Association of
AMI
Mortgage Intermediaries

The Value of Mortgage Advice

Association of Mortgage Intermediaries

Table of contents

1. Introduction

1.1. The UK mortgage market is one of the most diverse and sophisticated lending environments in the world. Key drivers for this include:

1.1.1. levels of homeownership at levels far in excess of other developed markets;

1.1.2. changing labour markets and the ever-increasing complexity of incomes;

1.1.3. a high level of interest in property as an investment vehicle in its own right.

1.2. The diversity within the UK population leads to many borrowers not satisfying the standard lending model used by traditional lenders. Increasingly this obstacle has been overcome by new entrants and new propositions from existing lenders.

1.3. The past decade has seen an unprecedented increase in both the number of active lenders and the range of products available to borrowers; within the UK mortgage market there are currently over 150 lenders offering in excess of 20,000 mortgage products, sold through multiple distribution channels.

1.4. This combination of increased choice and complexity has in turn fuelled the growth of an intermediary channel which now accounts for around 6 in 10 of all mortgages placed.

1.5. This paper seeks to understand and, where possible, to quantify the value of advice delivered through the intermediary channel.

1.6. Over the period January to March 2008, NMG Financial Services Consulting carried out both primary and secondary research into the value that the intermediary channel delivers to its consumer.

2. Distribution within the UK mortgage market

2.1. Consumers wishing to arrange a mortgage can select between obtaining one direct from a lending institution or via a mortgage intermediary.

2.2. Traditionally, the direct market has been dominated by high street brands though there is some evidence of new entrants such as the Post Office, also in the high street, and ING, via the internet. However, with over 70% of all direct to consumer lending taking place within bank branches, the high street appears likely to dominate this channel for some time.

2.3. Mortgage sales may be conducted on an advised or non-advised basis. Advised sales are defined by the Financial Services Authority (FSA) as those where an adviser of a regulated firm gives a personal recommendation to the customer after assessing the customer's needs and circumstances. The distribution of sales between channel and advice categories is:

Intermediary sales [2]

- 2.1m intermediary sales between April 06 and September 07
- 61% of all mortgage sales
- 92% of all intermediary sales were advised

Direct sales [3]

- 1.4 m direct sales between April 06 and September 07
- 39% of all mortgage sales
- 40% of all direct sales were advised

3. Background to the intermediary market

3.1. Following an initial finding of the Burns Committee in 1999, a recommendation was made for mortgage advice to fall within the remit of the FSA.

3.2. In December 2001, it was formally announced that the FSA would become responsible for the regulation of mortgage sales with implementation of the new regulatory regime taking place in November 2004.

3.3. Anyone selling a mortgage now has to be either directly regulated by the FSA or be an appointed representative of a regulated firm (principal).

3.4. Within the intermediary channel there are currently over 11,500 registered intermediary firms, with an estimated 40,000 advisers.

3.5. Currently there is circa a 50/50 split between directly authorised brokers and appointed representatives, with over 50 networks acting as their principals.

3.6. Advisers operating within the intermediary market are able to select products from a range of lenders and are not restricted to the products of one provider, as is the case for direct mortgage arrangers.

3.7. A recent survey has identified that over 96% of mortgage advisers provide whole-of-market advice and the benefits of this choice are examined later in this report.[3]

4. The value of advice – overview

4.1. Consumers purchasing a product via the intermediary channel are more than twice as likely to have received advice as those purchasing on a direct basis.[3]

4.2. There is early evidence here that the intermediary channel is delivering a higher level of value to its consumers than is the case for the direct channel.

4.3. In attempting to understand the value of advice, consideration was given to:

- **suitability** – whether a consumer who receives advice from an intermediary is more or less likely to have a mortgage best suited to their needs;
- **cost** – the extent to which consumers who purchase via the intermediary channel pay more or less than those who go direct to a lender;
- **service** – evidence of demonstrable service-related benefits that come from purchasing via the intermediary channel.

5. Suitability

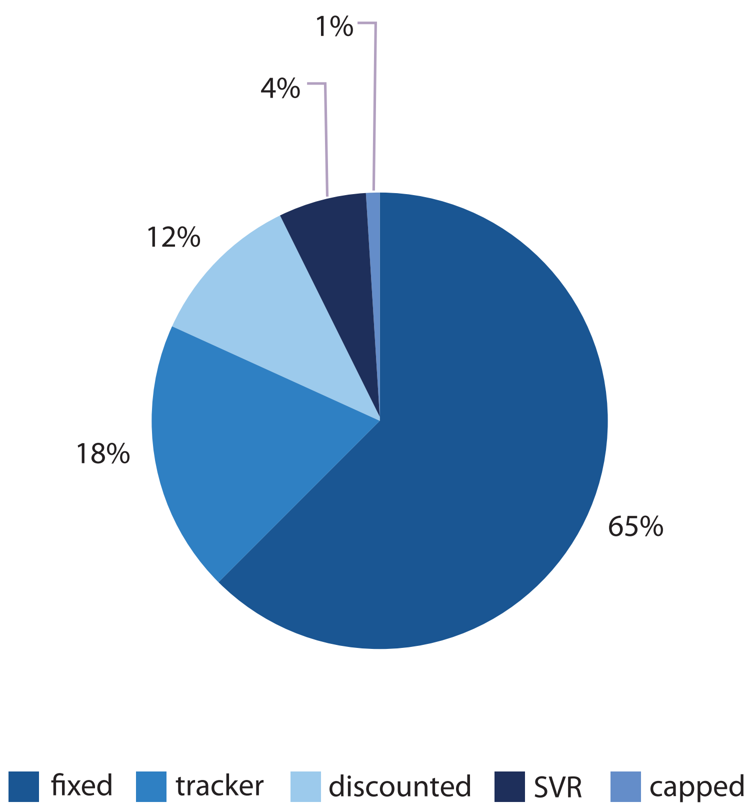
5.1. On the question of suitability this report considers:

- the extent to which a 'standard' borrower will be placed with the most appropriate product;
- the ability to secure an appropriate mortgage for a consumer who would otherwise be unable to secure mortgage finance.

5.2. This section first considers the question of 'standard' borrowers. Analysis of average mortgage interest rates (as compiled by the Bank of England) between April 2006 and March 2007 shows that the average fixed interest rate was 5.51%, compared to an average rate of 6.69% for a Standard Variable Rate (SVR) product.[4]

5.3. Given this difference in rates it is unsurprising that fixed-rates have proved to be the most popular choice of mortgage, followed by tracker and discounted rates. SVR products were relatively unpopular making up just 4% of sales.[3]

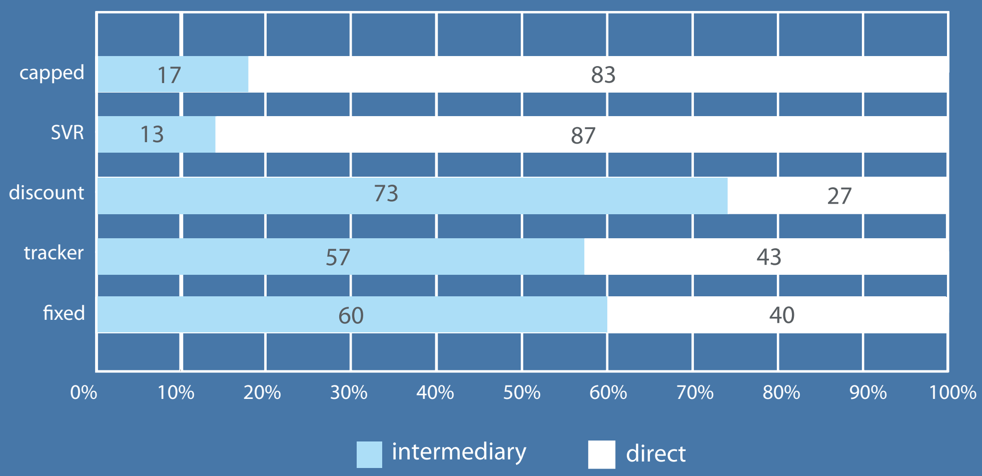
Mortgage sales by rate type



5.4. If products are being selected on a most-suitable basis, it might be assumed that the distribution of products would be consistent across channel.

However, analysis of interest rate types and sales channels, over the same time period shows that a majority of fixed-rate, discounted rate and tracker rate products were sold by intermediaries, yet conversely the majority of SVR and capped rate products were sold via the direct channel.

Rate split by channel



Source: FSA PSD Data[2]

5.5. Whilst there are occasions when the SVR route provides the most suitable product for a consumer, in a significant majority of cases it is probable that an alternative product would offer a better solution. (At the time of compiling this report)

5.6. The second area considered under suitability is the ability to secure an appropriate mortgage product for individuals who might otherwise be unable to obtain one.

5.7. With most high street lenders and hence direct sales channels operating solely within the more traditional prime market, a majority of non-conforming clients' needs are only met by the intermediary market.

5.8. In 2007, the non-conforming sector accounted for 30% of the UK mortgage market, providing options for those who do not meet the requirements of a majority of products sold directly. This group includes the self-employed (c.13% of the UK workforce)[5], those who have income from a range of sources, or those who have experienced financial difficulties.

5.9. Reasons for historical financial problems are often beyond the control of the borrower and may include ill health, previous employment issues or separation from a partner.

5.10. The extent to which this sector of the market is growing in importance can be seen by research carried out by Birmingham Midshires that identified that 63% of people claimed not to fit the average family profile, as preferred by direct lenders.[6]

5.11. For those who experienced financial difficulties, it is often only the intermediary sector that can help. During the period 1st April 2006 to 31st September 2007, 83% of borrowers who had suffered financial difficulties were assisted by mortgage intermediaries, with 9 in 10 receiving advice on their mortgage.[3]

5.12. In a recent survey nearly 40% of brokers questioned stated that more than 1 in 10 of their clients had been declined a mortgage having approached a mortgage lender direct. Over three-quarters of respondents reported that they were able to place a majority of these clients. Conversely, less than 3% of brokers were unable to place any of those clients who had previously been declined.[7]

5.13. In these scenarios the role of the adviser goes beyond simply fulfilling the mortgage requirement. A recent YouGov survey showed that 61% of homemovers who went to an adviser and were told that the mortgage they wanted was too expensive for them would take the advice of their adviser and look for a cheaper property.[8] Hence mortgage advisers have a vital preventative role to play in ensuring clients do not over-commit when seeking mortgage finance.

6. Cost

6.1. Obtaining the most competitively priced mortgage is determined by two key drivers:

- selecting the most appropriate product for the borrower's circumstance, (this has been addressed previously in Section 5);

- and obtaining the most favourable 'price' (rate, fees, penalties) for the chosen mortgage.

6.2. In seeking to obtain the most favourable price, the customer has two main choices:

- arrange their mortgage on a direct basis and carry out their own research i.e. 'shop around';

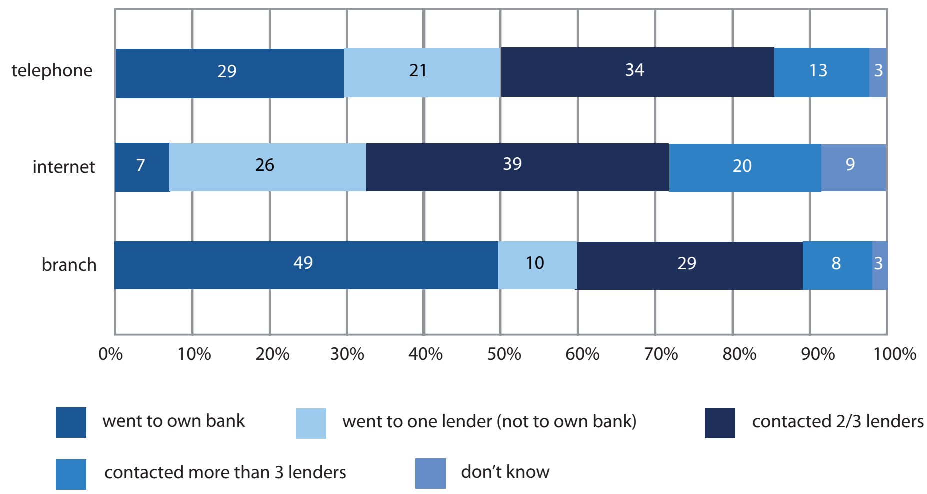
- make use of the services of an adviser who will seek out the best deal for the customer's circumstances.

6.3. Whilst data for the impact of the 'shopping around' effect on mortgages are not available, the recently published *Thoresen Review* has undertaken a significant body of work in this area in conjunction with the provision of generic advice. This suggests that there is considerable financial benefit to consumers in shopping around.

6.4. Yet recent research suggests that consumers have a low propensity to seek out the best terms available or to shop around when arranging a mortgage.

6.5. Forty-nine percent of consumers who purchased a mortgage on a direct basis did so from their own bank/building society without considering any other option.[8] A further 39% contacted no more than three lenders.[8] These behaviour patterns significantly reduce the likelihood of finding the most competitive mortgage for the individual's own circumstances.

Lenders contacted



Source: YouGov Research[8]

6.6. A key role for the mortgage intermediary is to shop around on behalf of their customer.

6.7. There are currently over 20,000[9] mortgage products available to the UK borrower. However, a many of these are not available directly from the lender.

6.8. Cost of distribution, marketing costs and choices over strategic distribution result in many lenders electing to make a large number of their products available solely through the intermediary channel, with many purely operating an intermediary-only distribution strategy.

6.9. Within the intermediary market, mortgage advisers have access to in excess of 19,000 products[10] and with over 96% of advisers offering a whole-of-market approach[11] this equips them to meet most clients' requirements.

6.10. Conversely, the total number of mortgage products available directly from lenders is estimated to be in the region of 1,300,[12] with a typical bank adviser having access to no more than 20 products.

6.11. The table over-leaf identifies current product numbers for some prominent high street brands.

High street lender	Number of products available*
Abbey	17
C&G (Lloyds TSB)	19
Nationwide	8 (excludes buy-to-let products)
Halifax	15

*as of 21st February 2008

6.12. Intermediaries will make use of a mortgage-sourcing system to sift through the large number of available products. A sophisticated database allows advisers to specify clients' exact requirements and, through their knowledge of the market, identify the most suitable and most price-competitive products for the client.

6.13. Even though sourcing (comparison) systems are available to clients over the internet, they will not provide the scope of product choice of the professional systems.

6.14. Evidence shows that online systems are predominantly used as an initial research tool, as identified within research carried out for the FSA: 'The internet will remain primarily a source of information rather than a transaction medium and consumers will show no increased propensity towards direct purchase [from the internet].'[13]

6.15. In order to understand the potential cost of going direct to a lender(s) and failing to shop around, an analysis was undertaken of ten specimen lending scenarios.

6.16. The scenarios covered remortgage and purchase borrowers as well as first-time buyers. Both employed and self-employed borrowers were also examined and other variations included those requiring high loan to values.

6.17. For each lending scenario, comparisons were made between the rates achieved from four prominent high street lenders and those available to the intermediary market.

6.18. The high street lenders chosen were a fair representation of those with nationwide coverage and a large number of branches.[14]

6.19. In all but one of the ten scenarios a more competitive rate was available via an adviser than through the four main high street brands used in the comparisons.[14] In five of the scenarios the most competitive rates were available from regional building societies and as such, would have been highly unlikely to be found by a direct borrower.

6.20. Even though the scenarios showed that a number of the most competitive products were available from high street brands, the chances of these lenders being chosen in any given situation are low. There were also examples of non-advised products, only available through the internet or telephone, providing some highly competitive rates to the borrower.

7. Service

P. 13 Service

7.1. Regarding the value of service consideration has been given to:

- the improvement in the customer experience throughout the mortgage application process;

- and ongoing advice and support that a customer may receive including advice on replacing the mortgage at the end of its term;

7.2. Arranging a mortgage has never been a simple task and when combined with moving house, as would be the case for nearly half of new borrowers, it can be extremely stressful. This is particularly so in the current climate.

7.3. It is therefore vital for the chosen mortgage professional not only to find client's the most appropriate product and the best rate but also to ensure the smooth transition from mortgage applicant to borrower.

7.4. Of brokers questioned through a recent survey, over 73% were able to place over 95% of their clients with a lender first time, thus saving time and worry for the potential borrower.[15]

7.5. Arranging a mortgage can be a time consuming process and brokers will typically spend over seven hours processing a mortgage.[15] Frequently, brokers are taking on this task without any certainty over remuneration as just 5% of brokers will charge a fee to clients when the mortgage does not complete.[16]

7.6. The service that brokers offer can provide peace of mind. A recent survey shows that borrowers who arranged their mortgage through a broker felt they were kept better informed on the progress of their mortgage application. Overall, more than half (55%) of borrowers who arranged their mortgage through a broker felt that they were kept informed on the progress of the mortgage application yet amongst those taking out a mortgage direct via the lender's branch, the figure drops to only a third (34%).[8]

7.7. Brokers have a key role to play in assisting clients to obtain the most appropriate product and best available terms at the end of the initial period when a special deal may come to an end.

7.8. At this time it is prudent to review the market to ascertain whether any more suitable and cost-effective products are available. Even though a number of lenders are implementing retention strategies and offering competitive products from their own ranges, they may not be the best available within the market.

7.9. Amongst non-conforming lenders, the normal practice is not to offer a retention product, with clients reverting to the lender's reversionary rate after their initial deal. This reversionary rate is likely to be the lender's SVR plus a loading for instances where there has been poor credit.

7.10. Research carried out by NMG has shown that mortgage brokers will typically contact over three-quarters of their clients to review the entire market against their new rate, with over 6 in 10 advisers questioned contacting over 90% of their clients.[17]

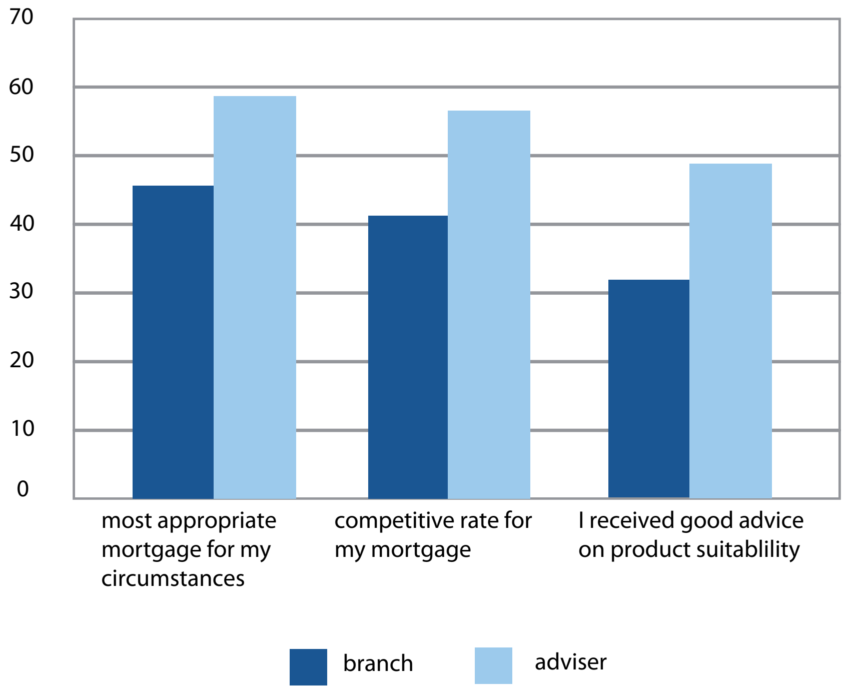
7.11. Furthermore, brokers expect borrowers who do not remortgage to see increases in payments in excess of 2% which, based on the average mortgage taken out in 2005, would equate to an increase in mortgage payments in excess of £210per month.[17]

7.12. Interestingly the majority of clients (84%) would expect to be contacted by their adviser at, or a few months before, the end of their initial rate.[17] Six in 10 questioned also felt that their mortgage adviser should provide an ongoing commitment to them, thus treating them as clients rather than customers.[17]

7.13. When looking at the service provided by either mortgage advisers or the lenders direct, it is necessary to consider all aspects of the sales process, from information gathering and meeting the client's needs, to keeping the client informed throughout the application process and maintaining relationships with the clients post-sale.

7.14. Recent research carried out for this report has shown that it is a clear trend of higher levels of satisfaction for borrowers when they have applied through the intermediary channel.[8]

Levels of Satisfaction



Source: YouGov Research[8]

7.15. Across almost all attributes, those who have purchased via the intermediary channel rate their level of satisfaction with their experience higher than those who purchased on a direct basis.[8]

- When considering the quality of advice received, only 3 in 10 borrowers who used a branch felt that they had received good advice compared to 6 in 10 who used a mortgage broker. Those who applied directly to a lender via the telephone rated the advice they received as the poorest, with only 24% feeling they had received good advice.

- For those who arranged their mortgage through a lender's branch, only 46% felt that they had the most appropriate product for their needs compared to 58% for the intermediary channel.

- Fifty-seven percent of borrowers who arranged their mortgage through a mortgage adviser were also more confident that they had a competitive rate for their mortgage with only 41% of those who dealt with a branch feeling confident they had the best rate.

- Sixty-one percent of borrowers who used a mortgage adviser are likely to do so for their next mortgage but only 45% of borrowers who used a branch plan to do so for their next mortgage.

7.16. The one area where direct lenders receive high scores is from those using the internet to arrange a mortgage. These mortgages achieve high levels of satisfaction with the entire process and with the product chosen. However, it is possible that this is misplaced given that many products are unavailable to the consumer face-to-face and therefore they are likely to have made their choice from a very restricted range of products.

7.17. It should come as no surprise that these figures correlate to the split in advised/non-advised sales with a far higher proportion of intermediary sales being conducted on an advised basis. The fact that clients appear more satisfied with their new mortgage when purchased via an intermediary strongly suggests that they value the advice process.

7.18. Overall, it appears that advice is an important factor in promoting satisfaction with the borrower's chosen mortgage and given the indicators on future choices in distribution channel, this trend is likely to continue.

8. Valuing advice

P. 17 Valuing advice

8.1. In attempting to place a value on the advice provided by intermediaries, the following elements have been considered:

- the impact of being in the most appropriate product;
- the impact of obtaining the most competitive rate once the product has been chosen.

8.2. Choosing the wrong product could at best be costly and at worst lead to borrowers losing their home. With the average size of a mortgage in 2007 being £152,468[18] a 1.5% difference in rate equates to an extra £190 per month in mortgage payments, based on a typical interest only loan; so the cost of a mistake is significant.

8.3. This report has already highlighted the disparity in the distribution of SVR mortgages. Of the 85,000 SVR mortgages sold between April 2006 and September 2007, 73,950 were sold by direct sales channels, leaving just over 11,050 sold by intermediaries.[3]

8.4. Over the period April 2006 to March 2007 the average interest rate for an SVR mortgage was 1.2% above that for a fixed rate deal.[4] The direct channel is therefore responsible for a much larger percentage of mortgages being placed on an historical higher rate.

8.5. Looking at the average loan size of £152,468[18], the extra average cost of an SVR mortgage equates to £1,830 per annum. This results in extra mortgage payments of £155m over a 12-month period of which £135m is attributable to the direct channel.

8.6. The second area of extra cost is the result of consumers purchasing direct and failing to shop around. As has been shown, 9 in 10 borrowers look at no more than three lenders when seeking out a mortgage and half of all lenders look no further than their principal banking relationship.[8]

8.7. Based on the specimen scenarios discussed earlier (see section 6.15–6.20), a clear cost saving can be demonstrated between products obtained direct from prominent high street branches and those likely to be used by a mortgage adviser.

8.8. The average initial rate achieved on a direct basis was 6.31%, with the equivalent rate achieved by a mortgage intermediary of 5.48%.

8.9. The scenarios showed an average annual saving achieved from purchasing via an adviser to be £962 per annum. With just under 1.36m intermediary sales in the 2006/07 financial year[3], we place a value on the savings achieved by intermediaries for their clients of between £1bn and £1.2bn per annum.

8.10. Whilst there is clear evidence of the value that intermediaries add through the provision of advice, it appears that consumers are not necessarily fully aware of this.

8.11. A number of studies have highlighted the need to provide education to the mortgage consumer, with one study discovering that nearly three-quarters of consumers did not recognise that mortgage intermediaries could provide access to mortgage products that are not available direct from the lender.[19]

8.12. The same study also questioned consumers on their understanding of the range of products and services offered by the different channels and 43% did not recognise that high street lenders only provide information on their own products.[19]

8.13. This view is reinforced by consumer research that identified that only 2 in 10 borrowers sought an adviser because they felt they would receive a more favourable rate.[8]

9. Conclusions

9.1. Throughout this report there is clear evidence of ways in which independent mortgage advice adds value to the outcome of the prospective borrower.

9.2. These can be demonstrated in terms of cost savings (such as in product availability and rate payable) or in terms of the quality of advice given and the overall levels of satisfaction with the mortgage process.

9.3. The positive effect of advice from the intermediary is reflected in the levels of satisfaction with the advice received by borrowers and in their willingness to recommend their adviser.

9.4. This report has shown that the main drivers in determining the value of advice are product type and shopping around to find the most favourable rate.

9.5. We place a value of sourcing the most appropriate product type in excess of £135m, delivered through the intermediary channel.

9.6. Whilst significant, the value of sourcing is far exceeded by the savings achieved by advisers searching the whole market to find the best rate for their clients. Based on scenarios examined within this report, annual savings achieved by using the intermediary channel are estimated to be in the region of £1bn to £1.2bn.

9.7. In a majority of cases advice is available free to borrowers as the majority of advisers will not charge their clients for their services, with their income being derived from commission payments made by the lender.

9.8. Furthermore, there is no evidence to disprove any argument that borrowers are incurring higher rates to meet the commission payments to intermediaries.

9.9. Poor mortgage planning can also have wider economic and social implications caused by failure to meet repayments, ultimately leading to repossession in the most severe cases.

9.10. Mortgage payments are likely to be the single largest household outgoing. Ensuring these repayments are affordable and sustainable at a time when borrowers are likely to be under financial pressure is imperative.

9.11. Higher mortgage payments are likely to lead to lower spending on other essential and non-essential items and could fuel an economic slowdown. This is especially the case in times of increasing interest rates. Advice that results in borrowers gaining access to the most competitive rate may mitigate the potential knock-on economic effects.

9.12. It is apparent that there is a lack of understanding of the benefits offered by independent advisers, and very likely the sheer range of products available.

9.13. With such a diverse range of products available, why should a prospective borrower limit themselves to two or three local lenders, when there is likely to be a mortgage adviser within the same geographical area? The answer to this question seems to be a lack of awareness on the part of the borrower.

10. Sources

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11. Annex Current market conditions

- This report has been prepared based on analysis of data sourced during a stable period for the mortgage market.

- Since the latter part of 2007 upheaval within the worldwide money markets has led to unprecedented changes within the UK mortgage market.

- Most mortgage lenders are unable to fund their lending through assets on their balance sheets and need to raise funds on the wholesale money markets. Liquidity issues within the wholesale borrowing of money has lead to a large-scale reduction in the number of products available and a general tightening of credit availability to both the lending institutions and the consumer.

- Initial issues of poorly performing mortgage-backed securities in the US market has led to a worldwide crash in confidence in mortgage backed securities which has resulted in the compete shutdown of the wholesale money markets.

- At the time of preparing this report a number of lenders have withdrawn from the market, with those remaining struggling to maintain their risk profile and service offering.

- The effect has been greatest within the adverse sector of the market, with high and even medium asset class products now unavailable. This is due to the inability to secure funding and the perceived high risk of the resulting security.

- Past lending practices and new entrants have further heightened concerns within the UK market due to continued margin erosion and higher risk profiles on securitised books.

- The result of these issues for the consumer is the inevitable reduction in choice across both channels, further highlighting the need to seek independent advice for the most competitive deal.

- With many lenders actively trying to control new business volumes through pricing of products, there are likely to be further disparities between the main high street lenders and the 'best available product' as sourced by an independent adviser.

- Given this lack of funds for new borrowing, many lenders are increasing their client retention activities, especially for lower risk asset classes. Herein lies a danger of borrowers not seeking independent advice. It may be beneficial where an adviser can compare their retention product against the market as a whole.

- Wider economic issues currently being experienced include slowing house prices, inflationary pressures (of increasing fuel and food prices) and a general economic slow down.

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