Association of
Mortgage Intermediaries

Association of Mortgage Intermediaries' response to CP 19/32: Building operational resilience: impact tolerances for important business services

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI) and the Association of Finance Brokers (AFB). AMI is the trade association representing over 80% of UK mortgage intermediaries. AFB sits within AMI and represents second charge (formerly secured loan) brokers.

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. AMI members also provide access to associated protection products. AFB members also provide access to unsecured products.

Our members are authorised and regulated by the Financial Conduct Authority (FCA) to carry out mortgage, insurance mediation and consumer credit activities. Firms range from sole traders through to national firms and networks, with thousands of advisers.

Introduction

Coronavirus has demonstrated the importance of operational resilience and tested firms' capabilities in some areas on an unprecedented scale. It is important for firms to recognise that the pandemic has tested primarily the resilience of people and does not necessarily reflect the nature and speed in which other scenarios could affect a business and subsequent business response. For example, coronavirus was a horizon risk for many weeks (and potentially months) ahead of Government lockdown; its effects have been felt universally; and Government support provided, or continues to provide, assistance to many financial services firms. The same parameters would not apply in other scenarios. For example, if an individual firm suffered a malware attack the response and approach would differ.

Nevertheless, as financial services firms continue to digitalise; there is a greater dependency on third party firms and their systems; and the development of Open Finance and APIs allow data to flow more freely between firms we understand the need for the FCA to put operational resilience into defined policy for the largest of firms. It also helps to generate discussion and engagement on the subject across firms of all sizes. The fact that this is a joint consultation paper issued by the FCA, PRA and BoE is significant, as it sends out a clear message to firms and wider stakeholders on the importance of this topic.

The Senior Managers and Certification Regime has brought a greater understanding and awareness of accountability, especially given the remit of SMF24 and allocation of operational resilience responsibilities. It is an opportune time for the FCA to consult on the topic. However, as a trade association that represents a range of firm sizes, we are mindful that finalised guidance needs to be proportionate. AMI's view is that, as proposed, defined policy is only required for the larger enhanced SM&CR firms, as existing rules and risk management requirements are adequate for smaller to medium firms. However, if the FCA at a later stage decided to extend the scope of the paper to include smaller-medium firms we ask that this is carefully considered with a thorough additional consultation period. This would need to include a comprehensive cost benefit analysis based on the implementation costs from these proposals.

Q1: Do you agree with our proposal for firms to identify their important business services? If not, please explain why.

We think it is sensible to allow firms to identify their important business services, as they are best placed to do so. By identifying important business services, it helps firms to understand their risk exposure in specific key parts of the business and shifts firms' corporate mindset towards customers and the effect of disruption to business services. Also, it should help to bring together areas of the business, encourage engagement between senior management and other layers of the business and help a firm to focus on its purpose.

We agree that important business services should be identified at least once a year and when there is material change to the business or environment in which they operate.

Q2: Do you agree with our proposed guidance on identifying important business services? Are there any other factors for firms to consider?

We appreciate the more refined definition of important business services provided in the consultation paper (CP) compared to the discussion paper (DP) and the guidance is useful. The inclusion of cases studies is helpful; however, we note that none of the case studies are relevant to networks. Many of the largest mortgage intermediary firms are networks and fall under the scope of this guidance. We appreciate that the FCA cannot provide case studies to cover every firm structure but if there is the opportunity to provide a wider range of case studies, one based on a firm that operates as a network would be welcomed.

There was more information provided on identifying important business services within the DP but not within the CP, for example the DP gave guidance that "smaller firms are likely to only have a few business services" and stated that "a small bank or building society might identify operating customer savings accounts and the provision of mortgages as its most important business services".

Some of our member firms have said they would appreciate more detailed guidance on how succinct the important business services should be. For example, one firm has identified its preliminary important business services as: mortgages, protection and dealing with complaints. However, they have not included ancillary services such as the finance team that make procuration fee payments to brokers. Instead, their approach has been to base the identification of important business services on the advice process and how these services tie into the consumer facing advice journey.

The nature of mortgage advice and the various stages in the customer journey mean that the likelihood of customer harm materialising is greater in areas such as between application and recommendation of a mortgage product but less so in the initial stages, where the customer could use the services of another broker. These 'pinch points' are where customer harm could occur. Again, we and our member firms would appreciate more steer from the FCA as to whether this type of proportionate approach is the intention of the proposed requirements.

In addition, we ask for clarification as to whether basing the identification of the advice process is consistent with the draft guidance or whether this should be broken down further into the stages of the advice journey e.g. for a mortgage intermediary this could include the fact find, recommendation, submission of an application or ensuring post offer completion.

Some of our member firms also feel they need more guidance from the FCA in terms of appointed representatives (ARs) and how they fit into the process of identifying important business services.

Our member firms recognise that identifying important business services is a key stage of operational resilience planning, with decisions on additional stages of planning based on this initial identification. It is therefore important that firms' interpretation of this stage of the guidance is correct and is why we request additional guidance and clarification from the FCA on this section. This will also allow AMI, as a trade association, to assist member firms.

Q3: Do you agree with our proposals for firms to set impact tolerances? If not, please explain why.

We agree that a firm should set impact tolerances and not a regulator. Again, this is because a firm is best placed to make this assessment and to review and amend where necessary. We agree that setting impact tolerances is important to shift thinking away from 'it won't happen' to acceptance that things do go wrong. Media coverage of high-profile disruptions (such as Travelex in December 2019) and the ongoing impact of coronavirus means that people are more aware of what can go wrong and coronavirus has shown the importance of a proactive, rather than reactive, approach in firms. We agree with the FCA's approach to focus on resilience outcomes, rather than a firm's ability to demonstrate compliance and this ensures consistency with the FCA's approach on outcomes-based regulation.

We agree that it is important for impact tolerances to be practical and for firms to ensure that they are not deliberately set at high levels so that firms will never breach them. It is important that senior management foster a culture where staff feel comfortable to speak freely and constructively and share ideas when setting impact tolerances as this will yield better results.

Q4: Do you agree that duration (time) should always be used as 1 of the metrics in setting impact tolerances? Are there any other metrics that should also be mandatory?

We agree that time should always be used as one of the metrics as it is a critical factor when trying to mitigate disruption, especially when dealing with outsourced and third-party services given that a supply chain exists. Firms' response to coronavirus and the shift to mass home working also demonstrates the importance of time, as businesses have had to react quickly to ensure continuity of supply of their services. For example, mortgage intermediary firms had to move staff quickly to mass home working and procure additional IT equipment to enable staff to carry out their job efficiently in a new environment.

However, when setting impact tolerances firms need to consider that the maximum tolerable duration may differ dependent on the scenario and in some instances a quicker response may be necessary. To illustrate, a cyber incidence may require a more rapid strategic response within the first hour of the materialisation of an attack. It is therefore important that firms consider this level of detail when setting impact tolerances and in scenario testing.

The joint FCA and PRA webinar on operational resilience (March 2020) provided useful information on risk appetite vs. risk tolerances. In section 5.9 of the CP it mentions how impact tolerances are different to risk appetite, but there was greater detail provided in the webinar and therefore this information should be shared by the FCA more widely. Due to the delay to this consultation, the FCA should run another webinar on operational resilience as AMI feels this would be beneficial to our members.

Q5: Do you agree with our proposal for dual-regulated firms to set up to 2 impact tolerances and solo-regulated firms to set 1 impact tolerance per important business service?

We agree and appreciate that firms who are dual-regulated need to look at their important business services through two different lenses. One impact tolerance per important business service for solo-regulated firms is sufficient.

Q6: Do you have any comments on our proposed transitional arrangements?

It is important that firms understand the task ahead as this will take commitment of both time and resources. We note that in the September update of the Regulatory Initiatives Grid it states that the FCA Operational Resilience Policy Statement is expected in Q1 2021, followed by 'at least a 12-month implementation period' but this has been the only communication in this regard since the consultation paper was issued It would be useful if this timeline could be communicated in an issue of the FCA's 'Regulation Roundup' email, for example.

We understand that firms will have at least 12 months from the publication of the final policy statement to: identify important business services; carry out mapping and scenario testing; and to consider how they will implement the requirements on communications, governance and self-assessment. We understand that the transitional period relates only to firms remaining within their impact tolerances. We feel that the timeframe for certain requirements (i.e. 12 months from policy statement until the rules are enforceable) should be made clearer in the final policy statement, as this 12-month period is not mentioned in the consultation paper.

We feel that the proposed transitional arrangement of "reasonably practicable" but no later than three years is sufficient for impact tolerances, as these proposals supplement existing rules and risk management requirements that firms already have in place. An arrangement over three years would, in our opinion, be unnecessary and excessive.

Q7: Do you agree with our proposed approach to mapping? If not, please explain why.

We agree with the proposed approach to mapping systems and processes within a firm. It is sensible that the FCA is proposing that firms can develop their own methodology, as ownership and control is important as well as flexibility and autonomy over how this is carried out. We appreciate the importance of including third parties and outsourcing within this process. Firms are likely to become increasingly more dependent on other firms (regulated or unregulated) in the future, especially as a result of the acceleration of technology usage due to coronavirus; fintech development; and the adoption of Open Finance.

We ask the FCA for clarification as to whether principal firms that have AR arrangements need to include AR firms in the mapping of resources or whether this applies only to the regulated entity.

We also ask for clarification that the mapping of third-parties and outsourced firms only relates to those firms where the regulated entity has a direct contractual agreement in place. Our members understand why regulated entities need to take responsibility when it comes to operational resilience. However, the concern is that in section 8.15 of the CP, it states that "firms should ensure that their risk management systems and controls adequately manage the risks associated with their outsourcing and third-party service providers, including…effectively applying the rules and guidance through the extended supply chain". If a regulated firm is responsible for applying the rules and guidance throughout the extended supply chain, then this is too onerous on the regulated entity as it would involve multiple firms that the regulated firm may not have relationships with/control over and may not even be aware of their existence and role in the supply chain.

Q8: Do you agree with our proposed approach to testing? If not, please explain why.

We agree that firms are best placed to determine the scenarios used for testing and the scenario factors and example case studies provided of how firms may carry out scenario testing are useful. However, it would be useful for the FCA to publish information on its expectations on how firms should include third parties/outsourcing/cloud systems within their testing i.e. what questions should they be asking these suppliers, what is best practice? This shouldn't be prescriptive but could be in a similar vein to the FCA's cyber insights document (March 2020) which provided suggestions on questions to ask third party suppliers.

Our opinion is that a 'lessons learned' exercise is important as it is vital that firms learn from both the negatives and positives gained through scenario testing and practical experiences and this information and insight will help with gap analysis and support meaningful changes to processes, systems and controls. Whilst coronavirus has mainly tested people and IT resilience in firms, there is useful knowledge that firms can take from the ongoing crisis and apply to other scenarios. It is still important to review the risks that may have emerged due to coronavirus, especially if new or ancillary technology has been adopted by firms e.g. the use of digital communication applications and cloud-based storage solutions.

In the joint FCA and PRA webinar on 13 March 2020, it was mentioned that it would be interesting to hear views on whether impact tolerances and scenario testing should be disclosed to clients as many clients are increasingly becoming interested in this information. Our view would be that, should this idea be considered further, this should be voluntary as we do not feel publishing this information necessarily encourages the correct behaviour and may not result in the desired consumer outcomes.

Q9: Do you agree with our proposals for communication plans? If not, please explain why.

We agree with the proposals as communication is vital to maintain continuity of supply of services. It is important that firms consider vulnerable customers as part of their communication plans, as the CP encourages firms to 'consider in advance of a disruption how they would provide important warnings or advice quickly…this includes where there is no direct line of communication' but firms need to be mindful that if they use communication channels such as social media (as an alternative if direct communication is unavailable), this could exclude some vulnerable customers (such as those with no access to the Internet or a lack of digital skills). Ofcom's digital exclusion analysis[1] shows that one in ten adults is digitally excluded, so it is important for firms to consider this when creating communication plans.

It is important that firms gather information about the cause, extent, and impact of operational disruption. The right culture in a firm can help ensure that employees feel comfortable speaking out over any near misses or operational disruptions. Therefore, the Board and senior management should focus on cultivating the right culture in a firm as culture and operational resilience are intrinsically linked. It is positive that the FCA's stocktake report into the SM&CR regime in banking talked about how implementation of the SM&CR had provided "a safe environment for staff to speak up[2]".

[1] http://www.broadbanduk.org/2020/06/02/ofcom-publishes-digital-exclusion-analysis/

[2] https://www.fca.org.uk/publications/multi-firm-reviews/senior-managers-and-certification-regime-banking-stocktake-report

Q10: Do you have any comments on our proposed requirement for a self-assessment document?

We feel that a self-assessment document is necessary, as it will help firms to focus their thinking and set out their strategy. We agree that boards should review and approve the self-assessment document regularly as this is crucial to ensure that operational resilience gains priority, is led from the top and embedded throughout the organisation. Also, we agree that there should not be a requirement to submit this periodically to the regulator but appreciate the need for firms to be able to provide this upon request. This, in our view, is an adequate level of supervision.

We appreciate the flexibility that the FCA is proposing to allow firms in this area. Proportionality is important and this approach allows a firm to dictate how this will be carried out and helps to avoid a 'tick-box' mentality.

Q11: Do you have any comments on the cost benefit analysis?

We are concerned about the one-off and ongoing costs that firms will face given the financial pressures faced by mortgage intermediaries (such as changes to FOS funding and increasing PII premiums and/or excesses) but appreciate that operational resilience needs direction and prioritisation by firms and, in the long term, can help them to make better strategic business decisions.

Some of our member firms have expressed that it has been hard to specify one-off and ongoing costs. The initial costs are likely to be 'business as usual' but I.T. costs are more difficult to quantify. This is because costs could escalate dependent on the outcome of mapping and scenario testing and therefore it is difficult for firms to quantify these costs.

We note that there are no mortgage intermediary firms featured in the list (Annex 2, section 14) of recent fines and operational disruption examples. The mortgage intermediary sector is resilient and in our view poses a lower risk of causing wide-reaching harm to consumers and market integrity, the viability of firms and causing instability in the financial system due to the advice nature of their work (compared to lenders and insurers as the product manufacturers and providers). However, AMI recognises and acknowledges that enhanced scope SM&CR mortgage intermediary firms are by no means immune from operational disruptions and recognise the importance of the FCA's proposals.

Whilst not included within the scope of this CP, AMI is aware of comments made by the FCA, PRA and BoE in a Treasury Select Committee report[3] which addressed the Committee's recommendation to increase financial sector levies. This specifically related to an operational resilience levy and in the response by FCA, PRA and BoE it stated that "we will keep the possibility of raising the levy in the future under review". AMI is not supportive of any further levies being imposed on mortgage intermediary firms and the FCA's comment in the CBA that "we do not consider that our proposed approach will result in any significant increase in costs for the FCA" indicates that a future operational levy will not be necessary.

Q12: Do you have any comments on the examples of existing legislation?

No comment.

[3] https://publications.parliament.uk/pa/cm5801/cmselect/cmtreasy/114/11402.htm