropriate examination requirements?**

We firmly believe that to gain consumers’ confidence and improve the reputation of financial advisers, robust professional standards must be met. AMI believes that professional standards embrace three complementary factors: qualifications to evidence technical knowledge; skills that demonstrate the ability to apply knowledge and ethical behaviour.

The same is true for those in a sales role. As a minimum we believe QCA Level 3, is the appropriate benchmark. For firms operating within the SRB market, this would equate to a minimum benchmark qualification of CeMap 3 (Certificate in Mortgage Advice and Practice).

Q13: Do you agree with our proposals to apply only the high-level competence requirements to all other activities carried on by SRB firms?

Please refer to our answer to Q4.

We do not agree that the risks associated with the application of an interim regime, outweigh the benefits of putting in place consumer protection.

Firms identified during the HM treasury and OFT studies as being of concern, will be allowed to maintain their activity levels, without evidencing the appropriate level of competence. The industry should not be required to compensate for the advice and products supplied to consumers by such firms.

We feel that any participant in this market should be immediately vetted with a greater emphasis placed on a firms fitness and propriety.

Q14: Do you agree with our proposal to apply the MCOB guidance on high-pressure sales?

AMI agree with the proposals to apply the MCOB guidance on high-pressure sales.

Q15: Do you agree with our proposal to apply rules requiring firms to protect consumers' interests?

AMI believe that the benefits to the consumer in offering absolute clarity of whether a firm is 'agent of the client' or otherwise will go a long way to restoring trust in the sector and protecting their interests.

YouGov research commissioned by AMI, indicated that when considering the most important features of an FSI, consumers believed that dealing with a firm that is on their side, or "agent of the client", is the most important consideration. We believe this underlines the importance of the differentiator that advisers work on behalf of and as agents of their clients.

The same research also found that hat when buying financial products, 77% of people thought knowing an FSI was on their side would build trust in FSIs, while 81% thought knowing whether they were being sold a product or advised to buy one, would build trust.

We believe an independent advisor is the only true agent of the client. Only they can give true advice as they are legally bound to put the best interests of the client first, and avoid all conflicts of interests.

Q16: Do you agree with our proposal to apply a rule requiring independent valuation?

We agree that a valuation should be completed, independent of the SRB provider.

Q17: Do you agree with our proposal to apply a rule on beneficial interest to safeguard consumers?

The proposals as outlined are unclear with regards to whether you are referring to the previous owner having a beneficial interest i.e. shared ownership or on going ownership by the landlord, as the Tenant will be protection by the Assured Shorthold Tenancy (AST) and the Land and Property Act. Ongoing beneficial interest in the latter case would be inappropriate. Clarification on this matter would be required.

Q18: Do you agree with our proposal to apply rules relating to financial promotions and communications?

Disclosure occurs once a potential consumer has engaged with a firm. However by that stage consumers may already feel under-pressure to continue with the process. Financial promotions will often engage the consumer prior to any disclosure. It is therefore essential that any financial promotion regime insists that the limits of the firm's scope, and individual's competence, are set out clearly so that the client may better judge the value of the service offered.

AMI would propose that a new financial promotion regime is introduced which helps the public understand what the firm can offer them even *before* they enter into a conversation. This would include not only above the line advertising but also the signage on any retail premises – and most certainly the firm's websites and all promotions. We would also like to see financial promotions make absolutely clear to consumers what firms are unable to offer customers and any potential 'dis-benefits'.

Financial promotion rules of the past have focussed heavily on micro detail – font size or prominence of warnings – rather than overall impact. This caused confusion for both consumers and firms and only served to dilute the promotion's meaning. We recommend that future regulation requires a clear comparison between "product" and "service" advertising. Where products are being advertised, consumers are being invited to purchase; clear risk warnings and product features should be present. Consumers must be in no doubt about what they are purchasing. When intermediaries are advertising their service, they are inviting clients to contact them to discuss areas in which they may be able to offer their service. In this service proposition, it is our belief that product features and relevant risk warnings serve no purpose.

We also believe that the current rules do not address the internet-based propositions of aggregators, lead generation firms, and other business models that fall outside the letter of regulation but would be caught under a definition of consumer-risk, all of which are prevalent within the SRB market. We propose that these rules should be reviewed with a view to an e-enabled world, where most consumers shop on the internet – at least as a source of information before (or after) speaking with an intermediary or lender. AMI would be happy to discuss this further with FSA, with the assistance of our member firms who are active in this area.

Q19: Do you agree with our proposal to apply a rule on excessive charges?

We agree with the proposed application of the rules relating to excessive charges.

Q20: Do you agree with our proposal to apply a bespoke conduct of business rule on pre-sale disclosure for the interim regulatory regime?

Please refer to our answer as outlined in Q7.

Q21. Do you agree with our proposal to apply most of our DISP rules to SRB firms?

As outlined in Q4, we feel that all firms should be subject to the normal authorisation, conduct of business and DISP rules from the first day of transacting business under the regulatory remit of FSA.

Q22. Do you agree with our proposal to bring SRB firms into the compulsory jurisdiction of the FOS?

We would seek clarification of whether SRB firms will be part of the A18 block and therefore eligible for three free cases with Financial Ombudsman Service (FOS). Subject to clarification of this, we would agree that SRB firms should be subject to the jurisdiction of FOS.

Q23: Do you agree with our proposal to not bring SRB firms with an interim permission into the scope of the FSCS?

We agree that SRB firms should not be brought into the scope of the Financial Services Compensation Scheme (FSCS), which is further reinforced by the FSA proposals to bring in an interim regime. The authorisation of firms immediately - without the appropriate fitness and proprietary checks - may create the potential for liability, at such a time when firms need to be removed from FSA authorisation due to poor standard of business written, or the potential risk posed to the market.

Q24: Do you agree with our proposal that, for firms which have an interim VoP for SRB, the scope of the FSCS should apply only for advisers and arrangers and not for providers and administrators?

We disagree. We feel that for reasons stated above, SRB advisors and administrators should not be brought into the scope of the FSCS, until a proper assessment of competence, fitness and propriety has been carried out. This can only be achieved if firms are authorised once the appropriate bespoke regulatory regime has been implemented.

Further, once implemented, we would call for providers and administrators, advisors and arrangers to be treated as equals. While previously, it may have been argued that the circumstances in which a borrower is likely to suffer loss in the event of a provider defaulting are limited. The financial crisis has demonstrated the extent to which this theory can break down. In the past it has been thought that the potential scope for a market solution, such as a transfer of a portfolio to another lender, generally without loss to the borrower, would prove a viable and dependable solution. The collapse of the wholesale markets played out over the last eighteen months or so, has shown these types of previously "guaranteed" solutions do not hold the same certainties as they once did.

Q25: Do you agree with our proposed interim application fee for sale and rent back? 2 Annex 3

Given the perilous state of the mortgage market, and the economic climate, any new regulatory proposals must be subject to a detailed cost benefit analysis to ensure the consumer "betterment" more than compensates for the costs imposed on firms. It is consumers who ultimately pay for regulation and, if firms are forced out of business due to excessive regulatory costs, this will only weaken the ability for consumers to secure the most suitable product at affordable rates.

If a new regulatory initiative is considered, we would recommend that the National Audit Office is asked to set independent assessment criteria which it could then be measured against. The current state of the market suggests that new costs will be difficult to justify

to firms (and perhaps even consumers) – such transparency of approach by FSA would reassure them that change would bring considerable benefit and so it would be worth undergoing the task.

While AMI agree with the fees the FSA have associated with the application of the SRB regime. We would urge that such fees must - once paid - be appropriately apportioned to the market they are being paid from. Where firms are paying such regulatory costs, they must be assured that they themselves will reap the benefit.

Q26: Do you agree with our proposed application of periodic fees?

Please refer to our answer as outlined in Q25.

Q27: Do you agree with our proposed application of FOS fees?

Please refer to our answer as outlined in Q25.

Q28: Do you agree with our proposed application of FSCS fees?

Please refer to our answers as outlined in Q23-Q25.

Q29: Will the proposed interim regulatory regime generate any further costs that have not been identified here?

If firms are brought within the scope of the FOS during the interim regime, this may give rise to unnecessary costs and preventable consumer detriment by firms inadequately checked prior to authorisation.

Q30: Will the proposed interim regulatory regime framework generate any further benefits that have not been identified here?

None

Q31: Do you have any other comments on our CBA?

None

Q32: Do you agree with the compatibility statement?

None

AMI

May 2009