



Association of Mortgage Intermediaries' response to FSA's CP10/28 Mortgage Market Review: Distribution and Disclosure

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI). AMI is the trade association representing over 80% of UK mortgage intermediaries.

Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product 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.

AMI welcomes the opportunity to respond to FSA's consultation paper on Mortgage Market Review (MMR): Distribution and Disclosure. We welcome that FSA continues to consult openly with industry on its thinking on the MMR. However, the fragmented approach of dividing the various consultation papers and policy statements into separate subjects has made it difficult to respond as robustly as we would like. Furthermore, this has restricted us from responding with a detailed analysis identifying the full impact of the proposals, their interrelationships and the consequent costs and benefits.

AMI's response in this paper is based on the impact of the proposals as described by FSA. Due to the integrated nature of these proposals any changes to the policy position on the appropriateness test would require further consultation. In addition, FSA cannot make singular changes in any one area without reconsidering what impact this may have on its other proposals and the resulting handbook and its impact on the market. Because of this we are unable to assess what the cumulative impact on the MMR will be.

We are aware that the European Commission is producing a directive that will impact on this market. Any changes emanating from this source will, in our view, require a full re-consultation on all MMR recommendations and proposed rule changes.

Executive Summary

- As a default, mortgage advice (a recommendation) should be provided to all consumers obtaining a mortgage. However, those consumers confident enough to go through the process without advice should be able to do so, once they have understood the added protection they have lost.
- FSA should consider whether for some consumers and products mortgage advice should be mandatory to provide the extra protection afforded to consumers in receipt of regulated mortgage advice.
- FSA's rules and guidance need to reflect its policy position that lenders should be fully accountable for the decision on overall all affordability.
- The requirements around intermediaries assessing a consumer's ability to meet a lender's affordability requirements should only be based on the lenders published criteria, not its internal and unknown underwriting criteria.
- As a default, appropriateness should be assessed for every sale whether it is sold via an intermediary or directly by a lender. However, FSA should consider whether some exemptions should be allowed for high-net worth individuals or those consumers with a 'professional understanding'.
- Given the proposed requirements for the appropriateness test, a level playing field for professionalism is essential across all mortgage sellers, as well as those who can amend the mortgage term, repayments or the type of the loan. A level three mortgage exam is an appropriate qualification standard for the mortgage industry.
- Although the initial disclosure document (IDD) can still be used as the durable medium to present key information to consumers, after oral disclosure has taken place, it will not be a mandatory document. Without a set document in place some firms could manipulate the description of their service offering to the detriment of consumers.
- We agree with FSA's conclusion that the Key Features Illustration (KFI) is not generally used by consumers to compare products, therefore the number of trigger points upon which it is issued should be reduced.
- When a direct only deal is recommended by an intermediary, the intermediary should only be required to provide a record of the recommendation. The KFI itself will need to be provided by the actual mortgage lender. Consideration will also need to be given as to how the process of recommending a direct only deal will operate in practice. This is because our interpretation of the current proposals indicate that the lender will still be required to undertake appropriateness and affordability assessments. Accordingly, all the responsibility will be with the lender.

- FSA has proposed that when consideration is given to fees being added to the mortgage two KFI's are produced to allow consumers to compare costs. FSA appears to be looking at a disclosure solution to address this issue, whilst at the same time acknowledging that consumers do not use KFI's to compare product options. We believe FSA should consider alternative solutions to this issue.
- The cost of issuing multiple KFI's is also an issue. FSA should consider the impact of such changes on small and medium enterprises (SMEs), adopting the European "Think Small First" principle where appropriate. The potential number of KFI's being produced could also further confuse the consumer.
- The labelling terms suggested should be simple for most consumers to understand. However, using the same terms from the Retail Distribution Review (RDR), but with different definitions for the mortgage industry, could cause some level of confusion to some consumers.
- FSA has not demonstrated any evidence of commission bias in the mortgage market. Therefore, the provision of a fee only option does not underpin the ability to offer independent advice. We support FSA's decision to remove the fee only option from the definition of 'independent'.
- We would again be concerned over documenting that a reiteration of scope has taken place. Firms will need to be able to demonstrate that this has taken place but this places higher costs on the firm and is likely to drive greater levels of documented disclosure being provided to the consumer.
- We support FSA's decision not to make suitability letters mandatory but to still allow firms to issue them as a matter of good practice.
- Prior to any implementation of MMR taking place, FSA should issue an amalgamated consultation paper containing its full set of draft rules to allow stakeholders to consider the full impact of the changes and assess the full interrelationship of the proposals and impacts on the market.

Mortgage advice

Entering into a mortgage agreement is one of the most important decisions a consumer will make. To ensure that potential consumer detriment is kept to a minimum, mortgage advice should be the default route for all consumers obtaining a mortgage. However, we acknowledge that not all consumers who take out a mortgage will require advice. For the minority confident enough to go through the process without advice, an opt-out from the advice process should be available.

Whilst there will be some consumers who do not require advice there are also some groups that could benefit from mandatory advice. There are vulnerable groups such as first-time buyers, credit impaired and those borrowing into retirement as well as specific product groups such as interest-only mortgages that should not be obtained without advice and a specific recommendation being received. Compulsory mortgage advice for these groups obtaining certain higher risk or more complex

products should be considered as a means of reducing potential consumer detriment.

Requiring that regulated mortgage advice is provided will give greater protection to consumers than they would otherwise receive from a non-advised sale.

We are concerned that as the gap between advised and non-advised sale is reduced, by making it a requirement that all mortgage sellers undertake an appropriateness assessment, this could lead to firms losing their unique selling point and forcing firms to de-risk by only offering non-advised sales. Such a consequence would cause consumers to lose the added protection that regulated advice provides.

FSA's impact assessment does not consider what effect these proposals will have on the current distribution methods used by lenders. Whilst these changes could drive some lenders to greater levels of intermediated distribution other may increase their direct only offerings or move totally to one form of distribution or the other. This would result in a substantial change within the structure of the market that should be considered as part of the MMR consultation.

Affordability assessments

FSA's policy position in this paper is stated in the proposals as "*lenders should bear ultimate responsibility for assessing affordability*". To achieve its policy proposals FSA's final rules and guidance need to make clear that the accountability for assessing affordability is solely with the lender. The current draft rules do not reflect this position.

Applying the rules as currently drafted could lead to confusion over who is responsible for what within the mortgage process, which may weaken FSA's proposed changes and cause some of the very problems the MMR was intending to address to be replicated.

Whilst FSA needs to be clear in the rules around assessing a consumer's ability to meet a lender's affordability requirements, the factors that an intermediary should consider to do this would be better presented as guidance than as rules.

FSA proposes that intermediaries should be "*limited to doing no more than checking that the consumer fits within the expected parameters of lenders' affordability criteria*". It is important that FSA makes a distinction between a lenders published criteria and its internal underwriting criteria, which will be unknown to the intermediary. For such proposals to be workable, intermediaries can only be required to check that a consumer fits the lenders published lending requirements. However, intermediaries should still be able to discuss cases with lender's underwriters on an individual basis.

Appropriateness assessment

For the proposed appropriateness assessment to be effective, as a default, it will need to be undertaken for every mortgage sale whether advised (recommendation) or non-advised basis, from an intermediary or direct.

However, whilst this should be the default position FSA should consider those circumstances where some form of exemption may be fitting. The Consumer Credit Act 2006 (CCA06) allows for some exemptions from some requirements for high-net worth individuals¹. The European commission's work on Markets in Financial Instruments Directive (MiFID) allows consumers who are considered to be 'professional clients', with the necessary knowledge and experience to understand the risks involved with the investment services, to require less protection than standard retail clients². FSA should consider whether such limited exemptions should also be applied to the mortgage market.

Disclosure of key messages

The proposed changes to the disclosure regime will require an early disclosure of key messages, generally on an oral basis, followed by further disclosure in a durable medium. The proposals will allow intermediaries to still use the IDD as the durable medium to present key messages to consumers, once oral discourse has taken place. However, our concern is that without a homogenous document some firms may manipulate the description of their service offering to the detriment of consumers.

FSA has applied oral discourse requirements to the ICOBS rule book. However, it has recently raised concerns about the effectiveness of such disclosures as part of its post implementation review³. Furthermore, these enhanced oral disclosure requirements would place additional compliance requirements and costs that could have a substantial impact on SMEs such as mortgage intermediaries.

FSA should also consider how mortgage intermediaries who are advising on the mortgage product but conducting a non-advised insurance product sale should disclose this to the consumer. Should both disclosures be made upfront followed by a durable medium disclosure or should each sale be conducted separately?

Scope of service

The proposed 'independent' and 'restricted' labelling terms should be simple for most consumers to understand. FSA has not produced any evidence of commission bias in the mortgage market, therefore, the provision of a fee only option does not underpin the ability to offer independent advice. As such, we support FSA's decision to remove the fee only option from the definition of 'independent'. Allowing firms to decide whether they offer advice on direct only deals allows flexibility whilst the

¹ 'Consumer credit – regulated and exempt agreements'
http://www.offt.gov.uk/shared_offt/business_leaflets/consumer_credit/oft140.pdf

² Implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:241:0026:0058:EN:PDF>

³ Insurance: Conduct of Business Sourcebook (ICOBS) post-implementation review: statement of findings
http://www.fsa.gov.uk/pubs/other/icobs_review.pdf

requirement to disclose whether direct only deals are being considered or not should remove the potential for consumer detriment in this area. We remain concerned over evidencing and disclosing such sales within these proposals.

Key features illustration

As part of its Mortgage Effectiveness Stage 2 report⁴ FSA identified that the key features illustration (KFI) was not generally being used as originally envisaged. Consumers were not using the document to compare products. However, the KFI is seen as valuable for consumers as a record of the mortgage product they have taken out.

We are supportive of FSA's acknowledgement that as the KFI is not generally used by consumers for comparing products, the number of trigger points at which it is issued should be reduced.

Whilst intermediaries may issue KFIs, where possible, if a direct only deal is recommended, the intermediary will not always have access to the KFI. Some KFIs for direct only deals are available to intermediaries but this is certainly not always the case and lenders could restrict this further in the future. Therefore, if an intermediary recommends a direct only deal to a consumer, the intermediary should only be required to provide a record of the recommendation. The KFI itself will need to come from the actual mortgage lender.

FSA's proposals for two KFIs to be produced when a consumer is considering rolling up fees into their mortgage would seem to contradict its findings on how consumers use the KFI document. Making consumers aware of the costs and benefits of adding fees to the mortgage represents good practice. However, if consumers do generally only use the KFI as a product record then using it as a tool to compare the costs of rolling fees up into mortgages would seem to be ineffective as a way of preventing potential consumer detriment. Furthermore, if consumers do not use the KFI to compare all the varying features of products, it would seem unlikely that they would choose to do so to compare just one factor.

The assessment of which product to select may be interwoven with the issue of whether fees will be added to the mortgage or not. On some occasions the product may have already been selected before the fee issue is considered, however, different products may have varying fees and this may influence the product selection process. Therefore, multiple KFIs may need to be issued when discussing all the relevant factors.

The cost of issuing multiple KFI's is also an issue. FSA should consider the impact of such changes on SMEs. The number of KFI's being produced could also further confuse the consumer.

⁴ FSA Mortgage effectiveness review - Stage 2 Report
http://www.fsa.gov.uk/pubs/other/MER2_report.pdf

The Oxera report “what cost would be incurred as a result of the MMR sales and advice process reforms?” does not appear to consider the additional cost of producing multiple KFIs if fees are rolled up into the mortgage.

FSA’s cost benefit analysis (CBA) briefly considers the cost but declares “*The compliance costs of this proposal are minimal as it will only apply to a subset of sales and would only require printing an additional KFI and where a consumer chooses to roll-up fees a minimal addition to their record-keeping*”. However, this assumption seems to be based on only one additional KFI being printed. Whereas it is foreseeable that the intermediary will want to keep copies of either option to demonstrate that the discussion and comparison took place.

The costs of this, particularly on SMEs, start to appear to be substantial. FSA’s CBA does not consider how many mortgage transactions result in fees being added to the loan. NMG research found that around 75% of consumers choose to roll up lender product fees into the mortgage loan⁵ while only 38% rolled up any broker fees⁶.

If we were to assume that multiple KFIs will need to be produced in around three quarters of all intermediary mortgage transactions then the cost of this proposal is likely to be significant. We do not believe that producing multiple KFIs for consumers to compare costs will produce an outcome any better than where KFIs are used to compare products.

In PS10/9: Mortgage Market Review - Arrears and Approved persons - Including feedback to CP10/2⁷ the FSA states:

“We have further tightened the definition of which individuals will require approval for a CF31 to exclude all transactions where no new monies are advanced (to reflect our original intention)”.

This is further confirmed within the near final rules:

“10.10.11 R

SUP 10.10.8R(6) does not include home finance providing activities if the transaction does not involve the advance of monies or further monies to the client.

10.10.12 G

For example, the FSA would expect SUP 10.10.11R to remove from the customer function (home finance business) transactions such as the addition or removal of a party to a regulated mortgage contract, rate switches, the alteration a regulated mortgage contract or an alteration to the payment method. In each case this is as long as no new monies are advanced.

⁵ NMG research – December 2009 - Whether intermediaries offer facility to roll up lenders’ product fees into mortgage

⁶ NMG research - December 2009 - Whether intermediaries offer facility to roll up adviser fees into mortgage

⁷ PS10/9: Mortgage Market Review - Arrears and Approved persons - Including feedback to CP10/2

http://www.fsa.gov.uk/pubs/policy/ps10_09.pdf

10.10.13 G

SUP 10.10.11R would also remove from the customer function (home finance business) the switching of a mortgage contract entered into prior to October 2004 into a regulated mortgage contract as long as no new monies are advanced.”

FSA has confirmed to AMI that the definition of no new monies allows for product fees to be added to the advance by the lender. If FSA were to conclude that the production of two KFIs is required to avert potential consumer detriment, then two KFIs would need to be produced in the circumstances where a lender is merely amending a mortgage contract but no new monies are advanced. FSA has not considered this loop-hole within this paper.

However, if FSA does not consider that the issue of fees disclosure is important then this should be applied across the market. Consumers who decide to remain with the same lender at the end of a product term should have an equivalent protection to those who move lenders. To not do this would create disparity within the market.

It may be more appropriate for FSA to consider an alternative approach to ensure that consumers do not suffer detriment when rolling up fees into their mortgage. The most logical proposal would be for FSA to make a consideration of the costs and benefits of adding fees to the mortgage part of the requirements for the appropriateness test in all mortgage transactions.

Reiteration of scope

We are concerned about firms evidencing that a reiteration of scope has taken place. Whilst the reiteration of scope will be communicated on an oral basis, firms will still need to be able to record and demonstrate that this has taken place for their own internal processes and potential FOS or court action. This will place higher costs on the firm and is likely to lead to more documented disclosure being provided to the already overburdened consumer to demonstrate that the oral discourse has taken place.

If early disclosure, followed by disclosure in a durable medium is effective, then there should be no reason for a firm's scope of service to be disclosed again once the product is recommended or presented to the consumer.

Suitability letters

Under FSA's MMR proposals its perception of the benefit of suitability letters to consumers appears to have reduced. FSA has stated, *“We also recognise the limited value that these letters have in the mortgage market given that they are received after the sale when it is likely to be too late for the consumer to change to another product without incurring significant cost”*⁸. Whilst such letters are issued after the

⁸FSA Mortgage Market Review: Distribution & Disclosure
http://www.fsa.gov.uk/pubs/cp/cp10_28.pdf

mortgage is sold, they still provide a record of why the mortgage product was recommended to the consumer. Consumers see benefits in retaining the KFI as a record of the product purchased, the suitability letter provides the consumer with a record of the advice received.

Research shows that almost all mortgage brokers provide clients with a suitability letter as part of the sales process⁹. Firms should be allowed to decide when and how they issue suitability letters. We support FSA's decision not make suitability letters mandatory but still allow firms to issue them where required, as a matter of good practice. If a reiteration of scope is required it would seem likely that most intermediaries would use the suitability letter to evidence it.

Professionalism

To avoid potential consumer detriment a level playing field for professionalism is essential across the mortgage industry. This will become even more crucial given the proposed requirements for an appropriateness test to be conducted in all sales, including the implications of rolling up fees.

The current level of mortgage qualification is generally suitable for the mortgage market. We agree that the syllabus may need to be refreshed but a level three competency is the appropriate qualification standard.

Any change in the syllabus should not result in any new qualifications needing to be undertaken by any mortgage adviser that is already qualified. Continuous professional development (CPD) should be used for those mortgage advisers who are already qualified but only to gap fill any new areas of the syllabus.

FSA may have concluded that an enhanced level of CPD was required in the investment market, as part of the Retail Distribution Review (RDR). However, the range and diversity of products and services in the mortgage market is simply not as vast as that in the investment world. Therefore, the enhanced CPD requirements to fulfil 35 hours a year made in the RDR should not be applied to the mortgage market. Whilst CPD is required within the mortgage industry and should be demonstrated, it does not require a specified minimum number of hours.

Implementation of MMR

Prior to any implementation of MMR taking place, FSA should issue an amalgamated consultation paper containing its full set of draft rules to allow stakeholders to consider what the complete proposals and rules under the MMR will be. This should be accompanied by a combined cost benefit analysis and impact assessment for the proposals.

Given the potential cumulative impact of the proposal and the segregated manner in which FSA has consulted on each section to date, a final consultation on the full set of draft rules is essential before a policy statement is issued.

⁹ NMG research November 2009 and March 2010

Furthermore FSA should not undertake any implementation until it has considered the work that the European Commission is undertaking on the Responsible Lending and Borrowing Directive.

Questions – MMR Distribution and Disclosure

Q1: Do you agree that we should continue to allow consumers to get a mortgage without advice? If not, what other options should we consider and how would these result in better outcomes for consumers?

To reduce the potential for consumer detriment, mortgage advice should be the default route for all consumers obtaining a mortgage. However, not all consumers who take out a mortgage will require advice. For the small minority confident enough to go through the process without advice (a recommendation) an opt-out from the advice process should be available to them.

There are also some vulnerable groups such as first-time buyers, credit impaired and those borrowing into retirement as well as specific product groups such as interest-only mortgages that should not be obtained without advice and a recommendation being received. Compulsory mortgage advice for these consumers or complex product groups should be considered as a means of reducing potential consumer detriment. Requiring that regulated financial advice is provided will give greater protection to consumers than they would otherwise receive on a non-advised basis.

Q2: Do you agree with removing from sellers any requirement to assess affordability?

We are concerned that this question does not represent the position laid out in this paper. Whilst the policy position in the front of the paper may be to remove from sellers any requirement to assess affordability, the draft rules to not replicate this proposal.

In the draft rules 4.7.2 R (in a high-level format) and 4.7.6 R (in greater detail) both place requirements on the seller to assess affordability. Any supervision of these rules would leave the seller in a position where they are jointly responsible for an assessment of affordability.

FSA will need to be clear in its final rules that the sellers' requirement to assess affordability is limited to an assessment for appropriateness not the key test imposed on lenders.

The intermediary will still need to assess the consumer's ability to meet the parameters of the lenders affordability assessment. For this to be practical the requirement must be that this is measured against the lenders published lending requirements. Intermediaries should not be measured against a lenders internal underwriting criteria.

Q3: Can you see any risks from us adopting this approach?

Not if FSA is sufficiently clear in its rules and guidance. If the rules are produced in the current draft format it will not produce the clarity of lender responsibility which FSA stated is its policy intention in this paper and CP10/16.

Q4: Do you agree with our proposed approach to ensuring appropriateness is assessed in every sale? If not, in what circumstances do you believe the checks should be waived and how could we prevent this being used as a mechanism to circumvent our requirements?

There will clearly be some circumstances where such an approach is unnecessary. However, setting clear exemption(s) that cannot be used to circumvent the requirements could be difficult. An outright execution only regime would not seem to be in-line with what FSA is trying to achieve within its work. However, some consumers, such as professional clients and/or high net worth individuals may be in a position to justifiably not need to go through such rigorous requirements.

The CCA06 provides the possibility of an exemption for high-net worth consumers who consider that they are capable of looking after themselves. FSA should consider how such exemptions could be applied to the mortgage industry.

Under the CCA06 where the borrower is a natural person of high-net worth the regulations under the Act will not apply. "High-net worth" individuals are defined as persons whose income after tax and national insurance is not less than £150,000 per year or as persons who have net assets of no less than £500,000 excluding their primary residence, any redundancy payments or any pension or other retirement benefit payments.

In order for an agreement to fall within this high-net worth exemption, the agreement must include a declaration made by the borrower that they agree to forgo the protection and remedies that would otherwise be available to them if the agreement were to be a regulated agreement.

Any such declaration must be accompanied by a statement of high-net worth. This statement must be provided by a qualified person such as an accountant (who must be a member of a relevant chartered body) or, in the case of income only, an employer. A borrower is not permitted to provide their own statement.

Likewise for professional clients the MiFID implementing directive states, *"An objective of Directive 2004/39/EC is to ensure a proportionate balance between investor protection and the disclosure obligations which apply to investment firms. To this end, it is appropriate that less stringent specific information requirements be included in this Directive with respect to professional clients than apply to retail clients. Professional clients should, subject to limited exceptions, be able to identify for themselves the information that is necessary for them to make an informed decision, and to ask the investment firm to provide that information"*.¹⁰

¹⁰ Implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms, and

MiFID identifies that consumers will not all possess the same level of knowledge and there may be groups, such as professional clients, who do not require the same level of information requirement as other retail consumers. Whilst the MiFID directive does not apply to the mortgage industry, the principles behind its limited exemptions should be used as a point of inspiration for FSA when considering its MMR proposals.

Q5: Do you agree with our proposal for a ‘client’s best interest’ rule and removing the obligation for a recommended mortgage to be the ‘most suitable’ product?

FSA needs to provide greater clarity over what this change of terms actually means. The policy intention may be to provide greater flexibility around the product that is recommended. However, the term ‘clients best interest’ could also be considered as being more restrictive than the ‘most suitable product’ term. FSA needs to provide further guidance or a definition for this proposed change in term.

If a consideration is to be made as to what is in the ‘clients best interest’, rather than the ‘most suitable product’, we would need to see direct lenders looking outside of their own product range to consider whether the products they have on offer are actually in the ‘clients best interest’ compared to other options. Such a requirement would act to level the playing field between the requirement for intermediaries to disclose whether or not they offer direct only products and what lenders should consider.

Q6: Do you agree with our approach to applying common professional standards across the mortgage market?

To avoid potential consumer detriment a level playing field for professionalism is essential across the mortgage industry. This will become even more important given the proposed requirements for an appropriateness test to be conducted in all sales. A level three competency is an appropriate qualification standard for the mortgage industry.

The syllabus may need to be amended but this should not result in any new qualifications being required by those individuals who are already qualified. CPD should be used to gap fill any new areas of the syllabus.

The enhanced CPD required in the investment market under the RDR should not be applied to the mortgage market. The range and diversity of products and services in the mortgage market is not as multifaceted as in the investment world. CPD should be used in the mortgage market but does not require a minimum number of hours per year.

These issues should be considered under Senior Management Arrangements, Systems and Controls (SYSC) and Statements of Principle and Code of Practice for

defined terms for the purposes of that Directive
http://ec.europa.eu/internal_market/securities/docs/isd/dir-2004-39-implement/dir-6-2-06-final_en.pdf

Approved Persons (APER), rather than in the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).

Q7: Do you agree with our proposals to include these three elements as part of the new appropriateness test?

They should be considered as part of the appropriateness test. Most mortgage advisers will already consider retirement, other finance options and whether paying a fee or adding it to the loan is more appropriate. However, FSA needs to consider how those consumers who are currently with a lender with products the intermediary cannot consider should be treated. However, any changes to the requirements to consider further advances will need to consider the level of information that is available to intermediaries on these options. Some lenders will not be forthcoming with detailed information on their further advance options and/or criteria. Those circumstances where the consumer has a product from a direct only lender may find that the lender is unwilling to provide any information about its further advance options. For an appropriate consideration of further advances to take place in all circumstance lenders must be required to provide sufficient information about the option to the intermediary. To not do this will make the practical consideration of further advances in all scenarios unworkable.

Q8: Do you agree with our proposal to improve the disclosure of the impact of the roll-up of fees through the provision of a second KFI?

We agree that making consumers aware of the costs and benefits of adding fees to the mortgage represents good advice. However, FSA appears to be looking at a disclosure solution to address this issue whilst the same time acknowledging that consumers do not use KFIs to compare product options.

We acknowledge that the product may have already been selected before the fee issue is considered but different products may have varying fees and this may affect the product selection process. Therefore, the two issues may not easily be differentiated in all circumstances. Furthermore, with and without fees options may need to be considered for multiple products.

The cost of issuing multiple KFIs is also an issue. It will not just be the two KFIs which are produced to discuss the fee option. Copies will also have to be retained on file, sent to the lender and sent to the consumer (possibly more than once as it is standard to send a further copy with mortgage offer). Therefore, FSA needs to consider the true cost of producing these multiple KFIs.

If FSA is to apply a two KFI disclosure regime this must be applied to all mortgage transactions, including retention deals negotiated by back office staff. Consumers should not be subject to unequal standards purely based on whether they take out a new mortgage with their existing lender or decide to shop around for a new product.

Q9: Do you agree with our proposal to require firms to present consumers with a choice of rolling-up the fees and charges, and to record the decision made?

See question 8.

Q10: Do you agree or have any other suggestions about how to improve consumer awareness of the impact of rolling-up fees and charges?

We agree with FSA that consumers should still be permitted to roll up fees into their mortgage if they wish and that in doing so they should be aware of the costs and impacts, as well as the benefits. The most suitable way to do this, given the way in which the KFI is used by consumers, is to make it part of the appropriateness test.

Q11: Do you have any views on other ways in which we could promote consumer engagement?

The borrower's own responsibility should not be forgotten in this process. The European Commission is considering this issue as part of its work on the Responsible Mortgage Lending and Borrowing directive. Once this paper is published AMI will respond to this question separately.

Q12: Do you think that these distribution proposals will impact any groups with protected characteristics (e.g. race, religion, age, disability)?

No comment.

Q13: Do you agree that it is appropriate to focus our service disclosure on these key messages? Do you agree that this is the correct approach for communicating these messages to consumers?

The proposals will allow intermediaries to still use the IDD as the durable medium to present key information to consumers, providing that oral disclosure of key messages had taken place first. Our concern is that without a homogenous document some firms which are perhaps offering only a restricted service may manipulate the description of their service offering through their own durable medium, to the detriment of consumers.

We have also noted that FSA has applied oral disclosure requirements to the ICOBS rule book. However, it has recently raised concerns about the effectiveness of such disclosures as part of this post implementation review of ICOBS. Any changes to the current IDD process should not be implemented without FSA undertaking robust testing of the new process with consumers. FSA needs to demonstrate that replacing the IDD will result in enhanced consumer outcomes.

Furthermore, oral disclosure requirements place additional compliance requirements and costs that could have a substantial impact on some intermediary firms.

If intermediaries are required to disclose the commission they receive up front at the stage then it is questionable why the same requirements are not to be applied to direct sales from lenders. To provide transparency for the consumer lenders should be required to provide a commission equivalent remuneration figure to consumers. To not do so would leave an un-level playing field that the potential for consumer detriment by allowing lenders to present a position where it could be perceived that there is no costs attached to their distribution model. Clearly lenders do incur costs

through direct distribution which are passed on to the consumer without this being disclosed in a transparent manner to them.

Q14: (i) Do you agree with our application of the ‘independent’ and ‘restricted’ labels to the mortgage market?

The proposed ‘independent’ and ‘restricted’ labelling terms should be simple for most consumers to understand. However, using the same terms as those applied in the RDR but with different definitions for the mortgage industry could cause some level of confusion to some consumers who require products and services from both markets. FSA should re-test these labels in the context of mortgages and not just rely on the conclusion drawn from the consumer testing in relation to the RDR.

(ii) Do you agree that we should require ‘independent’ firms to disclose whether they consider direct-only deals?

Intermediaries who choose to describe their scope of service as ‘independent’ should also disclose whether they are able to offer direct only deals. However, this does not provide for the scope of direct only deals being considered or offered. Are all direct only deals being considered or just those from a selection of lenders?

A more general term disclosing whether the advisers will consider other products or that ‘other products that may be available’ could be more applicable. This would allow firms to consider some but not all of the direct only products available. It would also cover the issue of exclusives being available to some intermediaries but not to others.

We are also concerned about how an intermediary can be certain of the recommendation they have made without full access to the details of the direct only mortgage product.

FSA also needs to consider how this process will work in practice. If the intermediary provides a recommendation on a direct only product the consumer will then visit the lender to obtain the recommended product. The consumer will still have to go through an appropriateness test before the mortgage can be sold to them by the lender. However, it becomes unclear who will be ultimately accountable for ensuring the product is appropriate. Is the adviser who recommended the product accountable or the lender which undertook the appropriateness test for the product sold? FSA needs to further consider how this process will work in practice.

If the adviser charges a fee for recommending a direct-only product under these proposals the transaction will have to be completed by the lender with an appropriateness test being conducted, it will not be possible to complete the deal under the current non-advised sales route. Therefore, such a service could result in a VAT liability on the firms as the adviser would not be intermediating on the product delivery. This issue does not appear to have been considered within the CBA.

(iii) Do you agree that we do not need to retain a fee option as part of our requirements for the label of 'independent'?

FSA has not produced evidence of commission bias in the mortgage market as part of its review. Therefore, the provision of a fee only option does not underpin the ability to offer independent advice. We are supportive of FSA's decision to remove the requirement to offer a fee only option from the definition of independent.

Q15: Do you agree that firms should reiterate their scope at the point that they put the product(s) forward?

FSA has proposed changes to the disclosure regime by requiring an early disclosure of key messages, generally on an oral basis. This is followed by disclosure in a durable medium. If these changes are thought to be effective then there should be no need for a firm to reiterate its scope of service again once the product is being recommended / presented. FSA has not stipulated how such disclosures should be evidenced and we would again be concerned over evidencing that a reiteration of scope has taken place.

Q16: (i) Do you agree that we make these changes to the trigger points for the pre-application KFI?

In its mortgage effectiveness stage 2 report FSA identified that the KFI was not generally used by consumers to compare products. We are supportive of FSA's proposal to reduce the number of trigger points at which the KFI is issued.

However, if a consumer does wish to receive multiple KFIs to compare product options then this should be provided to them. Furthermore, the KFI remains useful as a valued record of the mortgage product the consumer has taken out.

(ii) Do you agree that we should have a requirement to make firms tell consumers that they can request a KFI for any product they offer?

Firms should be clear that consumers may receive a KFI for any product but that they are only required to receive one for the recommended/selected product. However, intermediaries will need to evidence that this has been disclosed to the consumer. This could further increase the amount of disclosure documentation that consumers receive and will also add to the cost of producing such documents.

(iii) Do you agree that we should require firms to provide the consumer with a record, rather than a KFI, where they recommend a direct-only deal?

Yes. The requirement should be for the KFI to be produced by the lender in these circumstances. Some intermediaries may be able to issue a KFI for some direct only deal but they will not have access to KFIs in all circumstances. Therefore, the requirement should not be placed on the intermediary to issue the KFI, the intermediary should only be required to provide a record of the recommendation.

Q17: Do you think that these disclosure proposals will impact any groups with protected characteristics (e.g. race, religion, age, disability)?

No comment.

Q18: Do you have any comments on the most appropriate way to read these proposals across to equity release?

If a firm is involved in equity release it should be required to offer both lifetime mortgages and Home Reversion plans. Consumers who are considering equity release should have all the available options presented to them. To not have this requirement gives rise to the potential consumer detriment. This is because the difference in the eventual outcome that each product creates could leave a consumer in the wrong position for their needs and circumstances.

Q19: Do you have any comments on the most appropriate way to read these proposals across to Home Purchase Plans?

No comment.

Q20: Do you have any comments on the cost-benefit analysis?

The proposals FSA has made in the MMR are interconnected and cannot easily be considered in isolation. The segregated way in which FSA has conducted its consultation has made it difficult to analyse the costs.

Given the potential impact on consumers and firms, we believe that FSA will need to produce a further CBA on the full set of proposals prior to any final rules being decided on.

Q21: Do you have any comments on the compatibility statement?

No comment.

Q22: Do you have any comments on the draft rules?

Overall throughout the MMR process we have been concerned about the disconnect between the stated policy position and the actual wording of the draft rules.

Consideration needs to be given as to how the draft rules will be interpreted not only by firms but also by FSA's supervisors. A lack of clarity and inconsistency could result in poor outcomes regardless of the policy intention.

We have commented below on some of our concerns:

Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

4 Advising and selling standards

4.3 Scope of service provided

Guidance on providing an independent service

4.3.6 G

(1) When offering only a selection of *regulated mortgage contracts* as described in MCOB 4.3.5G, a *firm* should ensure that its analysis of the market and of the available *regulated mortgage contracts* is kept adequately up to date. For example, a *firm* would need to update its selection of *regulated mortgage contracts* if it became aware that a *regulated mortgage contract* had become generally available offering an improved product feature, or a better interest rate, when compared with the *regulated mortgage contracts* currently in the *firm's* selection.

(3) A *firm* may provide an *independent service* by using 'panels'. A *firm* would need to ensure that any panel is sufficiently broad in its composition to enable the firm to make *personal recommendations* or give personalised information based on a comprehensive and fair analysis, is reviewed regularly, and that the use of the panel does not materially disadvantage any *customer*.

A better interest rate should not be the only factor to consider. A focus on overall costs would be more appropriate than simply considering just interest rates.

4.4 Initial disclosure requirements

Disclosure in all cases

4.4.1 R

(1) A *firm* must, on making contact with a *customer* when it expects to give a *personal recommendation* or personalised information on a *regulated mortgage contract*, it provide the *customer* with the following information:

- (a) whether it will provide an *independent service* or a *restricted service*. A *firm* must include the term "*independent service*" or "*restricted service*" or both, as relevant, in the disclosure;
- (c) whether the *firm* will provide a *personal recommendation* or personalised information.

(1A) If a *firm* expects to provide the *customer* with a *restricted service*, the initial disclosure information in (1) must also include:

- (a) an explanation about whether the service is limited to *regulated mortgage contracts* from a single *mortgage lender* or a limited number of *mortgage lenders*; and
- (b)
 - (i) where the service is limited to a single *mortgage lender*, an explanation about whether it is limited to certain *regulated mortgage contracts* from that *mortgage lender*; or
 - (ii) where the service is limited to a number of *mortgage lenders*, an explanation that the *customer* can request a copy of the list of *mortgage lenders* whose *regulated mortgage contracts* it offers and confirmation of whether the *firm* provides services in relation to all of the *regulated mortgage contracts* generally available from each *mortgage lender*.

(1B) If a *firm* expects to provide the *customer* with an *independent service*, the initial disclosure information in (1) must also include whether the *firm* will, as part of its services, consider *regulated mortgage contracts* that can only be obtained direct from a *mortgage lender* which is not the *firm*.

A more general term of ‘other products that may be available’ may be more applicable. This would allow firms to consider some but not all of the direct only products available in the market. It would also cover the issue of exclusives being available to some intermediaries but not to others.

4.4.6 R

(1) If a firm provides a restricted service it must maintain, and keep up to date, in a durable medium and in a form which is appropriate for distribution to the customer, a list of the mortgage lenders whose regulated mortgage contracts it offers. This list must also confirm whether or not the firm provides services in relation to all of the regulated mortgage contracts generally available from each mortgage lender.

(2) The customer must be provided with a copy of the information described in (1) on in a durable medium as soon as possible following the customer’s request and in any event no later than five business days thereafter.

We agree with the principle of keeping an up to date record but this could become more complex as the market grows and the number of lenders increase.

4.7 Sales standards

Giving a personal recommendation or personalised information

4.7.2 R

(1) Except as provided in (3), a *firm* must take reasonable steps to ensure that it does not give a *personal recommendation* or personalised information to a *customer* about, a *regulated mortgage contract* or the variation of an existing *regulated mortgage contract*, unless:

- (a) the *customer* **[appears to meet]** ~~meets~~ the lender’s **[published]** eligibility criteria in relation to affordability for the *regulated mortgage contract*; and
- (b) the *regulated mortgage contract* is appropriate to the needs and circumstances of the *customer*;

(2) Where the *firm* identifies that there is no *regulated mortgage contract* to which it has access which meets the requirements of (1), it must not make any *personal recommendation* or give any personalised information.

(3) A *firm* may provide a quick quote for a *regulated mortgage contract* in the course of the activities in (1) provided that, if the *customer* wishes to proceed beyond that initial quote, the *firm* carries out the assessment in (1) before proceeding beyond that stage.

Rather than a requirement to take reasonable steps, the rule should require that the firms would see no reason why the consumer would not be accepted by the lender.

Furthermore, 4.7.2R (1)(a) should be redrafted to read “the customer appears to meet the lender’s published eligibility criteria in relation to affordability for the regulated mortgage contract

In 4.7.2R (3) it would be helpful if FSA provided a clear definition of what it means by a ‘quick quote’.

Affordability criteria

4.7.6 R

For the purposes of complying with *MCOB* 4.7.2R(1)(a), a *firm* must give due regard to the following:

- (1) the *customer’s* income, personal expenditure, credit commitments and any other resources that the *customer* has available;
- (2) any known or reasonably foreseeable future change to the *customer’s* income, personal expenditure, credit commitments and other resources;
- (3) the costs that the *customer* will be required to meet once any discount period in relation to the *regulated mortgage contract* comes to an end; and
- (4) any reasonably foreseeable ~~interest rate~~ **[Product]** changes.

It is questionable how ‘foreseeable future change to the *customer’s* income, personal expenditure, credit commitments and other resources” and “foreseeable changes” could be applied in practice. If these rules are retained then they should be redrafted from “*any reasonably foreseeable interest rate changes*” to “*any reasonably foreseeable product changes*”.

The OFT considered this problem as part of its irresponsible lending guidance document. OFT stated that:

*“The Guidance makes clear that the OFT would regard ‘reasonably foreseeable’ in this context as a future event that may impact on the borrower’s ability to make repayments on a credit agreement in a sustainable manner which the borrower knows will occur and of which the creditor is, or should be, aware”.*¹¹

The customer’s needs and circumstances

4.7.8 R

For the purposes of complying with *MCOB* 4.7.2R(1)(b), a *firm* must give due regard to the following non-exhaustive list of factors:

- (1) whether the *customer’s* requirements appear to be within the *mortgage lender’s* expected eligibility criteria for the *regulated mortgage contract*;
- (2) whether the *customer* should have an *interest-only mortgage*, a *repayment mortgage*, or a combination of the two;
- (3) whether the *customer* has a preference for a particular term;

¹¹ OFT - Summary of responses to the consultation on 'Irresponsible Lending – OFT guidance for creditors' August 2010

http://www.of.gov.uk/shared_of/business_leaflets/general/OFT1107resp.pdf

- (4) whether the *customer* has a preference or need for stability in the amount of required payments, especially having regard to the potential impact on the *customer* of significant interest rate changes in the future;
- (5) whether the *customer* has a preference or need for payments to be reduced at the outset (for example, a loan with an initial discount rate period);
- (6) whether the *customer* intends to make early repayments;
- (7) whether the *customer* has a preference or need for any other features of a *regulated mortgage contract*;
- (8) where the term of the *regulated mortgage contract* will extend into the *customer*'s retirement, whether the *regulated mortgage contract* remains appropriate;
- (9) where the *customer* is looking to increase the borrowing secured on the property which is the subject of an existing *regulated mortgage contract*, whether it may be more appropriate for the *customer* to take a further advance with the existing lender rather than entering into a *regulated mortgage contract* with another lender; and
- (10) whether it is more appropriate for the *customer* to pay any fees or charges in relation to the *regulated mortgage contract* up front, rather than rolling them into the loan (see also *MCOB 5.5.19R*).

We do not believe that both 4.7.6R and 4.7.8R should be applied to enhance 4.7.2R. If 4.7.6R is to be applied then it should be amended in line with the suggestions above. Furthermore, we are unsure how 4.7.8R could be applied to a non-advised sale as the requirements within this rule will inherently lead to advice being given. 4.7.8R would be better applied as guidance rather than as a rule if it is to be applied practically to the mortgage market.

4.7.9 G

- (1) Examples of criteria in *MCOB 4.7.8 R* (1) are: the amount that the *mortgage lender* permits a *customer* to borrow; and whether the *mortgage lender* will lend in respect of properties of a non-standard construction.
- (2) An example of another feature in *MCOB 4.7.8R* (7) is a payment holiday.

4.7.10 R

Where a *firm* makes a *personal recommendation*, or provides personalised information, in relation to a *regulated mortgage contract* for a *customer* where a main purpose is to consolidate existing debts it must also take account of the following, where relevant, in assessing whether the *regulated mortgage contract* meets the conditions set out in *MCOB 4.7.2R*(1):

- (1) the costs associated with increasing the period over which a debt is to be repaid;
- (2) whether it is appropriate for the *customer* to secure a previously unsecured loan; and
- (3) where the *customer* is known to have payment difficulties, whether it would be more appropriate for the *customer* to negotiate an arrangement with his creditors than to take out or vary a *regulated mortgage contract*.

A definition of what is meant by 'main purpose' may be required. Without such clarity it is unclear whether advisers should base this assessment on the consumer's stated purpose or whether they are expected to make this assessment based on the percentage of the borrowing that is being used to consolidate debts.

Rejected recommendations

4.7.17 R If a *customer* has:

- (1) rejected all of the *personal recommendations* made by a *firm* to the *customer* of *regulated mortgage contracts* which the *firm* considers meet the requirements of *MCOB 4.7.2R(1)* and requested personalised information instead on one or more *regulated mortgage contracts*; and
- (2) been given new initial disclosure in accordance with *MCOB 4.4.1R* and, if applicable, *MCOB 4.4.4BR*; a *firm* may provide personalised information on those *regulated mortgage contracts* provided that they meet the requirements of *MCOB 4.7.2R(1)*.

There is already the concept of an insistent customer in the investment industry. There needs to be rules in place to allow for this type of consumer to be accommodated.

Record keeping

4.7.18 R

(1) A *firm* must make and retain a record of :

- (a) the *customer* information, including that relating to the *customer's* needs and circumstances and the *customer's* satisfaction of the lender's eligibility criteria in relation to affordability, that it has obtained for the purposes of *MCOB 4.7*;
- (b) each *regulated mortgage contract* in relation to which the *firm* has made a *personal recommendation* or given personalised information to the *customer*, that explains why the *firm* has concluded that each of them satisfies *MCOB 4.7.2R(1)*; and
- (c) any cases where the *firm* has given personalised information to the *customer* under *MCOB 4.7.17R* including the reasons why the *regulated mortgage contracts* which were the subject of the initial *personal recommendation* were rejected by the *customer* and, where applicable, details of the *regulated mortgage contract* the *customer* has proceeded with.

(2) The records in (1) must be retained for a minimum of three years from the date on which the *personal recommendation* or personalised information was given

The potential for both court and FOS action should lead to firms keeping their records for at least six years. FSA's rules and guidance should reflect these general timeframes.

AMI

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