

## *AMI Factsheet: The cheapest rule*

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### Introduction

This factsheet has been prepared by the Association of Mortgage Intermediaries as guidance for firms following the introduction of FCA rules [MCOB 4.4A.1R\(1A\)](#) and [MCOB 4.7A.23AR](#) from 31<sup>st</sup> July 2020, included in the [policy statement](#) on mortgage advice and selling standards. This factsheet has been drafted following discussions with FCA's mortgage policy team and AMI members, and is intended to give firms additional clarity on the requirements and considerations.

Following the MMR, thematic work showed that some firms were struggling to demonstrate the reasons for the recommendation of a particular product. Similarly, one of the key findings of the Mortgages Market Study was that 30% of consumers appeared to have ended up with a product that was more expensive than others (that the consumer seemed eligible for) in the market at the time. This was found in both direct and intermediated sales.

### The impact on advice

FCA wants there to be a greater clarity as to how price has been taken account of when advice is given. This is not to say that price is the over-riding concern. The priority remains that the mortgage must be appropriate to the needs and circumstance of the customer and any recommendations must be based on the suitability of a product to meet these. The 'cheapest rule' applies only where there is more than one product available to the customer that suits their needs. Then, if the cheapest of these products is not recommended, the firm must ensure that the reasons for this have been explained to the customer and evidence of the reasons for recommendation must be maintained on file.

The advice rules indicate that assessing a suitable product should lead the discussion and advice provided, with the check on cheapest as only a final step. This may lead advisers to have to loop back to earlier in the process to clarify "needs", particularly in the areas of fee consolidation or incentives such as cashback, free valuations or conveyancing.

### The cheapest rule

To read the rule in full, please see [MCOB 4.7A.23AR](#) of the FCA's handbook.

- The rule applies to **all** regulated mortgage products where there is more than one product that is appropriate to the needs and circumstances of the customer and the cheapest product is not recommended;
- The rule uses the discounted or 'introductory period' of the product where there is one;

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- The 'total amount payable' used in the rule is calculated using just the aggregated monthly payments and any product or arrangement fees that are paid upfront. Where product or arrangement fees are added to the loan they will feature in the aggregated monthly payments;
- Cashback, legal fees, valuations and other fees are not included in the FCA's approach.

FCA is aware that the calculation as specified in [MCOB 4.7A.23AR](#) has some limitations and that a more holistic view of which is the 'cheapest' deal may be possible (and could form the basis of any explanation used by a firm). The emphasis is on finding the product that is right for the customer and where there is more than one that meets their needs and the cheapest is not selected, explaining the reason for this to the customer and documenting this on file.

## Mortgage sourcing

AMI understands that the sourcing systems have incorporated changes to facilitate the calculation of the 'cheapest' product as per the new rule. These methods differ between sourcing systems and firms should ascertain how they are meeting the rule and whether the required filters are fixed or need to be manually selected.

Firms should be aware that the calculation required to be applied in order to comply with the new rule may be different to that previously used by firms.

Firms may find they prefer to calculate the 'cheapest' product in two different ways in order to both comply with this rule and calculate the 'true cost' of the product over the incentive term.

Firms should contact their sourcing systems if they are unclear how to use the modifications.

## Demonstrating compliance with the new rule

All firms should ensure that their sales process documentation is updated to include compliance with the new rule.

The 'cheapest rule' requires that where the product recommended to the customer is not the 'cheapest' product that meets their needs and circumstances, then the reasons for this must be explained to the customer. There are a number of valid reasons for this including: cashback, free valuation, free legals, service standards, property type etc. Other reasons may include service quality, application to offer times, and more detailed knowledge of how specific income or costs are assessed by the different lenders.

Some firms may wish to include the explanation in documentation given to the customer, for example in a suitability report. This is a decision for individual firms to take and is not a requirement of the new rule.

[MCOB 4.7A.25R](#), the rule on record keeping, states that a firm must make and retain a record of the explanation given under [MCOB 4.7A.23AR](#) [the cheapest rule] where applicable. The record must be maintained for a minimum of three years from the date that the explanation was given.

Advisers must keep a record on file which would enable a firm to demonstrate to a supervisor why the recommendation was made. Firms may wish to include in this record details of any suitable products that were showing as cheaper with the reason(s) that they were not recommended.

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## Summary and next steps

- Firms should ensure that they read and familiarise themselves with the new rule;
- Sales process documentation should be updated to include the new requirements;
- The priority remains that the recommended mortgage must be appropriate to the needs and circumstance of the customer and any recommendations must be based on the suitability of a product to meet these needs;
- The new rule applies only where there is more than one product that meets these needs, and where the recommended product is not the 'cheapest' when using the calculation in the rule;
- The adviser must explain to the customer why they have not recommended the product that showed as the cheapest when using the calculation in the rule;
- It is acceptable to take into account all of the fees and costs when giving advice on the overall most cost-effective product. When you then recommend a product that is not at the top of the list using the calculation in the rule, you should explain that it is more cost effective when taking all these factors into account;
- Other valid reasons for not recommending the 'cheapest product' include (but are not limited to): cashback, free valuation, free legals, service standards, property type, service quality, application to offer times, and more detailed knowledge of how specific income or costs are assessed by the different lenders;
- This explanation should be documented in the customer's file and held on file for a minimum of three years.

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