



## **A REVIEW OF MORTGAGE REGULATION – SUMMARY PAPER**

### **INTRODUCTION**

AMI believes that good firms thrive in a properly regulated market. We believe the hallmarks of a good regulatory system include: one in which consumers are encouraged to shop around, regulation is risk-based and is delivered in a cost-justifiable and accountable manner.

For many consumers buying a home is the single most important financial commitment they will make. Yet, unlike every other financial services product the decision to take out a mortgage is both optional and its effects immediately obvious. Any regulatory structure needs to balance the obvious need to protect a consumer from taking on unaffordable debt – with their desire to buy a home of their own.

The options for not taking out a mortgage could mean living with family members or renting a property (and losing any potential for financial return and the lack of psychological benefit that “having a place of one’s own” can bring). The UK has a romantic (and financial) engagement with property, and this has been at the centre of public policy since the start of the “property owning democracy”. As can be seen from the current political engagement in the mortgage market, there are fewer aspects of financial services that create such an intense interest.

There is a continued need to regulate both lenders and intermediaries, if only for the reason of consumer protection and to ensure an “unbroken regulatory chain”, stretching from the consumer to the provider of the loan. The current regime has strengths, and it is important that these are built upon as well as its weaknesses compensated for. We have set out below our initial thoughts, designed to provide reflection and act as a summary document for the associated questionnaire.

#### **1. Scope of Service**

Intermediaries will focus on their prime source of income, which in many cases remains to be mortgages. In the current climate firms may have diversified into additional business areas or auxiliary products. There is however currently, no regulatory requirement for firms to review their clients needs holistically, offering advice on all products in which they are authorised too.

Levels of consumer protection are declining, between April 2007 and March 2008 around 668,000 pure protection contracts were sold, representing a fall of 20% on the previous year<sup>1</sup>. 93% of these contracts were sold on an advised basis. Public borrowing is also thought to spiral to £173 billion for the 2009 fiscal year. This means the needs of each consumer is now more far reaching than just arranging the funding

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<sup>1</sup> FSA Pure Protection Contracts – September 2008

to purchase a property. In this new environment, should authorised firms be required to offer holistic advice across all areas of authorisation?

Firms may also be encouraged to specialise in product areas. Certain product categories are seen by consumers as niche and may require additional training, knowledge and consumer protection. Would limiting the scope of an intermediary's advice offer more protection and a greater degree of understanding to consumers? Should consumers receive advice from specialists within their individual fields and not across a range of products? Or should clients be able to seek independent advice on dependent on their holistic circumstances, not just their immediate needs.

Should lenders take responsibility for advice? If lenders were to take responsibility for the advice provided by intermediaries, lenders will inevitably want to assess the appropriateness of the intermediary, and indeed the advice provided, acting as a quasi regulator to firms.

## **2. Authorisation Process**

It should 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. Should the FSA implement individual authorisations within the mortgage market?

Is the FSA's exiting authorisation process flawed? It enables firms to be authorised and later criticised by the same regulatory regime. Is there a need for the FSA's current process to be overhauled, increasing the level of due diligence undertaken when considering the authorisation of new firms, which in turn may enable a greater emphasis to be placed on the fitness and propriety tests of those who lead, and have significant influence on firms. Should this test provide more emphasis on past behaviour, a firms business affairs and the way in which they have managed other, similar firms?

## **3. Disclosure**

The disclosure regime has taken many forms. In its most current, the requirements mandate firms to disclose the services they are able to offer prospective clients. Research conducted by FSA<sup>2</sup> demonstrated that while consumers readily understand that the Initial Disclosure Document (IDD) provides them with details of the services the mortgage firm could offer, it failed to represent a read-across over the whole market.

Should the current disclosure regime be turned around, assisting consumers to recognise the motivation of the individual they are dealing with: are they the agent of the client or the agent of the lender? Should it provide a read across, based on the services the firm is unable to provide i.e. whole of market advice, as an alternative to offering details of only the services the firm can provide? Would consumers, and the market benefit from a greater understanding of what is true independent, whole of market advice and where this can be found?

Should the disclosure regime be re-designed? Does the current paper based, prescriptive regime offer the right level of consumer buy in and understanding? If we were starting with a blank sheet of paper, what would a more appropriate regime look like?

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<sup>2</sup> Consumer Mortgage Disclosure FSA

#### **4. Financial promotions**

The perception of the current financial promotion rules, are that they have focussed on micro detail – font size or prominence of warnings – rather than overall impact. This has caused confusion for both consumers and firms and has the potential to dilute the true meaning of the promotion.

Should there be a clear separation between “product advertising” and “service advertising”? Where products are advertised consumers are being invited to purchase; there is an expectation that clear risk warnings and product features would be present. Consumers are in no doubt about what they are purchasing. When brokers are advertising their services, they are inviting clients to contact them to discuss areas, in which, they may be able to assist. In this service proposition do features and product details serve a purpose to the consumer? Should financial promotions rules focus on this separation between product and advice?

Should the existing regime be abolished and replaced with a principles-based regime, built on an overarching principle of “clear fair and not misleading”? Should the rigid rules which bind firms be abolished? If so would firms welcome the additional responsibility for assessment and interpretation?

#### **5. Affordability**

Affordability assessments are heavily dependent on the information provided by the consumer. The current rules on affordability place an equal degree of responsibility with both the lender, and intermediary to assess the client’s financial standing.

Typically, intermediaries do not have access to credit records and will not be responsible for underwriting a loan. Lenders are able to match a consumer’s credit history against their own credit models and risk profiling techniques and are required to pay due regard to responsible lending rules, as stipulated by FSA. Does the ultimate responsibility for taking a lending decision therefore rest with the lender? Is the current equal responsibility appropriate? Or should this assessment rest firmly with the supplier of the funds?

Independent intermediaries are repeatedly proven to be the preferred and most trusted advisory route for consumers. This is largely due the value placed on their advice, expertise and independence. If any part of this responsibility is removed - in this case the affordability assessment - would this dilute this value for consumers? Should credit information be readily available to the intermediary sector, will this provide more certainty that the firm is providing the most suitable advice for the consumer?

#### **6. Product Regulation**

In his 122 page report, Lord Turner commented that the Paper, due to be released in September would provide thought into product regulation, specifically around Loan-to-Value (LTV) and Loan-to-Income (LTI) ratios.

At its heart, any mortgage product is simply an interest rate and a term. Would a logical view be that this does not require regulating? Would product regulation within the mortgage market have the potential to stifle innovation? The types of which have created specific product types and specialist niches. These specialist areas have been fundamental in meeting the needs of certain sectors of consumers. Could it be argued that sufficient regulatory tools are already in place? Would any additional rules only stifle innovation and risk undermining the markets recovery?

If product regulation is the only plausible option to provide true consumer protection, how could this be formulated to ensure the appropriate innovation is free to develop, whilst advice can be effectively delivered? Is there a place for institutional regulation? Would a more appropriate structure be one where product manufacturers retain liability for a product's design and its promotion?

### **7. Fee Based Models**

Remuneration should be the hallmark for transparency and fair value. The mortgage remuneration model has remained relatively unchanged since inception, however evidence suggests it represents a key issue affecting consumer trust. If we do not continue to see the highly discounted, short term, fixed rate mortgages reach such sustained levels as evidenced pre-credit crunch; will lenders choose to promote longer term, fixed deals in a bid to increase consumer loyalty? Could the introduction of a "trail" based remuneration model - taking into account future changes and market stability - provide an alternative to the current remuneration model? Would this improve the robustness of all business models going forward?

An alternative may be the introduction of "procurement fee" equivalence. Are changes to the current disclosure regime needed to achieve greater consistency between that earned by whole of market advisers, compared to the commission equivalent earned by tied advisers? Further explanation of the commission equivalent figures could be included and contextualised by reference to the quality of the service and advice received. Could this create a greater degree of comparability for consumers and a "level playing field" for firms?

Factory gate pricing can be determined by the cost of manufacturing a mortgage product, minus the distribution costs. Will this method of remuneration be more appropriate in the mortgage market of the future? Customer Agreed Remuneration (CAR) is the cost of advice provided to the client. Would CAR work in the mortgage market? By entering into a discussion with your client about the true cost of advice, will this enable you to promote your role and demonstrate the value of the service you are providing to your client?