



## **AMI response to DP07/1 “A Review of Retail Distribution”**

The Association of Mortgage Intermediaries (AMI) is the trade association representing intermediaries operating in the mortgage market, who advise on both regulated and non-regulated mortgage contracts and associated protection arrangements. Our members predominantly offer advice to clients, and make recommendations from a suite of protection products in discussion with the consumer. AMI represents brokers who are responsible for approximately 80% by volume and value of the intermediary channel, which itself is responsible for arranging around two-thirds of UK lending.

### **Overview**

The Retail Distribution Review (RDR) is a review of the retail investment market. We therefore acknowledge that there should be no direct impact on mortgage intermediaries. However, we do not share FSA's confidence that retail markets are so clearly segmented and we therefore submit this response highlighting our initial thinking, and the fundamental market differences, as a precursor to any unintended regulatory or industry creep.

58% of IFAs also conduct mortgage business. Adoption of RDR proposals by IFAs operating in the mortgage sector could result in two distinct regulatory and disclosure regimes, which would be highly undesirable for consumers. Providers could also adopt RDR proposals across all product groups, bypassing formal consultation for those in the mortgage market.

In line with standard FSA practice, we welcome regulatory intervention only when warranted by market failure and justified by a robust cost-benefit analysis. We expect solutions designed to address the specific issues relating to the mortgage market.

We are acutely aware of market advances, and note FSA's comments that the 'industry should lead changes'. As regularly verified<sup>1</sup> our market consistently demonstrates its innovative and market led approach to fulfilling consumer needs, and we continue to believe that a competitive, innovative market is best suited to achieving good consumer outcomes, without unnecessary regulatory intervention.

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<sup>1</sup> In particular the Miles Report of 2004 and the European Mortgage Green Paper 2005 both note the innovative mortgage market in the UK.

However, we do have concerns that in encouraging industry led change, FSA can inadvertently achieve regulatory read-across without due consultation, by the industry adopting inappropriate practices which FSA have evolved specifically for other sectors, such as retail investments. We recommend that FSA consider the implications of articulating such comments from an industry-led regulatory read-across perspective. Management and monitoring of this potential issue is something FSA should actively pursue.

## **Public Policy**

Over recent years, public appetite for debt has dramatically increased, and currently stands at over £1.3trn. Mortgage intermediaries play a vital role in the management of a substantial proportion of this debt through close client management, and any intervention that impairs effective mortgage intermediation could have the undesirable consequence of seriously damaging the UK economy and causing significant consumer detriment.

Previous regulatory interventions by FSA and preceding regulators have resulted in increased regulatory burdens for advisers, and we are now facing a forty-seven year-low savings ratio, and a notable protection gap<sup>2</sup>. We would therefore caution FSA to carefully monitor any fall out from the RDR.

On a wider level, AMI continues to welcome FSA's work on consumer capability. We feel that better educated consumers benefit the industry as a whole. We hope that Otto Thoresen's ongoing work on Generic Financial Advice (although we do not believe the word 'advice' is correct in this context) will help to address some of the educative issues for the generation that will not benefit from increased knowledge through the education system.

## **Market Conditions**

AMI is concerned that the RDR could have a destabilising effect on the mortgage industry. As highlighted above, the unintended and industry-led consequences of the RDR could impact on the mortgage market.

At present the mortgage market is reeling from the widely reported liquidity crisis which emanated in the US. The property market is still coming to terms with the introduction of HIPs, the full extent of the implementation remaining unclear. Consumers are also suffering from both the delayed effects of interest-rate rises, the increased margin that LIBOR is trading at above Bank Base Rate which is leading to increases in SVRs, and from the tightening criteria of lenders.

In this environment we are concerned that even the smallest unintended consequence could lead to further pressure on an already fragile market. We therefore urge FSA to monitor any potential read-across or fall out carefully, to mitigate the risk of market damage.

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<sup>2</sup> Swiss Re research

## **Europe**

Further to current conditions, the EU Mortgage White Paper was published on the 18<sup>th</sup> December. The document primarily addresses supply-side concerns but subsequently has potential to significantly alter some aspects of the UK mortgage market, for lenders, intermediaries and consumers. Clearly we would not welcome the RDR leading to change now which will only be superseded by Europe shortly afterwards. The cost of change to the industry, particularly given our reliance on complex technology, is substantial, and we would therefore urge consideration of European-wide issues when considering mortgage regulatory work over the coming months. This includes potential read-across of work in other sectors.

## **Adviser Segmentation**

In establishing the concept of tiered advice, we are concerned that foundations could be laid for the basis of subsequent market changes in other sectors, such as the mortgage industry.

We do not agree with the tiered approach currently outlined in the RDR. We do support the concept put forward by AIFA of a two-segment market of 'advice' and 'sales', as AMI continues to believe in the importance and value of advice. However, we believe the unique nature of mortgage intermediaries does not fit in the RDR's tiered investment stratification as proposed, and is further evidence of why RDR read-across would be undesirable.

When considering the mortgage market we are concerned that the basic market fundamentals are so different. Mortgage advisers enjoy a range of qualification options, but which do not yet extend beyond the level corresponding to Diploma, and certainly as yet not to the equivalent of Chartered. This again illustrates that mortgage advisers operate in a unique 'focused' specialised market, rather than merely as a subset of 'financial advice'.

Mortgage advice covers a significant spectrum of levels of advice, servicing many different consumer groups. We would therefore not wish to see mortgage advice pigeon-holed within one level of any stratification. Some advisers could consider their client relationships fitting better in a primary/general advice arena, whilst other firms may aspire to higher levels or desire the concept of an equivalent 'professional mortgage planner' status. This variation demonstrates that mortgage intermediaries would not fit comfortably in any regime based on a fundamentally different market.

We also have grave concerns relating to potential product regulation. The concept of 'simple advice' in the primary advice arena could lead to risk classification of various mortgage products – from one extreme of residential repayment mortgages to interest-only, self-certification or lifetime mortgages which could be deemed more complicated. It is important that consumers can access full advice on a range of potentially suitable products and we would strongly resist any future product differentiation.

We acknowledge FSA's desire for enhanced professional qualifications, and entirely agree with the concept of creating aspirational professional advice standards for those that desire them. The requirements for this could be wide ranging, from qualifications to membership of a professional body with codes of ethics, and should be rewarded with regulatory dividends relating to fees rather than capital.

We believe that professional bodies should lead the development of the 'Profession'. They would need to be more rigorous with their CPD requirements and tougher with their disciplinary processes. However, we feel that mandatory membership of a professional body would risk counter-productive outcomes. It would be extremely difficult legally to expel individuals from membership and disallow them to practice. Failure at individual level could also be the results of a firm's policy or business culture. A professional body would not be able to deal with systemic failure within a firm.

### **Remuneration**

Whilst we welcome efforts to improve the transparency of product and advice costs, we feel that the mortgage sector already benefits from a robust balance of product versus distribution fee transparency, in itself virtually a form of CAR. We also have prescriptive rules relating to offering a fee-only method of payment and independence.

Mortgage products do not incorporate commissions through complex product charges, with products transparently illustrating all costs, and APRs allowing consumers to make direct comparisons. We feel there is little scope to simplify costs further, with the costs of distribution (intermediary fees) already disclosed fully, and the various explicit costs of the mortgage lender discussed at length in the advice process as part of the 'fee versus rate' discussion, and highlighted in the KFI.

We therefore do not see any need any revisions to product pricing, and any change could cause significant and costly technical difficulties for providers/advisers. Variations of fees for any given mortgage rate could also vastly complicate any lender's offering, to the detriment of the consumer.

We would also raise concerns that there is the potential for a consumer to carry indemnity risk, in terms of early repayment of a mortgage, which isn't desirable but is a real concern.

### **Definition of Independent**

The prized title of independent is already prescriptively defined within MCOB, with requirements of both access to whole of market and the offer of fee-only payment for advice.

AIFA consumer research clearly indicates the significant importance of the

whole of market offering to consumers in the definition, and any move away from this would cause AMI great concern.

### **Statute of limitations**

AMI supports the introduction of a meaningful interpretation of a Statute of Limitations. Limitations legislation needs to be firmly embedded in FSA regulation, FOS and the FSCS, in line with common law. This is one area of the RDR where we would welcome further consultation with the mortgage industry, particularly in light of the changes in insurance contract law currently under consideration with the Law Society.

With mortgages being one of the few 'bought' financial products in the UK, we would welcome an open discussion on the responsibilities of consumers.

### **Prudential Requirements**

In conjunction with the RDR, FSA also released an issues paper on Prudential requirements (DP07/4). Whilst this document was again written for PIFs, we consider read-across as less likely due to the relatively prescriptive nature of the content and the lack of opportunity for the industry to advance changes without normal FSA consultation, and with European requirements of IMD and to a lesser extent MiFID.

Broadly, we feel that capital is not a behaviour driver for firms on the whole, and clearly in particular for appointed representatives. However, should FSA seek to reward with regulatory dividends AMI feel that a reduction in fees, against a published and measurable standard, would be a far more effective driver.