Association of Mortgage Intermediaries

Association of Mortgage Intermediaries' response to FCA CP20/6: Regulated Fees and Levies: rates proposals 2020/21

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.

Response

Current context

AMI appreciates the FCA taking action to freeze minimum fee levels in light of the Covid-19 pandemic in order to help alleviate the pressure on small firms, as well as the measures taken to extend the payment terms for small and medium sized firms. However, we question whether this is enough to support firms through this crisis and ask the regulator to consider taking steps to reduce fees or extend payment terms for all firms to help alleviate temporary financial distress caused by Covid-19.

Since the start of the pandemic, the UK Government, the Bank of England, HM Treasury and HMRC have introduced a raft of changes and support packages to support firms of all sizes, large and small, the employed and the self-employed. The FCA has not taken the same approach. Its budgetary figures were approved by FCA Board on the 27 February, at a time when, though the disease was known to be a potential threat, the scale of devastation, or even whether it would affect the UK, was unknown. However, by the time the FCA's fee proposals were published on the 7 April the UK was in lockdown. The proposals had been amended to freeze minimum fees and to extend the payment terms for small and medium firms with a total regulated fees bill of less than £10,000. Yet the budgetary requirements were left unchanged with no latitude included on payment deadlines for large firms; instead their fees are to be increased to compensate for the fee freeze of the smallest.

Approximately half of intermediary firms are not directly authorised by the FCA, instead acting as appointed representatives (ARs) of another regulated firm. These ARs vary in size, but many are small firms that the FCA stated it intended to "protect […] from the burden of regulatory fees". The FCA has neglected to consider the make-up of the mortgage intermediary market. A network, an aggregator of intermediary firms, is viewed by the regulator for fees purposes as a large firm and has therefore seen no concessions from the regulator with regards to fees. Large firms' fees have increased and they have been given no leeway on payment dates. AR firms pay for these fees as part of their network membership fees and so small AR firms will continue to be penalised by the increased FCA fees.

AMI strongly believes that the FCA needs to act to support all firms within the mortgage intermediary sector. Whether a firm is large or small, directly authorised or an appointed representative, the impact of this crisis is relative for all. Whilst a larger firm may have a significant turnover, it has far larger overheads and a responsibility to a greater number of employees who are just as at risk during this situation as employees of smaller firms. In some respects, the agility of smaller firms works to their advantage as their processes, systems and controls will be easier converted to a working from home scenario than a larger firm, which may be reliant on call centre staff and segmented working practices.

The UK lockdown on the 23 March had a devastating effect on the UK's housing and mortgage market upon which mortgage intermediary firms rely. The new homes and sales pipeline evaporated resulting in income largely stopping immediately as the market ground to a halt. Surveyors were grounded so no physical valuations have taken place leaving the industry reliant on automated valuation models (AVMs) which have lower acceptable loan to value ceilings for lenders. Many lenders stopped lending on new build and their staffing resource has been needed to implement the payment holidays. The purchase market dropped to 20% of pre-crisis levels, ESIS levels by nearly 47%[1] and the market went from a predominantly purchase market (44% remortgage at the end of March) to a remortgage market (currently 70% remortgage). The mortgage market is a transactional market, intermediaries do not have income from back books to fall back on and are now reliant on the lower earning remortgage and product transfer business which will not sustain their firms.

Mortgage intermediaries and consumer credit firms are the vulnerable firms of this crisis. Whilst all financial services firms have struggled, for many this has been due to operational issues: the challenge of the business having to work from home and implementing the government's business and consumer support measures. For our firms, income levels largely ceased. Many building sites and estate agencies closed. Large broker firms have furloughed their advisers and are working on skeleton staff to try and stretch cash reserves for long term survival. The return to work will be slow. The current expectation is that we will not return to full market until September at the earliest and even then, it will be a new normal, potentially with social distancing measures still a requirement.

The difficulties faced by mortgage intermediary firms have been exacerbated by current FCA prudential requirements. Whilst the government funded schemes to support businesses whose cashflow has been damaged by the pandemic are available, intermediary firms' abilities to take advantage of these are hampered as the capital resourcing requirements, laid out in MIPRU, mean that any loans taken need to be included in capital requirement calculations. AMI has asked the FCA to consider a temporary exemption from these calculations for loans taken out to mitigate turnover deferral caused by Covid-19 but, as yet, has received no response.

Whilst firms have been stripping back costs and furloughing staff in an effort to survive, there seems to be no indication from the FCA that it is stripping back costs in order to run an efficient organisation with the minimum staff needed to offer basic support, supervision, enforcement and authorisation, to help reduce the financial burden on firms. It seems that we are not all in this together – in fact whilst firms are wondering whether they will be able to pay their staff, their regulatory fees and survive, the FCA

[1] Product numbers rise by 5.9%: Mortgage Brain, Leah Millner, Mortgage Strategy, 29th April 2020

has launched its advertising for next year's apprenticeship programme proving itself fundamentally culturally adrift from the firms it regulates.

The FCA has prioritised its plans for the next one to three years, documented in its recently published business plan, above the need of the firms that it regulates. We were concerned to read in the minutes of the FCA Board meeting of the 26 March that, when considering a range of mitigations to ease the financial burden on firms, "The balance between easing this burden and ensuring the FCA could deliver its business plan and meet its financial commitments was also considered." That the FCA felt it appropriate to prioritise funding for a business plan that was designed before the crisis hit and is largely now on hold and potentially out of date, over additional support for firms is disappointing.

Historical perspective

In our response to CP 16/9, we set out a range of arguments against the fee proposals in that year. These are repeated below. The sentiment applies as much to this consultation as then. The FCA appears to be following its own agenda without appropriate recognition of the operational limitations within the mortgage and related market.

In 2009 when the bill for regulating intermediaries ticked over £10m most saw this more than doubling in costs since FSA acquired responsibility from the MCCB in 2004 as a milestone. This was nothing compared to the 32% hike in 2010 to fund the work to be undertaken in the Mortgage Market Review. Despite the pain, the industry swallowed hard, paid the fees and worked with the regulator to implement the agreed plans and build better, more compliant firms with significant compliance and risk support that did not exist pre-crisis. Verbally it was inferred by FSA that some of these costs were one-off and project based and would recede once MMR was implemented.

Inflationary increases prevailed until 2015, when we received another significant, inflation busting, increase in costs ascribed to the Mortgage Credit Directive (the FCA seems to forget it used this as the reason for last year's disproportionate increases as well as this) together with a need to build a new shiny competition vehicle within the FCA. It appears the Competition and Markets Authority and their approach is not enough – financial services needs its own special breed of competition economists and lawyers to pick over what remains of the advice industry following all the improvements ushered in by RDR and MMR.

The last two rounds of FCA fees reviews has introduced a further 16% increase in fees on mortgage advisers, for what is the same industry we have always had. A fee block charged £10.9m in 2009, then £15.7m in 2015 will be charged £18.2m in 2016. In this time direct supervision of mortgage advice firms has evaporated so we have no direct access to advice and help. A call centre that routinely provides contradictory or incorrect responses is unhelpful.

The mortgage industry pays £36.8m (A2 and A18 classes) which is 7% of the total AFR. With an estimated total of 3,000 FCA staff this infers that there are 210 FTE individuals working on the mortgage market on a daily basis. The other way of analysing this is to look at how a commercial firm would look at the £36.8m budget and say that 50% of most firms' costs are staff related. This gives a total of £18.4m and as a fully absorbed average cost might be £100k per individual, then there would be 185 FTE engaged in the mortgage sector. We know that this is not the case therefore we ask for a full justification for the amount being levied on the sector.

In addition firms are carrying the yoke of a regulator that has significantly failed to police effectively, meaning the costs being levied through the FSCS continue to escalate. The recent National Audit

Office report set out the need for better accountability and co-ordination. It cannot be right that the FCA is allowed to add cost to firms without any accountability for its own failings.

We are concerned that much of these continuing high costs are to fund a competition study in the mortgage market which has little foundation. Most of the issues raised in the recent report could be addressed via business as usual policy, thematic and supervision work. This is a market which following MMR is open, competitive, with a rich variety of products and providers and has the consumer enjoying interest rates that are without precedent. The costs and benefits associated with this work, which are not estimated or addressed in the feedback statement, need to be explained to maintain the FCA transparency principles.

Firms have the millstone of risk and costs around their neck with a regulator that thinks they have an open cheque book.

Looking forward

The business models of many organisations in the home buying process mean that they do not receive income until a significant time, typically three to six months, after work is undertaken. This model is in place to protect consumers and ensure that businesses carry the risk rather than those moving house. The recovery of the sector will consequently be delayed until businesses have re-built income, and whilst firms are currently taking every step possible to protect jobs, there will be a gap between the market re-opening and income levels reviving. Without this gap being bridged, skilled employees across our sector are likely to be made redundant with vital capacity lost, impacting current transactions and our long-term ability to enable vital home moves.

This crisis has had a significant impact on the number of moves forecast to take place across the remainder of this year. Industry estimates suggest the number of total transactions could be lower than the year of the financial crisis, as even essential moves are delayed or cancelled. Instead of pausing moves, people are pulling out of transactions altogether, with evidence showing the fall-through rate in late March was 60% higher than in the weeks before.

Intermediary firms that weather this crisis will not return to business as usual. There are predictions of a 35% drop in new homes delivered this year. It will take time to rebuild these chains and for people who have exchanged to be able to move. Many housing transactions are dependent upon others in the chain. If one person pulls out, perhaps because their income has been affected during the crisis, the whole chain could collapse and it will take a minimum of three months to rebuild. We are currently seeing offers being pulled and applications being rejected due to consumers' incomes having changed or furloughed during this crisis and expect to see the knock-on effect of this continue for some time to come.

AMI is concerned that the current crisis will see a large number of firms exit from the mortgage intermediary sector. Some commentators have predicted a 50% drop in distribution capacity between now and Q3 2020 which would have a grave effect on the industry going forwards. We are emerging in a different world where consumers are more vulnerable and with higher amounts of unsecured debt. People will need good quality advice to help them to understand the best product available, under their potentially changed personal circumstances, to meet their requirements and lenders will be reliant on intermediaries as a distribution channel as restart, with social distancing, will likely be immensely complicated for them.

The FCA should look to reduce operational costs where possible rather than continuing along the path that was deemed appropriate pre-crisis. We are concerned that this fee proposal neither reduces FCA's current expenditure nor suggests an intention to reduce spending next year in view of the likely reduced turnover of and indeed likely reduced number of regulated firms. Essential costs including authorisation, supervision and enforcement must be prioritised over strategy and competition agendas until there is a clear view of the post-lockdown landscape. We are surprised that it was felt prudent to include a £30m cost over three years, £10m this year, for a transformation plan in these proposals with scant information and no cost benefit analysis. As an open and transparent regulator we would expect the work and costs to be clearly scoped, justified and shared with all regulatory fee payers as a minimum, and in light of the current circumstances, recognition that the work should only go ahead if it would save money in the long run and if the costs were tightly controlled.

Over the last two years we have observed the focus on strategy and competition becoming ever more prevalent at the regulator. In the years 2017-2019 the average number staff has increased by a substantial 29.8% in strategy and competition, whilst supervision staff have increased by 5.1% and enforcement and market oversight staff by just 3.4%. These changes in the regulator's priorities have manifested in the number of complaints about the regulator. In 2019 complaints rose by over 50% on the previous year with the main driver being complaints relating to FCA's supervisory role: failure to act on information and failure to spot a problem. Earlier this year, the Complaints Commissioner wrote to the FCA Board to express his serious concerns about delays in the FCA's complaint handling process branding the whole situation "wholly unsatisfactory"[2]. Enforcement cases are taking two to three years for settled cases and up to five years for cases going to tribunal which is too long a delay to be able to extract important lessons.

The change in focus has coincided with a marked increase in fees for firms from both the Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS). The FCA is the gatekeeper to these consumer protection schemes and the important work undertaken by supervision and enforcement is able to directly reduce the consumer compensation costs funded by good firms. The proposed change to the FOS funding model, increasing the proportion of the budget funded by a general levy, will increase the fees paid by the good firms, many of which have never used the service. AMI is firmly against this move away from the polluter pays model towards a more generalist approach which increases the fees cost for all. On the assumption that it will be spread across firms equally it will equate to a large increase in regulatory fees, planned for next year when firms will still be recovering from the effects of current crisis.

Given the annual costs of compensation now dwarf the costs of operating the FCA this must call into question the effectiveness of the authorisation and supervision processes historically applied by the FCA. The FCA must work harder in this area, in conjunction with both the FSCS and FOS, to root out and close down more efficiently, those causing detriment to consumers. We would welcome commitment from the FCA to further develop their use of "market intelligence", in the widest sense, in their authorisation process and in prioritising supervisory activity. The FCA Board needs to demonstrate the same level of commitment and oversight to "prevent" as we have seen from the FSCS Board.

The questions asked in this consultation indicate the remoteness of the consultation from the issues facing the advice sector. We have little to say in response to the areas the FCA feels it wants to know opinion. We hope that our significant concerns are recognised in the response and PS and in feedback to the FCA Board.

[2] As detailed in the final report to complaint number FCA00590

Questions

Q1: Do you have any comments on the proposed FCA 2020/21 minimum fees and variable periodic fee rates for authorised firms?

Whilst we agree with the FCA's decision to protect small firms and not increase minimum fees, we feel that the changes to the proposed fees in light of the Covid-19 pandemic should have been greater and further reaching:

- the budget should have been revised between original FCA Board approval and publication in light of the Covid-19 crisis;
- the FCA should have followed the lead of Government and introduced changes to support firms of all sizes;
- larger firms should not be charged more to allow FCA to freeze minimum fees;
- the proposed changes have not protected small AR firms from fee increases;
- when apportioning fees, there should have been consideration that some areas of financial service would be more directly and immediately impacted than others and this should have been factored into the proposals – mortgage intermediaries and consumer credit firms are particularly vulnerable due to the nature of their business models;
- intermediary firms have been badly hit in the crisis due to the transactional nature of their income and the reliance on the housing market. Some will not survive and those that do will see a greatly reduced turnover next year;
- capital resource requirements for intermediary firms mean that they are not able to benefit from government loans intended to support them throughout this pandemic;
- FCA must not continue with business as usual and must look to reduce operational costs. A business plan written pre-crisis that is now unachieveable should not be used to dictate fees;
- the proposed transformation programme must be clearly scoped and costed in order to continue and should only be approved if there are proven cost savings;
- FCA needs to prioritise focus away from strategy and competition and back onto supervision, oversight and enforcement to reduce complaints, increase learning and reduce compensation costs;
- AMI is firmly against the FOS proposals to increase the proportion of its budget paid by general levy which increases the fees cost for all, including firms that have no complaints against them. On the assumption that it will be spread across firms equally it will equate to a large increase in regulatory fees, planned for next year when firms will still be recovering from the effects of current crisis;
- AMI feels that mortgage intermediaries will be vital in the new world where consumers are more vulnerable and with higher amounts of unsecured debt. People will need good quality advice to help them to understand the best product available, under their potentially changed circumstances, to meet their needs. As with the trapped borrower cohort, advice will be key;
- the mortgage intermediary sector needs support from the regulator to ensure that firms will survive this crisis both in the short-term, but also into next year when cash-flow levels may not have fully recovered and the a lack of reduction in fees for the sector could cause a second swathe of firm failures.

Q2: Do you have any comments on the proposed FCA 2020/21 minimum fees and periodic fee rates for fee payers other than authorised firms?

No comment.

Q3: Do you agree with our proposal to undertake the consumer harm campaign and our proposed basis of recovering the 2020/21 costs from fee-payers? Please include the reasons for your views in the feedback you provide.

Whilst we agree with the importance of running a consumer harm campaign and would generally wish to support such an initiative, we question whether the regulator is the appropriate body to undertake this campaign? Whilst it fits in with the FCA's strategic objective to protect consumers, the FCA is not a consumer facing body; such a campaign would better sit with the Money and Pensions Service (MaPS) fitting neatly into its financial capability strategy.

We also question whether, under the current circumstances, with many in the UK furloughed and accumulating unsecured debt, it is an appropriate time to be running a campaign about investments. The messages will likely become lost or confused alongside messages from other financial campaigns such as Take 5 which is gaining prominence.

Any initiative to enhance the integrity of the financial system and protect consumers from harm is welcomed by AMI. However, if this campaign is purely focussed on helping consumers make better-informed investment decisions, targeting consumers investing in high risk, high return, illiquid investments then we do not agree that the cost should be spread across all fee blocks. Our members will, in the future, be paying an increased amount towards complaints in which they have no involvement nor culpability if the FOS proposals to increase the general levy are borne out. As an industry with relatively low levels of complaints and levels of consumer harm, we do not wish to subsidise other, less well-behaved sectors.

This campaign needs to be fully scoped and costed. A proposal for a 5-year campaign which has not been fully scoped, researched and for which only scant detail is given is not an appropriate use of regulatory budgets and it will not allow for the effectiveness of the campaign to be monitored and reported.

Q4: Do you have any comments on the factors we should take into account in our review of authorisation application fees, including inflation?

We agree with the outlined review of authorisation application fees and the potential proposal to increase fees in line with inflation. We would like the review of fees to delve deeper into the authorisations process. We have noted substantial degradation of service levels and turnaround times for the authorisations department over recent years. It now takes up to four months for a "straightforward" applicant to be allocated a case handler. We understand that the authorisations team has been contacting firms to ascertain whether they wish to continue with their application in an attempt to reduce the backlog.

We are cognisant, with the cessation of the purchase activity, that we may see a decline in the number of intermediary firms. In that event, advisers may need to move to another regulated entity to continue to service consumer needs we would like this to be enabled with minimum delay.

Q5: Do you have any comments on the proposed income tariff data reporting requirements for MTFs and OTFs. Do you have any comments on our proposed modification to the guidance on exclusions from reported annual income by RIEs, MTFs and OTFs?

No comment.

Q6: Do you have any comments on the proposed increase to Part VII insurance business transfer application fees?

No comment.

Q7: Do you have any comments on our proposed charges for exempted documents submitted under the Prospectus Regulations for prior FCA approval?

No comment.

Q8: Do you have any comments on the proposed method of calculating the tariff rates for firms in each fee-block towards the CJ levy and our proposals for how the overall CJ levy should be apportioned?

No comment.

Q9: Do you have any comments on the 2020/21 rates for the proposed MaPS money guidance levy?

We support this proposal.

Q10: Do you have any comments on the proposed 2020/21 rates for the MaPS debt advice levy?

No comment.

Q11: Do you have any comments on the proposed 2020/21 rates for the MaPS pensions guidance levy?

No comment.

Q12: Do you have any comments on the proposed 2020/21 rates for the Devolved Authorities' debt advice levy?

No comment.

Q13: Do you have any comments on the proposed 2020/21 illegal money lending (IML) levy rates?

No comment.