Association of Mortgage Intermediaries' response to FCA CP16/42
Reviewing the funding of the Financial Services Compensation Scheme

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

Response

As an industry we have positively subscribed to both the Financial Ombudsman Service (FOS) and Financial Services Compensation Scheme (FSCS) as important safety nets for consumers when things go wrong. Those on the receiving end of FCA fee bills know how much the FSCS levy for mistakes in the pensions market is costing them. We understand why the former Chancellor thought it wrong that banks should benefit from fines levied on their peers, so sequestered the funds for charitable benefit. If he had limited this to the fines on banks it would have been fair. By taking this from all authorised firms, the benefit of fee reductions to good firms from the fines on bad has been lost. The good firms have lost out in business to those who cheated and have to pay a second time for compensation with no fee reduction where the FCA has caught up with the bad firms.

We agree with stripping the banks of the benefits within that sector, but not the small advice firms that have bought into FSCS, with the concept that offset from the bad would reduce their bill. If firms cannot have their money back, then we need a new contract that is based on a fairer system so that the toxic products have paid towards their solution.

A product levy charged up front on all products sold would be fairer and ensure that at least some contribution comes from all firms, including those that cause the problems. We are disappointed that this option has been dismissed, ultimately because it is deemed too complex. We disagree with the view that it is the same as a sales tax, however we understand that a change in legislation would be required to support this. Not only would a product levy be the most proportionate solution for the industry, the increased transparency to consumers would help go some way in avoiding take up of non-regulated products. While consumers are aware of the protections of regulation they do not directly see the cost. A product levy would be made obvious to the purchasing consumer, so that they are aware of both the cost of the FSCS and other regulatory protections, and clear when a product has that protection. The ATOL scheme run by the Civil Aviation Authority is a prime example of this, and nor is it a tax. In addition should we achieve better understanding of riskier products or advice areas, then this could be reflected in the size of a levy and improve consumer understanding of relative risk.

Questions

Q1. Do you agree with the introduction of risk-based levies? Should we also consider other regulatory responses?

When looking at FSCS claims, the key factor that needs to be considered is how a firm has failed. If it is because a firm can no longer afford to continue trading, this can be a normal feature of the market unless there is volume suggesting a systemic cause, such as the level of regulatory fees. But where a firm fails and leaves a number of complaints, a legacy of poor advice and claims against it, the firm and its principals should not be allowed back into the sector. The FCA should recognise and be concerned about the difference in a firm that fails financially and one that fails and leaves liabilities, as the latter suggests a problem with the advice or product. Fraud, mis-representation and mis-selling are indeed the primary reasons for the FSCS claims being paid by our members, not financial failure. Risk-based levies will not address this issue on their own, as intelligent fraudsters will have wound down their businesses before complaints have time to arise.

We also consider that there needs to be another piece of work to deal with the appropriately named "rolling bad apples". There needs to be a much clearer conduit of market intelligence flowing between the FSCS and FCA. We would support a small team at each end actively looking at the loss flows, the involvement of directors and advisers, and monitoring their current activity in markets. This team should display passion to identify and prevent poor behaviours and outcomes.

Q2. Do you believe that risk-based levies could be appropriate in relation to:

- **a) higher risk investment products;**
- **b) insurance brokers that choose to place business with unrated insurers; and**
- **c) any other types of specific products or services?**

We agree that a premium should be added to higher risk products, such as those identified in the paper, which is essentially a product levy in limited form. The level of claims as a result of these products being mis-sold cannot continue as firms struggle to keep up with the rate at which the FSCS bills increase. An obvious example is where FOS and FSCS are still finding against advisers who open SIPP plans and try to abrogate responsibility for the investment choices made. The non-sequitur may be the "self-invested" title, but the activity has regulatory capture. All those products with higher FOS involvement must be seen as higher risk as the issues are clearly not well understood within firms or by consumers. We welcome further discussion and consultation on this.

Q3. Do you agree in principle that product providers should contribute towards FSCS funding relating to claims caused by intermediary defaults?

We strongly agree that product providers should contribute to the intermediary classes. We do not understand any argument that providers are not responsible for the distribution of their own products.

The FCA's Responsibilities of Providers and Distributors (RPPD) paper sets out guidance for firms around the fair treatment of customers. Although introduced in 2007, it articulated responsibilities already set out in the regulatory Principles, Rules and Guidance, financial services legislation and case law. During the consultation period there was broad consensus from the industry that the RPPD was accurate. It makes clear that when designing a product, a provider should identify the target market and give sufficient information to distributors. When providing this information they are advised to consider, for each distribution channel, what information distributors already have, their likely level of knowledge and understanding, and their information needs. Where more than one firm is involved in product design, it is likely to be appropriate for them to apportion responsibility between themselves. A firm cannot contract out of, or delegate, its regulatory responsibilities. Providers therefore must also be held accountable for the distribution of their products.

The AMI, CML and IMLA Working Together guide, first published in 2010, used the RPPD as a starting point. An industry guide to lender and intermediary accountabilities and responsibilities in mortgage sales and servicing, its third iteration was agreed September 2016. Within the mortgage market many lenders rightly apply proper due diligence over those being allowed to sell their products and measure ongoing quality of intermediary performance. Some link their procuration fees to quality measures. We consider this to be a blueprint that other sectors should employ to reduce overall market risks. Advisory firms are routinely removed from panel if they do not use some lenders for long periods of time as the lender cannot be certain of competence or ownership.

We have also seen the European Banking Authority's guidelines on product oversight and governance arrangements for retail banking come into effect in January 2017. The FCA Handbook remained unchanged as these requirements were already enshrined mainly through the RPPD. Throughout the last decade there has been no fundamental change in the expectations between providers and distributors. The Senior Persons Regime only reinforces these roles. It is therefore difficult to understand any argument that providers bear no responsibility for the effective distribution of their products. In our view, provider contributions mistakenly disappeared from the FSCS structure at the time the FSA split in 2013. Its reintroduction will only accurately reflect the existing regulatory landscape and will hopefully focus all minds more clearly on their respective responsibilities and accountability.

Q4. Do you have any views about the current effectiveness, or otherwise, of PII cover including in reducing the number and cost of claims on the FSCS, and about the role of PII in providing compensation to consumers who have claims against failed firms?

We support a wider regulatory review of the effectiveness of PII to include mortgage intermediaries, rather than just focusing on Personal Investment Firms. PI insurers impose a raft of criteria, exclusions and excesses on firms which means claims are often not made and are hardly ever paid. This essentially renders the product useless yet highly profitable for insurers. As an example, the level of excesses imposed will mean firms pay most claims themselves, essentially self-insuring. They will notify complaints to apply protection under the policy but not claim to ensure future insurability. A requirement for PII providers to disclose their claims ratios including volumes, amounts and proportions paid versus claim would highlight the current inefficiencies. Policies should not exclude claims if a firm is in receivership or liquidation.

We appreciate that this will increase premiums and overall costs in the short term. However this should drive up the scale of the market and the need for proper due diligence by insurers who will begin to "regulate" the market by limiting what they might be prepared to insure for some firms. This could be an effective third party control.

Q5. Do you have any views or suggestions about the possible features of more comprehensive, mandatory PII? Do you have any suggestions about other possible tools, remedies or approaches which could be used to reduce the scale of funding currently required by the FSCS?

In order to tackle the main issues relating to the FSCS, a balanced package of solutions needs to be implemented. As well as sufficient enforcement action needing to be taken against firms with greater scrutiny of individuals applying for re-authorisation and a restructure of the FSCS classes applied to ensure greater affinity, firms should not be double-paying for their liabilities. There has been a gradual shift over time from the FSCS as the last resort to now being the first point of redress rather than effective PII.

We have been involved in and hope to continue to be involved in workshops with the FCA and other market participants on this topic, which have been comprehensive and useful. Rather than repeating our contributions to these good debates in this response, we are content that our voice is being heard in these discussions.

Q6. Do you have any views on the impact of a requirement on PIFs to hold more comprehensive PII? For example, what would be its impact on the PII market, the financial advice market and on consumers in general?

Our previous response applies, but ultimately a product levy that is the industry insurance scheme of first and last resort is still our preferred outcome for both the industry and the consumer. Removing PII and moving to such an approach would be more transparent, remove the volatility of cost from firms and improve advice over time.

Q7. Would you support an increase to the FSCS compensation limit in relation to any or each of the investment provision, investment intermediation and life & pensions intermediation classes? If so, do you have any views on what those limits should be?

No. There should not be any increases to limits relating to investments or pensions business because it would be unfair for mortgage intermediaries to have to contribute even more in relation to an activity they do not carry out. In not taking an annuity the consumer is accepting a higher risk and in the same way that depositors often split their deposits across institutions, investors should similarly spread their investments to reduce their exposure.

Q8. Would you support a proposal to differentiate between investment provision and investment intermediation, and to introduce higher limits for either? If so, do you have any views on what those limits should be?

This is not our area of expertise.

Q9. Would you support a proposal to seek to make a distinction between pensions-related investment business and non-pensions investment business, and apply higher limits for pensions-related investments? If so, do you have any views on how the distinction might be made and what those limits should be?

No comment.

Q10. Do you have any comments about the possible risks to investors posed by crowdfunding and whether these might justify introducing FSCS protection?

We support the exclusion of loan based crowdfunding from the FSCS. As and when these activities are brought fully within the scope of regulation we could reconsider this.

Q11. Do you have any comments about the scope of the FSCS and whether promoting financial products, or any other activities, should be included within its coverage?

We agree that the scope of the FSCS should not be extended to cover financial promotions. We do not understand how their inclusion into the structure would work and we believe there should not be undue focus on this. The rules around their content and communication are already set out in the Handbook and any systemic issues should form part of the FCA's supervisory work.

Q12. Do you agree that it would not be justified for the FSCS to utilise a credit facility to further smooth levies, given the costs involved?

We agree.

Q13. Do you believe that we should seek to reduce the number of funding classes, in order to reduce volatility of FSCS levies?

Whilst merging the classes into one may be one way to reduce volatility, we do not believe that this adheres to the principle of affinity. Apportioning the levies to similar businesses is of the utmost importance to our members. The nature of FSCS claims will always mean that bills are unexpected. Firms are more concerned about the amount that is to be paid and where the claims stem from. With the majority of claims in the life and pensions intermediation class relating to mis-sold SIPPs, it is grossly unfair for mortgage firms as the primary writers of life insurance to be paying a disproportionate amount of investment advisers' invoices despite no connection between the two business lines.

Accordingly, we do not consider the reduction in the number of classes to be appropriate.

In order to reduce the number of claims responsible for the high FSCS bills there should be a focus on more efficient supervision of firms, better intelligence and earlier enforcement.

Q14. What are your views on the different funding classes we have set out here? Do you have any alternative proposals?

We strongly believe that pensions intermediation needs to be separated from life intermediation. None of the options reflect this. We believe there needs to be greater adherence to the need for affinity as set out in legislation, and this separation would more closely match the business models prevalent in the industry.

There seems to be concern about unsustainable smaller classes, however it does not appear that a closer affinity between the classes has been considered, such as life with general insurance or life with home finance. These are our preferred solutions.

Mortgage intermediaries cannot continue to be equally accountable for pensions failures, which is proposed under option 3. The risk in the pensions arena may cause significant future claims that will damage the reputation of the solutions in this review. Option 2 only increases this imbalance where mortgage firms take on the liabilities of investment advisers, which we strongly oppose. None of the three options offered is considered appropriate by AMI.

Q15. Do you agree with our intention to keep the current class thresholds for intermediary classes, merging the thresholds if appropriate to adopt a revised class structure?

Yes, in principle, but subject to our other comments on class structure.

Q16: Do you agree with our intention to keep our current class threshold of £200m for the investment provision class?

No comment.

Q17. Do you have any views on the idea of a fixed levy for smaller firms?

We consider that a minimum levy is not a fair solution as this could be to the detriment of smaller firms.

Q18. Do you have any comments on the mechanism by which we would propose to incorporate product provider contributions into the intermediary claims classes, for the various different class structure options described?

We agree that classes should have a lower total amount for intermediation and that the provider contribution starts from the first pound in equal proportion until exhausted.

Q19. Do you agree with our proposals to include protection for client money for debt management activities within the scope of FSCS protection and our proposed funding arrangements?

We are concerned about a lack of transparency in these proposals. We do not understand why a £45 million levy threshold would need to be set to cover client money in transit from a debt management firm to creditors. Such a high threshold seems to reflect an unrealistic scenario. Some debt management firms continue to hold interim consumer credit permissions with very few so far having progressed through to full authorisation. We fear that these proposals are a guise to cover clients of these waiting firms who the regulator knows will not become authorised. We would not wish our member firms to be captured under these proposals. Should this be approved, then coverage should only apply to funds with firms from the date of publication of the final rules.

We request clarification that mortgage brokers, who still have to unjustly hold a debt counselling permission for activities that is really part of their intermediation, will not contribute to the proposed new debt management class as they have no eligible income.

Q20. Do you have any views on whether or not coverage should be extended to negligent advice provided by debt management firms?

If such an extension is considered then it could only be for agreements which commenced after the date of publication of final FSCS rules. This must exclude historic agreements.

Q21. Do you agree with our proposals to extend FSCS protection to structured deposits intermediation and to fund it through the Investment Intermediation and Investment Provision classes?

Our member firms do not carry out this business so would not expect to be included in this class. This is a further example of why investments and pensions should not be linked to home finance and life insurance.

Q22. Do you agree with our proposed approach to provide FSCS protection for claims relating to fund management?

No comment.

Q23. Do you agree with our proposed new approach to Lloyd's of London?

No comment.

Q24. Do you agree with our proposal for a new reporting requirement on higher risk products in the RMAR?

We agree that the regulator should be collecting more information on higher risk investment products as a way of being able to identify higher risk firms earlier.

Q25. Do you agree with our proposal to remove the rule relating to paying FSCS levies by quarterly direct debits or should we consider other options?

There needs to be an understanding of the impact of significant unexpected bills on firms, for both large quoted companies with their responsibilities to shareholders as well as small businesses. There should therefore be adequate facilities for firms to spread their payments in order to be able to afford the levies. We are concerned that any removal of a rule in order to "avoid confusion" will not be made clear to firms that a quarterly direct debit option for their entire regulatory bill is still available.

Q26. Do you have any comments on our proposed class threshold and tariff measures for the new debt management claims class?

See Q19.

Q27. Do you have any comments on our proposed tariff measures and metrics for calculating the deposit taker contribution for direct sales in relation to structured deposits?

We are strongly against any cross-subsidisation of investment intermediation with life intermediation, as a significant proportion of life insurance is written by mortgage advisers and there is no affinity between these businesses.

Q28. Do you have any comments on how, in future, we might calculate any provider contributions required from deposit-takers, in relation to structured deposits, if we were to consult in detail on this approach?

No comment.

Q29. Do you have any comments on our decision to maintain the current tariff measures, except for life and general insurers?

No comment.

Q30. Do you have any comments on our proposal to bring the tariff bases for insurers into line with the PRA's approach?

No comment.

Q31. Do you agree with our proposal to require firms that must pay some of their FCA/PRA levies on account to also make a payment on account in respect of their FSCS levy?

The sentiment behind this proposal seems to be diametrically opposed to concerns around volatility. There seems to be little consideration of the impact of requiring firms to pay what is already an unexpected and significant bill even earlier, just for the sake of easing administration.