Association of Mortgage Intermediaries' response to FCA's discussion paper DP14/2 on Fairness of changes to mortgage contracts

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 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.

AMI welcomes the opportunity to respond to FCA's discussion paper on Fairness of changes to mortgage contracts.

<u>Overview</u>

A mortgage contract is a long-term agreement and is not just for the duration of the short-term initial rate that is offered at the outset, which is often a fixed rate in the current market conditions.

By the very nature of having such long-term contracts it would seem inevitable that lenders would want to have some flexibility to make variations to their terms and there is nothing fundamentally wrong with having that capability.

However, we have come from a market that has been used to easy refinancing options being available. This has led to consumers changing their mortgage products, and often their lenders, on a regular basis. The enhancements to MCOB brought about by the MMR, the lack of use of the transitional arrangement provisions by lenders and the move towards longer fixed rate products will mean that consumers may stay with a given lender for longer than they would have done in the last decade. This would mean that we are more likely see lenders wanting to apply variations to their contracts and consumers finding it harder to simply remortgage to another lender.

The new requirements in MMR have moved brokers further towards not just finding the best rates for consumers but also ensuring that recommendations are in the clients best interests. This means that a wider picture of the consumers needs is being considered and this will often incorporate the additional features offered under relevant mortgages products to meet those needs.

Lenders need to ensure that they are upfront about key features and what potential contract variations can be applied. However, even being upfront about this capacity does not mean that all changes are fair.

Ultimately the test must be one of meeting FCA’s Principles and TCF requirements rather than merely contractual legal obligations. The case for making a change must be explicit.

Question 1: Your experiences

• Has your mortgage contract been changed at any time?

No comment

• What change was made?

No comment

• Did you think the change was fair or unfair? Please explain why. Think about how the firm has treated you, how they communicated the change to you, and if you think they considered your needs or situation.

No comment

Question 2: Change to a standard variable rate (SVR)

Imagine you have a mortgage contract where the interest rate is the lender’s standard variable rate (SVR). This is a rate set by the lender which can be increased or decreased. The lender should set out the reasons why the interest rate may be changed in the mortgage contract.

• What do you think are fair reasons for a lender to increase the SVR?

The lender should be able to increase its SVR where the consumer is not precluded from leaving the lender and where the lender gives the consumer sufficient time to make the necessary arrangements to leave or take out a new product with the lender to negate the issue arising from the variation, such as a product with a new fixed rate.

• Is there anything that the lender could do to make sure the increase is fair? For example, does the lender give you notice of the change; do they clearly set out their intention to increase the SVR; do they set out your options if you do not like the change?

The increase should reflect a change in the lenders costs. The lender should inform the consumer ahead of the change and explain why its SVR is changing. Those consumers who are unable to avoid the increase, by changing lenders or switching to a new product with the existing lender, should be identified.

Question 3: Change to a fixed-rate contract before the end of the fixed term

Imagine you have a mortgage contract with an interest rate that is fixed for five years.

- **Would you expect the interest rate to be changed before the end of the five-year period? If so, in what circumstances do you think this could be fair?**

The fixed rate should remain unchanged during the term of the fixed rate period. The consumer should be aware of the duration of the fixed rate period at the start of the contract and be reminded of the end date of the period prior to the conclusion of the fixed rate. This will give the consumer sufficient time take out a new product, with a new or the existing lender, to avoid being charged under the lender’s SVR.

The only circumstance where it would be acceptable for a fixed rate to change would be if it was in the customer’s interest, such as a rate reduction.

Question 4: The removal of a feature from a mortgage contract

Imagine there is a term in your mortgage contract allowing you to rent the property out to someone else. There is also a term in the contract allowing the lender to withdraw your right to rent out the property at any time.

- **Do you think that it is fair for the lender to be able to withdraw your right to rent the property out during the term of the contract? Please explain your reasons.**

If the term was in the contract at commencement then it should be honoured by the lender. The lender should not have the right to make such amendments to existing contracts because such a feature may have been a key or secondary reason for the consumer taking out a particular mortgage contract in the first place.

Question 5: The removal of a feature from a mortgage contract

Imagine you have a mortgage that has a bank current account linked to it. The mortgage agreement allows you to borrow money from the current account, up to an agreed limit. This loan is repaid as part of your mortgage repayments.

- **If you took out a mortgage that had this facility, would you expect that there may be a term in the contract that allows the lender to withdraw it?**

This may lead to some brokers adversely selecting against that lender in future.

- **Do you think that it is fair for the lender to be able to withdraw this feature?**

As above the lender should not be allowed to make such changes as these terms and feature may have influenced the consumer’s decision to take out the mortgage contract with that particular lender. There would have been other mortgage options for the consumer to choose from.

Question 6: A variation caused by your mortgage provider changing

Imagine that your mortgage is taken over by another provider, perhaps because two mortgage lenders have merged to become one company.

• Would you expect your mortgage terms to remain the same for the duration of your mortgage?

We would expect the terms to remain, however where this was because of issues with say IT systems, customers could be compensated for a change that reduced the new firms costs.

• Do you think it is fair for the new provider, who has taken over your existing lender, to be able to change your contract? Please explain why.

Only within the terms of what is fair and reasonable

• Do you think that it is fair for the lender to be able to withdraw a feature?

The contract should not change as a result of one lender taking over another, unless the change is in the consumer's interests. For example, a new lender allowing the consumer to rent out their property in certain circumstances, where such a term did not previously exist under the original lender.

Case study questions:

<u>Change to a standard variable rate (SVR)</u>

Question 7:
(a) Do you agree that the factors we have listed are the most relevant in this case study?

Yes

(b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.

The borrower's capacity to make the increased payments.

(c) Do you agree with our view about the likely fairness of the change in this case?

Yes

(d) How would your view on fairness change with different facts?
For example, what if there is no change in the Bank of England base rate and:

• the lender is in financial difficulties caused by a significant increase in wholesale funding costs affecting all lenders; depositors are at risk if the firm fails; as part of its financial recovery plan, the lender increases its SVR by 1%; and other lenders are increasing their SVR at the same time,

This may be considered to be a legitimate reason to increase SVR but consumers should be made aware of the reason for the increase and given sufficient notice to allow those who can, and want to, to change their mortgage product/lender.

The lender should also ensure that the changes do not take advantage of mortgage prisoners.

• as above, but other lenders are not increasing their SVR at the same time, or

As above.

• the lender is under pressure from an activist investor to increase dividends; in response the lender wishes to increase its margins by raising its SVR, or

As above.

• Mr and Mrs Sall's mortgage forms part of a book of mortgages acquired by another firm; the acquiring firm has a lower credit rating, higher funding costs and a higher SVR; the acquiring firm wishes to raise the SVR on the acquired book of mortgages to match its own SVR, justifying this by reference to its higher funding costs.

As above but this scenario would seem to heighten the need to ensure that the lender is not taking advantage of those consumers unable to move to another lender/product due to being mortgage prisoners. As set out in MCOB 11.8.1E.

Furthermore, in purchasing the book, the lender should have completed proper due diligence and been aware of risks and issues. Consumers should not suffer from poor commercial judgment, which is why firms fund the FSCS.

<u>Change to a fixed rate of interest during the fixed rate term</u>

Question 8:
(a) Do you agree that the factors we have listed are the most relevant in this case study?

Yes

(b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.

No

(c) Do you agree with our view about the likely fairness of the change in this case?

Yes

(d) Please think about whether your view would change if:
• the lender is in severe financial difficulties and its depositors are at risk if the firm fails, or

This does not change the fact that the consumer appears to have been misled by the firm's marketing, whether intentionally or otherwise, into taking out a product that does not meet their stated needs.

• the lender had clearly set out its variation term in both its marketing material and its offer letter.

If such a term was clearly stated in both the marketing and the offer letter then it is reasonable to accept that the client took out the contract on the basis of those stated terms and features. However, under the clear, fair and not misleading rules it would seem reasonable to question how the lender classed this as a fixed rate mortgage?

If the lender in the case study had correctly described the product and not included the statement "Guaranteed certainty in your mortgage payments for five years", it would seem unlikely that the consumer in the case study would have been attracted to such a product and this issue would not have arisen.

The disparity between the features and the marketing should not happen. If it did this would be a failing of the firm and it should not rely on the strict contract terms if it has marketed the product as something it is not.

Change to a feature of a mortgage: ability to rent out the property

Question 9:

(a) Do you agree that the factors we have listed are the most relevant in this case study?

Yes

(b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.

Although the firm agrees to waive its administration fee for any borrower who wishes to move their mortgage during the notice period, the question is the customer actually able to move?

(c) Do you agree with our view about the likely fairness of the change in this case?

Yes but further circumstances need to be considered. In particular, for those consumers who took out a mortgage pre MMR and may now be unable to change lenders or obtain a new product from their existing lender under the post MMR rules.

(d) Please think about whether your view would change if:
• The marketing materials and/or offer letter do not make it clear to customers that the lending criteria are subject to change, or

The lender must make these key features and restrictions clear to the consumers at the outset. Consumers have an abundance of choices with regards to mortgage products. If there are other factors than simply price/rates, as there is in the case study, then the consumer needs to receive relevant information at the outset. If the lender has not made the restrictions of a key feature clear to the consumer at the outset it should not be able to rely on this at a later date.

• The firm only intends to withdraw the feature of being able to rent out the property for certain categories of customer. These categories are based on age (the facility is withdrawn for over 65s) and income (the facility is withdrawn for customers who have a household income of less than £25,000 per annum).

If this was the case these terms and conditions should have been present at the outset so that the products terms and conditions were right for those consumers who took out the mortgage.

<u>Change to a feature of a mortgage: ability to draw down additional funds against the mortgage</u>

Question 10:
(a) Do you agree that the factors we have listed are the most relevant in this case study?

Yes

(b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.

No

(c) Do you agree with our view about the likely fairness of the change in this case?

Yes

(d) Please think about whether your view would change if:

• The ability to redraw contractual repayments of principal did not result from a systems failure but was a contractual feature of a new product range that the firm marketed extensively (with a particular focus on the ability to redraw funds), and the firm is relying on a general contract variation term, or

This would appear to be unfair.

• The lender was only limiting the use of the re-draw facility for certain categories of customers: those who have a household income of less than £25,000 per annum and those with a loan-to-value ratio of greater than 80%. These customers cannot 'opt out' of the change, or

As above

• The lender is not allowing any customers to keep existing unused amounts available for redraw; it will reduce unused redraw amounts down to the amounts of any voluntary repayments of principal.

As above

<u>A change to terms and conditions following the takeover of one firm by another</u>

Question 11:
(a) Do you agree that the factors we have listed are the most relevant in this case study?

Yes

(b) Do you think any further factors are highly relevant to an assessment of fairness in this case study? Please state these.

No

(c) Do you agree with our view about the likely fairness of the change in this case?

Yes

(d) Please think about whether your view would change if:
• Lender B will allow any customer to 'opt out' of the proposed change. For customers who have already used the ability to take a repayment holiday, Lender B will ask them to 'opt in' to the proposed change, so that those who do not 'opt in' are still able to make use of repayment holidays, and will offer £100 worth of vouchers to those who opt in. In addition, for those customers from whom the ability to make repayment holidays is withdrawn, but subsequently are in arrears, Lender B commits to the FCA that it will take into account the fact that those customers would have had access to a repayment holiday when determining whether to exercise forbearance, or

This would appear to be a fair choice for consumers to make providing the changes are clearly explained to the consumer before they make their decision.

• Lender A is in severe financial difficulties and its depositors are at risk if it fails. Lender B is the only firm that is willing to take over the business of Lender A, and the only alternative is resolution under the Banking Act 2009 with the consequent risk to public funds. Lender B is not willing to ‘rescue’ Lender A unless it can make this (and similar) changes to the terms of Lender A’s book of mortgages.

If lender B did take over lender A in these circumstances those consumers who would be affected should be able to change lenders without incurring additional costs. The original mortgage features may have been influential in them taking out the mortgage contract with Lender A. As those features are now been withdrawn, the product may no longer meet their needs through no fault of the consumer.

12. Do you think these factors are relevant when assessing whether a change to a regulated mortgage contract is fair?

Lenders will needs to consider any changes in relation to the Principles 6 and 7. The factors in the examples will be relevant depending on the individual cases. Lenders should not make changes without considering the impact on consumers. The relevant terms and features of their contracts is a factor but so is the prominence of these features and there relevance to the consumer in their decision to enter the contract in the first place.

We do not believe that a conclusion made in one set of circumstances would be necessarily right in another which may at first appear to be very similar.

13. Are there any other factors that you consider may be relevant in this context? Please explain and be as specific as you can.

<u>MMR rule changes and transitional rules</u>

It is important to consider how easy it is for the consumer to exit any contract that they are no longer happy with. What barriers does the lender put up and are these justified in the context of the relevant rules and principles.

Lenders are already required to ensure they do not actively take advantage of borrowers who are unable to change lenders in MCOB 11.8.1E. Before making any changes to existing contracts lenders will need to consider whether such changes could result in a contravention of this rule. We would like to see FCA make more use of the evidential standard, where the onus is on the lender to prove they have acted properly.

If a lender has made a legitimate and ‘fair’ change to a rule and the consumer is not happy they must allow the consumer to leave the contract, although they may apply an early repayment charge where relevant. This principle is set out in the EU Mortgage Credit Directive (MCD) and FCA is currently consulting on transposing the MCD into rules. The proposed rule MCOB 2A.4.1 addresses the right of the consumer to discharge their obligations.

In practice most consumers would do this by remortgaging with another lender.

However, in the current market many consumers took out their mortgage under the pre MMR regime and may now struggle to meet the requirements under the post MMR MCOB rule book. FCA recognised that consumers should not be restricted from obtaining a mortgage solely based on its rule changes. To help consumers who found themselves in this situation FCA adopted transitional rules in MCOB 11.7.

The transitional provisions allow lenders to waive the MMR affordability assessment where a consumer has not had arrears in the last 12 months and was not borrowing more funds. This is to ensure that such consumers do not become mortgage prisoners.

To date lenders have been very poor in applying these provisions. This lack of application can only be to the detriment of consumers. The lack of use of the transitional rules is a significant factor as it restrains the ability of consumers, who may or may not be in an early repayment charge period, the ability to move away from a contract change that means the mortgage no longer suits their needs and circumstances.

Relevant disclosure of key features - ESIS/KFI

The case studies touch on the issue of relevant disclosure of the key features, terms, conditions and restriction. However, they do not really address the core factors in relation to the current and future disclosure regime.

The new European Standardised Information Sheet (ESIS) will eventually replace the mortgage KFI. The ESIS document will be introduced under the MCD and applies three sections for providing key information relating to the mortgage contract (in the context of this consultation). The relevant sections of the ESIS are 8. Additional obligations, 10. Flexible features and 14. Additional information.

Our view is that any features the lender wishes to rely upon at a later date must be expressly stated in these sections, or the corresponding relevant sections in the KFI. This is in addition to the relevant financial promotion requirements being met.

Mortgage intermediaries are required under the MMR to act in the best interests of consumers. This means the advice process is not simply about recommending a product with the lowest rate. However, mortgage intermediaries do not have access to the full terms and conditions of the mortgage. These are only provided by the lender to the consumer alongside the mortgage offer. As such a mortgage intermediary can only provide advice on the features and restrictions of the mortgage based on the literature provided to them by the lender. This does not generally go far beyond the information that is provided in the KFI.

Contractual requirements not being fulfilled

An additional issue that may need to be considered is where contractual obligations are not fulfilled. This could be where the contract states that it allows the consumer to port their mortgage to another property but the lender will not allow the consumer to port their mortgage because the consumer does not meet the lenders post MMR affordability assessment, even though such an assessment is not required under FCA's MCOB rule book (MCOB 11.7)

14. What factors do you consider to be the most important? Please explain why and be as specific as you can.

The consequences of the action/inaction on the consumer. As these are long-term contracts the consumer and those who advise on the market have an expectation that they can rely on the facts as published by the lender at the time of their purchase. Lenders should not offer contracts without fully understanding the long-term implications to their business.

AMI
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