Association of Mortgage Intermediaries

Association of Mortgage Intermediaries' response to FCA CP21/34: Improving the Appointed Representatives regime

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI) and the Association of Finance Brokers (AFB). AMI is the trade association representing over 80% of UK mortgage intermediaries. AFB sits within AMI and represents second charge (formerly secured loan) brokers.

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. AMI members also provide access to associated protection products. AFB members also provide access to unsecured products.

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

Our view

We request the FCA considers our comments in this section, alongside our response to the main consultation questions.

It is unhelpful that both the FCA and HM Treasury consultations have been issued at the same time; HM Treasury's Call of Evidence should have been issued first with the FCA's consultation and policy proposals informed by subsequent feedback. We are concerned that the FCA is using this consultation to verify the thinking behind its policy proposals, rather than as an opportunity to seek constructive and informed insight and feedback from industry before deciding on the direction of travel. However, we are grateful for the opportunity to speak to the FCA policy team and are keen to continue engagement as the policy proposals and wider thinking develops.

We are concerned by the FCA's approach of proposing sweeping reforms that capture all principals with ARs, rather than a tailored, specific approach that focuses on financial services sectors and/or particular AR models that are of concern. In our view the current proposals are not proportionate, as they do not recognise that the mortgage intermediary AR model functions and performs well.

We expected the FCA to undertake a thematic review on the AR regime ahead of a formal consultation. This would have allowed the FCA to investigate key risks based on a thorough review of the use of the model across different financial services sectors. The knowledge and insight gathered would have influenced and driven suggestions on how to tackle the problems identified, allowing the FCA to take a more proportionate approach to its policy proposals.

The consultation paper does not include a specific question on the FCA's Cost Benefit Analysis (CBA), which is concerning as it means stakeholders have not been prompted to comment on this section. With this question absent, the FCA risks a narrow-minded view on the cost to firms particularly as it has only used data already available to estimate the cost to firms of implementation and CBA figures gathered from principals as part of an FCA survey. This was based on principal's existing costs before details of the proposals were published and therefore we do not feel this is an accurate basis for the CBA.

We are concerned the FCA believes the extent of this consultation is low level when it is far reaching and will have considerable impact on our sector. We share our views on this throughout our response.

We have included our comments to the CBA in this section.

<u>Use of the AR model in the mortgage intermediary sector</u>

In our view, the FCA has taken a 'one size fits all' approach to its policy proposals. AMI represents a wide range of firms of different sizes and structures, including firms with ARs, IARs and those that operate a network model. Mortgage networks span those with a small number of Appointed Representatives (ARs), to larger networks with hundreds of ARs.

The AR regime is well developed, managed, and controlled in the mortgage intermediary sector. It brings benefits such as increased competition and consumer choice; reduced risk of consumer financial exclusion; reduced entry costs for new firms (compared to a DA route) and provides opportunities for entrepreneurial firms to build and grow businesses under the support and guidance of an experienced principal firm.

We feel the FCA's consultation demonstrates a lack of understanding and awareness of the structure and use of the model in our sector. The consultation paper states that just over half of all principals have only one AR – this type of model is uncommon in the mortgage intermediary sector. In our sector the AR regime is well established with robust oversight and control and both the principal and AR share a common commercial objective.

In addition, within the mortgage sector there is strong lender responsibility and oversight of a mortgage intermediary's activities as distributor. We envisage this oversight will be strengthened further by the price and value and products and services outcomes in the FCA's Consumer Duty and believe some of the harms identified previously by the FCA could be mitigated through the Consumer Duty. AMI is of the view that the Consumer Duty should be allowed to embed first before the FCA carries out this work on the AR regime.

<u>Lack of evidence of harms in the mortgage intermediary sector</u>

We understand one driver behind the FCA's desire to strengthen the AR regime is its thematic reviews of the GI and investment management sector, which found significant shortcomings in these markets. The FCA has been unable to provide evidence of similar harms occurring in the mortgage intermediary sector. We therefore feel the FCA is taking a broad brush approach that unfairly penalises mortgage intermediary firms. We do not feel it is satisfactory for the FCA to rely on a survey of mortgage intermediary principal firms as the basis of its information gathering exercise in our sector, to support its policy proposals. We disagree with the FCA's statement that there is sufficient evidence to support a need to intervene to address harm to consumers and markets associated with this model.

We have significant anecdotal evidence from mortgage lenders who obtain circa 80% of their business from the intermediary sector. This splits broadly 50:50 from DA and AR advisers. Historically they have indicated that they could not identify differences in the quality of business from the different channels. However, in recent times some larger lenders have indicated that overall the quality of business is marginally better from AR networks. The biggest gap however, is that the small AR firms are much better than the small Directly Authorised (DA) firms. **We strongly urge the FCA to obtain this factual information as part of its review process, given that this is a credible and reliable source and we are unable to do so due to claimed Data Protection Act (DPA) constraints.**

Unlevel playing field between DA and AR firms

We believe the FCA's proposals create an unlevel playing field between DA and AR firms. Should the proposals go ahead, DA firms will not be subject to the same level of data scrutiny and oversight by the regulator as principals with ARs.

Our member firms affected by these proposals are keen for the FCA to share any learnings from its supervision of DA firms, such as how DA firms manage effective systems and controls to avoid or mitigate similar risks. We do not feel this consultation acknowledges that there are likely similar issues in the DA space; it would be useful for the FCA to explain its supervisory approach in this area to ensure a level playing field.

Principals with ARs understand and accept the risk of appointing ARs and the responsibilities that come with this, as they remain the regulated entity and are liable for the actions of an AR (within the scope of the principal and AR contract). This is precisely why in the mortgage intermediary sector we see principal firms with robust and sophisticated structures and risk and oversight functions. For example, there are mortgage intermediary network firms that have an entire division dedicated to network operations with extensive resources allocated. We therefore question why an extra layer of oversight is required at regulator level within our sector, particularly when we consider the lack of evidence of harms from the use of the AR model within the mortgage intermediary sector.

Data

Figure one in the consultation paper shows the percentage of FSCS claims attributed to principals and ARs compared to non-principals but the FCA does not quantify the FSCS chart, as the FSCS levy limits or the level of claims for each sector are not included; it therefore does not show the full picture and is misleading. Crucially, it fails to acknowledge that a considerable claim amount was attributable to one firm and related to a connected property fraud dating back to 2004-2007.

Figure two (average number of supervisory cases, non-principal vs principal) provides data that is not granular enough to be used as evidence that there are harms arising from the use of the AR model in the mortgage intermediary sector. Mortgage intermediary firms are captured in the 'retail lending' category, a broad category with a wide variety of firms that will use the AR model in a myriad of different ways. We therefore ask the FCA to provide data on the number of supervisory cases (non-principal vs principal) specifically in the mortgage intermediary sector.

The only data the FCA has provided in relation to the mortgage intermediary sector specifically is figure three (complaints per £1m of revenue from regulated activities). Complaints for mortgage intermediary non-principals with revenue under £200,000 are higher than complaints for principals in this category. The FCA mention this briefly in its consultation whereas further analysis would have been beneficial. For example, has the FCA considered the value of complaint handling and guidance a principal firm provides to its ARs whereas a DA firm under £200,000 revenue would not have access to this level of support? Could this be the reason behind this anomaly?

The FCA acknowledges itself that the complaints data set has some limitations. We agree and in our view the data supplied within the consultation paper is not robust enough to evidence and justify why the FCA feels the policy proposals should apply to the mortgage intermediary sector. We request the FCA provides further evidence to demonstrate the issues it believes exists with the AR model in the mortgage intermediary sector.

We also feel that there is a lack of detail in the consultation on how the FCA is going to apply and interpret the data obtained from firms. Given the changes principals will have to make, we request the FCA provides further detail on this to assist both principal and AR understanding.

Regulatory host definition

We are concerned that some mortgage networks, based on the current draft definition, will be captured as regulatory hosts (we explain our reasons why in the relevant section of our response). We do not believe it is the FCA's intention to capture traditional mortgage networks under the regulatory host definition. Our members are keen to work with the FCA on an appropriate definition of a traditional network and regulatory host to ensure a clear distinction is made between the two.

Implementation/transitional challenges

Whilst the majority of our member firms within scope will likely already meet the majority of the proposed new requirements, they are unlikely to have the data calibrated to the FCA's prescribed formats and/or may not have data to the level of granularity required. This presents a significant challenge to principal firms, particularly when we consider the reporting timeframes and other significant regulatory work that will be carried out at the same time (such as the Consumer Duty and operational resilience).

It is therefore paramount that there is a minimum 12 months transitional/implementation period, with reporting time limits applying thereafter. This will allow firms to prioritise work alongside other regulatory commitments more effectively. We explain our thoughts further on this as part of our response.

There are also implications for principals under the Senior Manager and Certification Regime (SMCR). Due to the reporting and attestation requirements principals will have to make changes to statements of responsibility and responsibility maps, as these will become additional responsibilities under the SMCR. This builds further costs (e.g. time, resources) into the proposals, further demonstrating the proposals are not as straightforward as the FCA perceives.

Cost Benefit Analysis

Principals have already incurred increased ongoing annual costs due to the AR and IAR charge introduced in 2021. AMI estimates there are around 6,000 AR and 1,000 IAR firms in the mortgage intermediary sector. Therefore, mortgage intermediary firms are contributing in excess of £1.5m annually to the FCA through the AR and IAR levy (6,000 x £250 and 1,000 x £75), in addition to a firm's standard annual FCA fees. If we consider the average full time FCA employee (fully absorbed) cost is £100,000, then we would expect circa 15 full-time FCA employees to be working on the AR regime in the mortgage intermediary sector alone, based on our sector's contributions. In any case, this would be an excessive and disproportionate allocation of FCA resources and use of fee-payer funds and we therefore question what this levy is being used for in our sector.

We feel that "good" firms are paying for the performance of "poor" firms. Whilst we are aware that the FCA is using the AR/IAR levy as part of heightened supervisory, authorisations and policy resource, given the number of ARs in the mortgage intermediary sector mortgage intermediary firms are funding the bulk of this levy despite not being an area of concern in past FCA thematic reviews. Should these proposals go ahead, we struggle to see how the FCA can continue to justify a flat rate AR/IAR levy payable by all principal firms, as this is not a proportionate regulatory approach. The FCA states in the consultation paper that to date it has used funds from the AR/IAR levy to target high-risk principals and risky business models across sectors. We are not aware of any intervention of this type in the mortgage intermediary sector and therefore feel strongly that the AR/IAR fee moves away from a "polluter pays" funding model. In our view, an annual AR/IAR levy should only be payable by those sectors where shortcomings were identified in past thematic reviews, with ongoing thematic reviews and monitoring of data used by the FCA to identify other sectors where an annual AR/IAR levy may also be applicable.

We disagree with the FCA's statement that when estimating the costs, it considered the likelihood that most firms should hold the additional information they would be required to report already. Whilst they may have the majority of information, it will not be in the format and granularity required by the FCA. Therefore, principal firms will incur additional costs, such as familiarisation, gap analysis and governance changes; building of IT systems and controls; collation of data in the required format; submission of data; training of existing staff and potentially the recruitment of new staff.

The FCA has viewed this consultation in isolation and has not adequately considered the cumulative effect of existing and forthcoming regulatory requirements that overlap. Firms within scope of these proposals are also implementing/due to implement at the same time as the AR regime requirements the following:

- Operational resilience. By H1 2022 firms will be in the process of demonstrating they can remain within their impact tolerances.
- Fair value work (GI and pure protection products). Firms have until end of September 2022 to complete value assessments.
- Consumer Duty. The FCA has proposed that full implementation of the Consumer Duty will be required by end of April 2023.
- Diversity and Inclusivity (D&I). The FCA plan to publish a Consultation Paper on D&I in H1 2022 and a Policy Statement in H2 2022. We expect these requirements to also be data driven.

This is on top of firms being asked to finish embedding SMCR, operate new ways of working post-Covid-19, provide enhanced data for authorisations and provide data for ongoing FCA Covid-19 financial resilience surveys.

All of this puts significant stress and pressure on firms, particularly risk and compliance teams that are working on all of these projects. Therefore, a minimum 12 month implementation/transitional period is essential to allow firms to manage and execute their projects across all these areas.

Collectively, existing work and that of the AR regime requirements involve the same business functions and employees at a principal firm. We therefore disagree that one-off staff costs should be limited; whilst firms are already required to ensure they have adequate resources to monitor and enforce compliance in respect of the AR, this is by no means not the only variable that firms will have to consider as part of these proposals.

We believe the FCA has significantly underestimated the costs in the CBA as principal firms will incur large overheads, with both direct and indirect costs. The FCA has also vastly underestimated the amount of staff resources required to meet the requirements, notably the requirements relating to ongoing notifications, annual review and self-assessment. To illustrate, the proposed new requirement at SUP 12.6A.2.R would require a principal firm's board to review each AR's solvency and fitness and propriety. If we take a firm that has 700 ARs, this will take significantly longer than the six working days estimated in the CBA. Even if the annual review took one hour per AR (a reasonable estimation in our view), this equates to 700 hours which is 100 working days for one person. Another example is the proposed annual verification of all AR information on the FS Register. If this took 15 minutes per AR (a lower end estimate), based on 700 ARs this would equate to 25 working days for one person.

There is a risk that principals pass on increased regulatory costs to consumers (not only from this consultation but due to the overall effect of increased costs relating to the Consumer Duty and increased FCA, FOS and FSCS costs), increasing the cost of advice and the risk of consumer financial exclusion.

We believe the FCA has failed to explain how it estimated and quantified firm costs in the CBA. It is not sufficient to rely on the principal firm survey, as this asked firms about existing costs based on current requirements. We would ask the FCA to consider the time and staff resources it has invested to reach this point in the consultation stage and to be mindful that this is likely to be even greater in principal firms.

<u>Summary</u>

We request the FCA provides additional evidence on any shortcomings of the use of the AR model in the mortgage intermediary sector to justify why these policy proposals should apply to this market. It is not sufficient for the FCA to make the statement that there are more issues arising from principals and ARs than from other DA firms based on complaints data, and other evidence such as the principals survey, alone. This should be backed up by more robust evidence.

We feel mortgage intermediary firms are being unfairly penalised for failures in other financial services sectors, such as wholesale, technology, banking, GI and investments. Our member firms within scope will incur significant cost to implement the requirements, on top of the circa £1,500,000 we believe the mortgage intermediary sector contributes annually to the FCA via the AR/IAR levy introduced last year.

Notwithstanding our views on why these proposals should not apply to the mortgage intermediary sector, we ask the FCA to consider an implementation/transitional period, as this is not mentioned in the consultation. We believe a minimum of 12 months implementation/transitional period from the date of publication of the policy statement is essential to ensure firms can meet and evidence the requirements, submit the data in the required formats and execute their work effectively on the Consumer Duty (and for many larger firms operational resilience) at the same time as the AR regime requirements.

Overall, we are concerned that these proposals could radically alter the structure of the mortgage intermediary market and models. **AMI and a select group of its members affected by these proposals are keen to meet with the FCA to discuss our concerns further**.

We would remind the FCA Executive Director, Consumers and Competition of the words of the Economic Secretary to the Treasury that he considered the mortgage market to have low inertia, be competitive with decent consumer outcomes and that the FCA should take care not to damage that.

In addition, in a recent retail banking review, the FCA commented that it believes the increased use of mortgage brokers (63% of consumers used a mortgage broker for a new mortgage product in 2015, increasing to 73% in 2020) has contributed to increased price competition and lower numbers of consumers on Standard Variable Rates (SVRs)[1]. With the AR regime a common structure in our sector, we believe the flexibility and opportunity this model provides has played a key role in this growth and also in delivering good customer outcomes.

We do not consider that the AR regime in the areas of mortgage and protection advice requires any significant change. Indeed, we would ask that if change is to be undertaken, that “carve out” or protections are provided to avoid this effective market incurring limits to its ability to operate or additional costs.

[1] https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf

Questions

Q1: Do you agree with our proposal to require principals to provide more information on the business their ARs conduct?

We are of the opinion that whilst our member firms within scope are already collecting much of this data in some shape or form, the challenge will be ensuring it meets the FCA's proposed format. This will require principals to review and rebuild existing systems and controls, such as internal processes and IT systems.

The FCA explains that principals will be required to provide information about the nature of financial arrangements between the principal and AR and gives the example of whether the AR pays or will pay the principal commission, any flat fees, or any additional payments. This doesn't lend itself to the mortgage intermediary network model and our members are keen to have the opportunity to discuss this further with the FCA ahead of publication of the Policy Statement.

It is not clear from the consultation paper how long principals will have to provide information on the business conducted by their ARs. Many of our network member firms have a significant number of ARs, this is therefore a comprehensive and detailed task to ensure that the data is ready for submission in the prescribed format. Firms will not have confirmation of the final rules until the policy statement (PS) is published in H1 2022 and therefore cannot commence any projects with certainty. We believe there should be a minimum 12 months implementation/transitional period from the date the final rules are published.

We are concerned that this proposal creates an unlevel playing field between DA and AR firms. Should this proposal go ahead, principals with ARs will be required to supply to the FCA a much greater volume of data compared to the requirements placed on DA firms.

We agree with the proportionate approach for IAR data.

Q2: Do you agree with the reporting timeframes we propose for reporting?

We understand the 60 day timeframe proposal is an initial notification and therefore it is important the 60 day reporting timeframe does not impede nor lengthen existing processes.

AMI has received feedback from our members that the FCA authorisations team is slow to approve applications and on occasions has reverted back to the firm with further, often spurious and irrelevant, questions at the last moment in an apparent bid to ensure internal SLAs are met and the application is kept "in progress". We have concerns the FCA could come back to a principal firm on day 59 with additional questions and this would elongate the process. This could have a significant impact on an AR firm switching network as it will be unable to trade for a period of time and could also impact the revenue stream of the principal firm.

It is therefore important for the FCA to ensure it can achieve its SLAs without resorting to what we view as effectively internal "sludge" practices. We would also ask for assurances that existing FCA staff will be adequately trained in the necessary skills and expertise to review and interpret the increased volumes of data that will be submitted by principal firms. It is positive the FCA recently announced it has recruited 95 new employees in the authorisations team[2] and our member firms look forward to quicker authorisation approvals in due course.

The consultation states that for existing ARs principals will have up to 60 calendar days after the rules come into force. We believe a minimum 12 month transitional/implementation period is essential, with the 60 calendar day timeframe applying thereafter. This is to ensure that principal firms can evaluate

[2] https://www.fca.org.uk/news/speeches/enhancing-uk-capital-markets-fca-role-priorities

how current systems produce information and assess the changes required; update and test IT systems; amend internal processes and procedures; and collate, analyse and submit the data to the FCA in the prescribed format. This is an extensive task particularly for networks that have hundreds of ARs. A minimum 12 month transitional/implementation period ought to apply in respect of information for both existing and new ARs; if this is misaligned it has the potential to cause a chaotic submission process.

The consequence of not applying a minimum 12 month transitional/implementation period is that, in order to meet the deadline, firms would have to start collecting the proposed data now. This is unreasonable as the Policy Statement has not been published and should the requirements change upon finalised rules, firms would have to repeat this work. Firms therefore cannot commit to internal projects until they have certainty over the final rules. A transitional/implementation period of a minimum 12 months is seen as essential to ensure firms are sufficiently prepared for the first data submission, with IT systems tested and developed to a level that allows automation of the data and minimises the need for manual work. This all takes time.

AR firms will also need to change the way they collect and report information to their principal. This will be particularly burdensome for smaller AR firms (for example sole traders), who have limited resources. This is a further reason why a minimum 12 months transitional/implementation period is essential, to allow principal firms to co-ordinate changes with their ARs and to ensure AR firms can make necessary changes to their own systems, controls and procedures.

In our view, a transitional/implementation period of less than 12 months would prove challenging against other significant regulatory work, such as the Consumer Duty.

We agree with the proposal to require principals to report to the FCA any planned changes to the AR's name or to the categories of regulated activities the principal allows the AR to use, at least 10 calendar days before the change takes effect.

Q3: Do you have any suggestions on how the potential burden, particularly for firms with many ARs, of providing this information to us could be managed?

As noted in our response to question two, it is important that principal firms are afforded sufficient time to collate and submit data in respect of existing ARs. This hinges on the implementation/transitional period, with a minimum 12 month implementation/transitional period, in our view, essential to help alleviate the burden on those firms with many ARs.

The consultation explains that submission of information for ongoing reporting of new and existing ARs businesses will be via Connect. However, for firms with a large number of ARs (such as mortgage networks) this is a significant administrative task as under current proposals the FCA will require one form to be completed for each AR.

To reduce the burden, we suggest the FCA also considers the option of bulk upload (via Excel for example). This approach was used when firms submitted Directory persons data to the FCA. Should this approach be taken, it is important the FCA considers lessons learned from the Directory project. For example, Directory persons data submission was required by a set date and the risk with requiring data within 'x amount of days' (as per many of the current proposals), is that firms may all report at the same time and as close as possible to the final submission date. It is therefore crucial that the FCA is able to manage large volumes of data submitted this way. AMI and its member firms would be happy to provide feedback on their experiences of Directory persons data submissions, to help inform the FCA on a suitable approach.

Q4: Do you agree with our proposal to require principals to verify the details of their ARs?

We disagree with this proposal. In May 2018 the FCA removed the reporting requirement in SUP 16.9, which required firms to send annually to the FCA an updated copy of the Financial Services Register with changes to ARs marked. This annual reporting requirement was considered surplus to the FCA's supervisory needs given the notification requirements set out in SUP 12.7.

We believe a similar approach is required here, whereby firms are required to carry out an initial one-off update for existing ARs, after which the new information is included in notifications when a principal firm appoints a new AR, as well as the notification requirements for any changes in the information previously submitted. We do not feel there is a need to duplicate effort with an annual review of all the information on the FS Register, as this will be even more onerous than the SUP 16.9 requirement that was removed in 2018.

We ask for clarification that reference to a firm's accounting reference date (ARD) refers to the ARD of the principal firm and not the AR firm.

Q5: Do you agree with our proposal to include details on the regulated activities of each AR that a principal takes responsibility for on the FS Register?

We agree with the intent behind this proposal as it is important that consumers can easily verify the scope of the activities an AR is permitted to undertake. However, the Financial Services (FS) Register in its current guise is not consumer friendly and therefore we feel this may hinder the extent of the intended benefits anticipated by the FCA.

We are concerned by comments made by the Complaints Commissioner in her final report into the FCA's oversight of LCF[3], as she states that she 'received many responses raising concerns about the Register' and cites an example from a complainant that in their view the Register is too involved or complicated to manage, especially for those with limited IT skills.

Can the FCA confirm whether it has/will:

- Conduct consumer research post-launch of the updated FS Register to highlight areas for improvement.
- Test, before any rules are implemented, consumer understanding of additional text showing the scope of an AR's activities.

These assurances are viewed as important by our member firms.

We would also encourage the FCA to understand the % of Register users that are consumers. We are concerned that currently a considerable number of users are industry professionals or recruitment consultants and therefore this data is important to ensure this proposal is proportionate against the perceived benefits.

[3] https://frccommissioner.org.uk/wp-content/uploads/The-Complaints-Commissioner-Final-Report-LCF-15.02.2022.pdf

Q6: Do you agree with our proposal to require principals to provide complaints data on their ARs?

Whilst our member firms already supply complaints data to the FCA on an aggregated basis, the challenge is that they are unlikely to collect the data in the same format proposed by the FCA. It will take considerable time for principal firms to collect, collate, scrutinise and store this information and therefore, for most firms, will involve new processes and procedures.

We view the requirement to submit reports to the FCA within 30 business days of the end of the relevant reporting period as adequate, on the basis that firms are provided with a minimum 12 months implementation/transitional period to alter processes and IT systems and collate the data in preparation for the first submission.

We ask the FCA for clarification as to whose accounting reference date should be used – is this the principal firm's or the AR firm's? We have interpreted this as the principal firm; if this is correct, it should be made clearer in the Policy Statement and final rules. An accounting reference date based on each AR would be too complex for a principal to implement and administer, as each AR does not have the same reporting date.

We also ask the FCA for clarification as to whether this data requirement applies retrospectively. We would not expect firms to be required to submit complaints data for a period that falls before the rules come into force. We believe a transitional period for existing ARs is also appropriate under this section (i.e. principals provide this information for the first full year of data following the rules coming into effect), however this has not been included in the proposals.

Q7: Do you agree with our proposal to require principals to provide revenue information for their ARs?

The proposal to provide revenue information on ARs is more complicated than the proposal to provide complaints data. The challenge is collating this data, as the data will need to be obtained from multiple sources and the level of data currently asked will differ between each AR. It is not consistent with the data supplied on a firm's RMAR. This will therefore require significant change to a principal's internal processes and procedures.

We do not believe the current proposals under this section are proportionate and aligned with the FCA's policy aims. We understand that the FCA wants to be able to better assess the size of ARs and the potential impact their business might have on consumers or the principal's ability to pay any redress for harm, however most AR firms within the mortgage intermediary sector are sole traders. We are therefore concerned that principal firms will spend considerable time collecting and submitting data that will be of little value to the FCA.

We disagree with the proposal to require principal firms to provide data on an AR's non-regulated activities. We do not deem it reasonable for this requirement to apply to mortgage intermediary principal firms for the following reasons:

- A mortgage intermediary principal firm is not responsible for an AR's non-regulated activities under the AR's contract (to do so would make PII prohibitively expensive and/or reduce the benefits of the AR regime. It would also not prevent an AR from setting up a non-AR separate business for non-regulated activities).
- The FCA has not adequately considered the breadth of the proposal to report on non-regulated AR revenue. To illustrate, some principal firms would have to report non-regulated revenue of estate agencies within their business i.e. revenue derived from house sales. This appears an excessive requirement and is little benefit when considering the aims of this policy proposal.

- Many mortgage intermediary ARs undertake commercial buy-to-let business which is not regulated by the FCA. We propose that this type of non-regulated business (i.e. where it is undertaken by an AR that also carries out regulated business) should be included within regulated revenue figures, otherwise there is the risk that non-regulated financial services revenue figures present a distorted view of the size and scale of an AR. This would mean principal firms only report on non-regulated business of ARs where regulated financial business is not the primary activity, presenting the FCA with a much clearer indication of potential risks and harm.
- It creates an unlevel playing field between DA and AR firms. DA firms are only required to report via the RMAR earnings from non-regulated business activities if they are a firm where regulated financial business is not their primary activity.

An alternative and more proportionate approach would be for the FCA to identify areas of concern through thematic reviews. The results of a thematic review would then drive the assessment whether a principal firm operating in that specific market is required to provide non-regulated revenue information of its ARs.

If the rules go ahead as drafted, the practical implications of requiring firms to report on non-regulated activities is that both principals and AR firms will need to go to considerable lengths to obtain information on non-regulated activity, as AR management accounts are unlikely to capture this data. This means an AR firm would need to collate data from its own spreadsheets or, a more likely scenario in order to give assurances to the principal firm as the regulated entity that the data is accurate, obtain information from its accountant. We see this as unreasonable and risks a complicated process that is not balanced against the aim of the policy proposal.

Whilst our preference is for mortgage intermediary firms to not be required to report on non-regulated revenue of ARs, the FCA could consider taking an exception based approach on the reporting of non-regulated activities. In our view revenue should be viewed as:

- Regulated revenue (for example, regulated mortgages).
- *Revenue earned by an AR of a regulated firm that is non-regulated financial services activity (for example, commercial BTL).
- **Other non-regulated revenue that does not fall into the above two categories.

*Principal firms should be able to include this data within the ‘regulated revenue’ category. Given the policy aims, we cannot see the benefit to the FCA of splitting this out.

Only if the ‘other non-regulated revenue’ is above a certain % of an AR’s total revenue **and regulated financial business is not the AR’s primary activity, should a principal firm be required to report.

To illustrate, the FCA could require principal firms to report AR revenue derived from ‘other non-regulated revenue’ where this is at or above a set percentage of an AR’s overall income. This percentage would be set by the FCA at a certain percentage, such as 50% as an arbitrary figure, meaning principals will not be required to report on AR non-regulated business revenue that falls below this percentage. This approach should help the FCA identify firms of concern more easily but does not solve the challenge of some principal firms having to collate and monitor non-regulated revenue of their estate agency businesses, as an example, which we deem excessive against the policy aims.

We therefore do not deem it reasonable for the FCA to require all principal firms to report on non-regulated business. The FCA must take a more tailored and sector specific approach.

The requirement to provide the proposed information within 30 business days of a firm’s accounting reference date is not feasible. We believe this should be at least within 60 business days of a firm’s accounting reference date. We ask the FCA for clarification as to whose accounting reference date should be used – is this the principal firm’s or the AR firm? We have interpreted this as the principal firm; if this is correct, we believe it should be made clearer in the Policy Statement and final rules. An accounting reference date based on each AR would be too complex for a principal to implement and administer, as each AR will not have the same reporting date.

We agree with the proposal to apply a transitional period for existing ARs, so that principals provide this information for the first full year of data following the rules coming into effect. We agree that principals should not be required to provide revenue data on non-regulated activities of their IARs.

This is an area which would benefit from further discussion with the industry prior to completion of any Policy Statement.

Finally, as a data led regulator, does the FCA plan to link into HMRC systems as part its plans on digital regulatory reporting? This would allow the FCA to extract up to date information in a timely manner and reduce the reporting burden on principals.

Q8: Do you agree with our proposal to require principals to notify us if they provide or intend to provide regulatory hosting services?

We agree with this proposal, however it is important the definition of a regulatory host is re-drafted to ensure mortgage networks are not inadvertently captured within the definition of 'regulatory host'. Please refer to our comments in question 28.

Q9: Do you agree with our proposed guidance for principals to put appropriate safeguards in place where a function or task is delegated to an AR or tied agent?

We agree with the proposed guidance, however, whilst the draft guidance suggests that firms should consider SYSC 3.2, our members have asked for further clarification on the scope of 'delegation of a function or task' and the extent of FCA expectations. For example, is allowing an AR to have an individual, who is one of their own members of staff, to undertake T&C activity on the other advisers within the AR, and who in turn is supervised by the principal, considered to be delegating a function or task to an AR?

As a principles based regulator, it is important that the FCA is not prescriptive as this allows principal firms flexibility to apply appropriate safeguards relative to the size and scale of its ARs.

Q10: Do you agree with our proposals in relation to principals' annual assessment of ARs' fitness and propriety and the proposed considerations they should have to achieve this?

We believe this is a reasonable proposal, however at draft rule 12.6A.2 R (2) the word 'manager' is introduced yet no definition is provided. Will the definition of 'manager' fall in line with the definition in the FCA Handbook? If so, this is wide in scope and could capture a significant number of managers within an AR firm. We would be grateful for comments from the FCA on the extent of its expectations alongside clarification as to the definition that applies.

We agree with the proposals put forward and that the proposals in paragraphs 4.15 to 4.21 should not apply to IARs.

Q11: Do you agree with our proposed guidance on what we expect 'reasonable steps' to be?

Yes, we agree. Our member firms would view this as a common sense approach.

Draft guidance SUP 12.4.4G section four states that firms should 'engage regularly with its appointed representative, whether through in-person meetings, telephone calls or email communication'. Due to the pandemic firms have increased their use of virtual calls (such as Teams and Zoom) and we ask the FCA for clarification that this type of communication would be deemed to be part of a principal's regular engagement with an AR.

Q12: Do you agree with our proposals to clarify what we mean by adequate resources and controls and how to assess whether these are appropriate?

We agree with this proposal. It is important the FCA does not define 'adequate resources and controls' any further than the current draft guidance, as firms need to be afforded flexibility to make their own assessments and determinations.

We would appreciate confirmation from the FCA that as long as a principal's controls and resources are adequate, this does not limit the number of ARs a principal firm can have. Any consideration as to whether limiting the number of ARs is an appropriate policy approach should be consulted on separately and we share our views on this later in our response.

Q13: Do you agree with the proposed circumstances which should trigger a review of principals' oversight appropriateness?

We agree with the proposed circumstances. It is important the FCA does not define 'short period of time' as this allows principals to take an individual risk based approach with each AR.

We ask the FCA to clarify what it means by/its expectations on 'Other staff of the appointed representative involved in carrying on the regulated activities for which the firm has accepted responsibility' (SUP 12.4.4F 1 B ii). This could be viewed differently by firms based on whether staff in its ARs are involved in mortgage and/or insurance activities, this is because the scope of the Insurance Distribution Directive (IDD) includes individuals that are 'assisting in the administration' of insurance but excludes individuals doing work 'devoted solely to administrative tasks'.

We therefore request the FCA clarifies what is meant by 'involved in carrying on the regulated activities' as this is too vague. It's important that AR firms are not required to capture information to submit to its principal on turnover of ancillary staff, such as cleaners, receptionists, catering staff and security staff. We do not envisage this is the intention but further guidance is necessary to avoid any ambiguity.

Q14: Do you agree with our other proposals for principals to ensure they can effectively maintain pace with AR growth?

We agree with the proposal to require principal firms to ensure that its written contract with each of its ARs enables the principal firm to terminate the contract in the event that the principal firm determines that it is no longer able to adequately oversee the activities of the AR.

It is important that, as proposed, principals only have to amend existing AR contracts to capture this from the next contractual renewal date/revision point. Given the number of ARs that some of our member firms have, this will help to reduce the administrative burden of this proposal.

Q15: Do you agree with our proposed guidance for principals overseeing individuals at their ARs to a comparable standard as if they were directly employed by the principal?

We agree but it is important that this proposal does not change the nature of the relationship between the principal and financial services staff working at the AR firm in connection with a regulated activity. A principal and AR firm does not have the same employer/employee relationship as an employee working directly for a principal firm, therefore the same associated rights and responsibilities do not exist. There are also potential IR35 implications if a principal firm is expected to treat self-employed/AR staff as if they were employees of the principal firm.

Q16: Do you agree with our proposals on principals ensuring ARs' activities do not present an undue risk of harm to consumers or market integrity?

We agree. The FCA's proposed guidance at SUP 12.4.4CG helps mitigate concerns over the potential open ended nature of 'undue risk of harm'. For member firms within scope of the FCA's work on operational resilience, we feel this proposal complements requirements under PS21/3 Building operational resilience.

It will be important for firms to manage their MI effectively to help identify undue risks of harm before they crystallise.

Q17: Do you agree with our proposals in relation to principals conducting an (at least) annual review of their ARs' activities and business?

We agree that this is a sensible proposal. Most firms will already have a linear risk based assessment based on a number of triggers.

However, we refer back to our comments in our introduction on the extensive time and resources involved in an annual review. If we take a firm that has 700 ARs, this will take significantly longer than the six working days estimated in the CBA. Even if the annual review took one hour per AR (a reasonable estimation in our view), this equates to 700 hours which is 100 working days for one person.

We also agree that proposals in paragraphs 4.61 and 4.63 should not apply to IARs.

Q18: Do you agree with our proposals for the termination or remediation of AR contracts?

We agree.

Q19: Do you have any comments on our proposed requirement for principals to create, and maintain, a self-assessment document?

We agree with this proposal. It is important that, as proposed, the annual document will not need to be submitted to the FCA and, as suggested, principals with multiple ARs will only be required to produce a single self-assessment document covering all the required information, rather than one document per AR. This will help to reduce the administrative burden on our member firms.

Q20: What do you consider are the harms and benefits in the regulatory hosting model? It would be helpful to set out your views on whether principals providing regulatory hosting services can exercise adequate oversight over their ARs and be commercially viable, and if so how.

AMI is concerned that some mortgage networks might meet the definition of the regulatory hosting model as they only provide support services and do not employ advisers themselves. We do not believe the FCA intends to capture traditional mortgage networks in the regulatory host definition.

This does not mean mortgage networks lack competence, as the Senior Managers regime and the appropriate T&C model together with Sourcebook requirements provide clear rules for relevant oversight and control. In addition, in order to have access to lender products significant review is undertaken in order to allow these entities to submit business. These are important industry controls to ensure proper consumer outcomes.

We request the FCA re-drafts its definition of a regulatory host and defines what it views as a traditional network model. This will help to ensure a distinction is made between the two and ensure a mortgage network is not inadvertently captured as a regulatory host. Our member firms are keen to work with the FCA on suitable definitions.

Q21: Do you consider that the regulatory hosting model in the investment management sector (as described), including the secondment model, is appropriate?

No comment.

Q22: Do you consider that the use of the ‘Host AIFM’ model, including where staff are seconded from principal to AR, is compatible with ensuring good outcomes for consumers and markets?

No comment.

Q23: How should ARs be allowed to market themselves in relation to activities they cannot lawfully undertake, e.g. acting as investment managers?

No comment.

Q24: What do you consider are the harms and benefits in smaller principals with larger ARs? It would be helpful to set out your views on the conflicts of interest from the principal being overly reliant on its ARs for income within these business models and on whether these firms can exercise adequate oversight over their ARs, and if so how.

In the mortgage intermediary sector, there are smaller principals with larger ARs. This is the nature of a sector where a network model is used, as a principal firm, where appropriate and required by an AR firm, provides support and guidance to nurture the AR's business. With this naturally comes growth of the AR firm. We view the relationship between the principal and AR as one that extends beyond regulatory but feel the FCA does not give consideration in the consultation to this important point.

Many of our member firms are totally reliant on their ARs for income; again, this is the nature of the network model. We do not believe there is the risk of conflicts of interest from the principal being overly reliant on its ARs as a whole for income (provided the ARs are sufficiently managed and controlled, which the enhanced guidance under these proposals will help strengthen across all principal firms). However, in our opinion the risk lies with smaller networks that have a small number of ARs with one that is disproportionately large.

Most firms in the mortgage intermediary sector with ARs are well blended with a variety of firm sizes. They exercise adequate oversight over their ARs through monitoring of MI, specific advice checking teams (in some principal firms this can be as many as 50 people) and in some firms, use of technology to strengthen their oversight further.

Q25: Do you consider there are challenges where principals appoint overseas ARs? Are there benefits to appointing overseas ARs?

Our market excludes this and therefore we can see no benefit.

Q26: Do you have any comments on the policy options set out above in paragraph 5.34 onwards?

We have provided comments on policy options that we feel capable of providing an opinion on:

- **Limit the size of ARs**.
    - In the mortgage intermediary sector, there is a blended mix of AR firm sizes. It is not just the size of a firm that influences its decision to become an AR or DA firm, there are many other contributory factors.
        - For example, mortgage networks assist AR firms to evolve and if the AR is entrepreneurial, networks provide support and guidance to help them grow. AR firms may value this more than the flexibility and autonomy being DA affords.
        - Another factor is PII administration and/or costs, where the network benefits from economies of scale to secure renewal premium/terms that may be more competitive than a firm would be able to obtain as DA.

    - This proposal does not include details on what scale/size the FCA sees the size of ARs as an issue.
    - We are concerned that limiting the size of ARs is anti-competitive. We therefore disagree with this proposal and believe the concerns shared by the FCA on issues and harms within the AR regime can be adequately managed and controlled by the original proposals in this consultation, alongside robust FCA supervision and enforcement of its existing and new rules.
- **Require specific consent from us to provide regulatory hosting services or be a smaller principal with larger AR(s).**
    - The FCA has included in this consultation data on FOS and FCA complaints for 'regulatory host' firms. However, it has stated that there is currently no definition of 'regulatory host'. We ask the FCA to clarify which firms are therefore included in this data if 'regulatory host' is yet to be defined by the FCA.
    - Please see our comments to question 28. We do not feel the proposed definition of 'regulatory host' is adequate as it may inadvertently capture some mortgage networks. This definition should be reviewed and finalised before inviting further views on this policy proposal. **AMI would welcome the opportunity to discuss this with the FCA policy team.**
    - We consider a more proportionate approach would be to consider a 'principals permission' gateway for principal firms to go through if they have ARs over a pre-determined size (relative to the size of the principal firm). This will help the FCA to monitor smaller principal firms with a dominant AR. We would expect this proposal to be subject to a specific consultation (akin to HM Treasury's consultation on a financial promotions regulatory gateway), where further detail is provided on how it would operate and to seek industry and stakeholder views.
- **Require firms that want to provide regulatory hosting services to notify us of their intention to do so before beginning to provide these services.**
    - Our same comments apply as above – the definition of regulatory hosting services would need to be reviewed and finalised before inviting further comments on this policy proposal.
- **Principals to regularly review the proportionality of business carried on by ARs.**
    - We do not see the benefits this proposal would bring above and beyond the rules and guidance proposed as part of the main consultation (for example, the proposals in relation to principals conducting at least an annual review of their ARs' activities and business).

Q27: Are there any other options we should consider?

No comment.

Q28: Do you have any suggestions on how we should define 'regulatory hosting' or what we should consider in doing so?

We are concerned that some of our member firms may inadvertently fall into the definition of regulatory host, despite our understanding that this is not the intention as they operate as mortgage networks (principals that have a group of ARs, sharing a common commercial objective and operating in the same market).

Point (a) and (b) of the regulatory host definition (*the firm does not carry on any regulated activities in a principal capacity* and *the regulated activities carried on by one or more appointed representatives of the firm are not connected to any regulated activity undertaken by the firm in a principal capacity*) does apply to some of our member firms. For example, there are some principals that are directly authorised by the FCA and do not have advisers within their limited company or authorised entity. The parent legal entity may have other companies in the group who are ARs of the authorised entity as well as them approving other firms who are not "Companies House" connected. However, it's important to note in the mortgage intermediary sector AR firm(s) undertake regulated activities in line with the principal firm's permissions.

There is a risk that if the regulatory host definition captures mortgage networks, some networks may consider whether running a network is a viable business model. They may exit the market and set up a compliance support business instead. The industry could lose significant network expertise and experience, which has helped to drive the growth of the mortgage intermediary market and create a vibrant market with a diverse range of AR firms and healthy competition resulting in increased consumer choice.

It is therefore important for the definition of regulatory host does not capture mortgage networks. The FCA needs to clearly differentiate between a network and regulatory host; the FCA has done this in the narrative of the consultation paper but not in the draft definitions of the draft rules. **AMI and our member firms are happy to work with the FCA on a more appropriate definition.**

We also ask for clarification as to who will define a firm as a regulatory host - will this be done by the FCA or by the firm itself?

Q29: Do you have any views or comments on where prudential standards should be introduced or enhanced to reflect the harm posed to consumers and markets by firms with business models that include ARs?

In our firms' work on operational resilience very few processes have been identified which would occasion significant harm to consumers in the event of a "failure". Also, firms within scope of the operational resilience policy have considered the substitutability of their services and where disruption experienced by a mortgage intermediary firm is severe and prolonged (whether a principal firm or an AR), a consumer could, in the majority of situations, transact directly with the lender/insurer or use another intermediary.

In the event of network failure, the biggest "losers" tend to be the AR firms who are creditors of the network for work completed but not yet paid, rather than consumers. We witnessed this in the last financial crisis of 2007/2008 where three large mortgage networks failed due to the slowing of the mortgage market. These networks cumulatively had thousands of advisers but the monetary redress paid in compensation to consumers was negligible. As neither principal or AR firms hold consumer cash or assets there is unlikely to be detriment. Accordingly, we can see no requirement to increase prudential standards for such firms.

Furthermore, in supporting the FOS and FSCS frameworks as well as having relevant Professional Indemnity Insurance, the mortgage advice sector plays its part in ensuring there are appropriate and timely compensation routes.

We would also highlight how well the mortgage intermediary market withstood the seismic shock of Covid-19 and showed resilience at a time of increased demand due to the government's stamp duty holiday.