Association of AMI Mortgage Intermediaries

Debt consolidation and mortgages

November 2016

Background

- FCA recently carried out supervisory work with firms to assess the suitability of advice in debt consolidation mortgage sales. It reviewed debt consolidation policies, procedures and 110 customer files in 9 networks and 6 directly authorised intermediary firms, and considered final adjudications made by FOS
- AMI has been having continuous dialogue with the FCA on its work and its expectations
- FCA conducted a debt consolidation workshop in October 2016 to discuss the findings from its recent work, work through some case studies and to ensure firms understand its rules

FCA findings

Suitability of advice

- None of the files it reviewed contained evidence that the adviser considered costs associated with increasing the period over which a debt is to be repaid
- None of the files it reviewed detailed clear reasons why the product was appropriate for the customer's needs and circumstances
- Some files contained disclaimers and declarations signed by the customer, suggesting an intention to limit the firm's responsibility for the recommendation.

Senior management

- Some senior management were not able to demonstrate they had effective processes in place to identify, manage, monitor and report risks it is or may be exposed to. This includes conduct risks (SYSC 4.1.1R)

FCA findings

Record keeping

- Little evidence of advisers making and retaining a record which explains why the firm has concluded that the advice to consolidate debts is suitable and appropriate to the customer's needs and circumstances (MCOB 4.7A 15R (2))
- For example, the FCA found cases where the customer could afford to repay all their unsecured debts without consolidation
- The right outcome might still have been for the customer to consolidate; however there was insufficient evidence to show why the firm believed that their advice was appropriate to the customer's needs and circumstances
- Files didn't reflect whether it would be appropriate to negotiate an agreement with creditors rather than take out a mortgage (MCOB 4.7A 15R (3))

FCA findings

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Broker fees

- The FCA found a range charged by firms from £127 to £4,995. Higher charges were added to the loans which increased costs
- Firms must ensure that any regulated mortgage contract that it enters into does not impose, and cannot be used to impose, excessive charges upon a customer (MCOB 12.5.1R)
- Firms must ensure that its charges to a customer are not excessive (MCOB 12.5.2R)
- The FCA acknowledges different firms' business models and rather than expecting the same fee across the market, firms should be able to justify their fees
- Firms should also be mindful that debt consolidation customers are likely to be vulnerable

Case study 1

- Married couple, aged 40
- 5 years in the property
- No arrears or adverse credit reference history
- Estimated house value £750,000
- Mortgage balance £300,000
- Current mortgage is interest only at 4.99% with 23 years remaining

Income and expenditure assessment	
Monthly net pay	£8,600
Current mortgage payment	£1,580
Total other credit payments	£1,238
Living and lifestyle costs	£3,137
Disposable income	£2,645

Customer wants:

- remortgage to include fees and consolidate debts so all payments are taken on the same day
- to convert to capital and interest repayment (which can be done for a lower rate than currently)

Remortgage will cost £1.55 per £1 borrowed assuming 25 year period. Customer is currently making more than minimum payments on credit cards each month.

Loans and credit cards

Type	Balance	Monthly payment	Term left (months)	Annual interest rate
Personal loan 1	£6,426	£459	14	5.0%
Personal loan 2	£12,505	£305	41	4.0%
Subtotal	**£18,931**	**£764**		
Credit card 1	£8,135	£244 (min. required)	40 to clear at £244	0% for 10 months then 18.9%
Credit card 2	£15,000	£230	93	9.9%
Subtotal	**£23,135**	**£474**		
Total	**£42,066**	**£1,238**		

Case study 2

- Married couple, mid 30s, PAYE employed
- 5 years in the property
- No arrears or adverse credit reference history
- Estimated house value £250,000
- Mortgage balance £123,000
- Current mortgage is interest only at 4.99% with 25 years remaining

Income and expenditure assessment	
Monthly net pay	£3,446
Current mortgage payment	£511
Total debt payments	£1,422
Other expenditure	£1,200
Disposable income	£313

Customer wants:

- remortgage to include fees and consolidate debts to have more disposable income for non-essential spending
- to convert to capital and interest repayment (which can be done at 2.7%)

Remortgage will cost £1.50 per £1 borrowed assuming 25 year period.

Customer is currently making more than minimum payments on credit cards each month.

Personal loans and credit cards

Type	Balance	Monthly payment	Term left (months)	Annual interest rate
Loan 1	£4,228	£302	14	5.0%
2	£3,042	£169	18	3.3%
3	£12,505	£305	41	4.0%
4	£5,324	£121	44	4.25%
5	£4,975	£75	66	3.5%
Subtotal	**£30,074**	**£972**		
Card 1	£4,500	£80	75	9.9%
2	£9,000	£140	91	9.9%
3	£15,000	£230	93	9.9%
Subtotal	**£28,500**	**£450**		
Total	**£58,574**	**£1,422**		

FCA findings

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Case studies

- The advice given by firms in both scenarios was to consolidate all debts, which was unsuitable. Factors not taken into account included interest rate of unsecured debt, term left, sufficient affordability and weak reasons given by the customer
- Firms had not collected sufficient information from the customer, such as the cost of redeeming the existing debts
- Files did not show that firms had taken into account the costs associated with increasing the period over which the debt is repaid
- Firms relied on the customer wanting to consolidate debt as justification for the advice. If there is clear affordability a wider conversation with the customer is needed and the full rationale recorded

FCA work

Examples of remedial action taken by some of the firms

- Revised fact finds to include full cost-benefit analysis for securing each unsecured debt
- Revised suitability letters which are specific to customer's circumstances instead of generic templates
- Retraining advisers, specifically on the additional considerations required when advising on debt consolidation
- Increasing monitoring of adviser to ensure MCOB compliant advice is provided to customers
- Telephony systems being upgraded to allow recording of all mortgage advice calls
- Enhanced MI collection so that all debt consolidation, and other high-risk sales, are identified for quality assessment

FOS decisions

- Complaints handling procedures should, amongst other things, ensure that lessons learned as a result of determinations by FOS are effectively applied
- FOS decisions may also help as a reference point when considering future changes to firm policies and procedures
- http://www.ombudsman-decisions.org.uk/

Mortgage advice rules

- SYSC 3.1.1R requires firms to take reasonable care to establish and maintain such systems and controls as are appropriate to its business
- MCOB 4.7A.2R requires that if a firm gives advice to a particular customer to enter into a regulated mortgage contract (RMC) or to vary an RMC, it must take reasonable steps to ensure that the RMC, or after variation will be, suitable for that customer
- MCOB 2.5A.1R requires firms to act honestly, fairly and professionally in accordance with the best interests of its customer

Debt consolidation rule

MCOB 4.7A.15R requires that, where the main purpose of a remortgage is the consolidation of existing debts, the adviser should take account of:

- any costs associated with increasing the period over which the debt is to be repaid,
- whether it is appropriate for the customer to secure a previously unsecured loan, and
- where the customer is known to have payment difficulties, whether it would be appropriate for the customer to negotiate an arrangement with his creditors rather than to take out a regulated mortgage contract

A debt consolidation policy

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Firms should have in place a policy which sets out a framework for its advisers. It should cover:

- Main purpose – how the firm defines whether the 'main purpose' is to consolidate debt. This is not just about a percentage of the debt consolidation as a proportion of the total re-mortgage.
- Suitability – firms should be able to demonstrate why their advice is suitable, which may include identifying examples where debt consolidation is unsuitable
- Best interests – firms should act in the customer's best interest, e.g. calculating the effect of debt consolidation even if it is not the customer's main priority. Vulnerability in debt consolidation cases should be addressed and this could cross-refer to wider customer vulnerability policies