

Mortgages Market Study

Interim Report

Market Study

MS16/2.2

May 2018

How to respond

We are asking for comments on this report by 31/07/2018

You can send them to:

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takes you to helpful abbreviations

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1 Executive Summary

Introduction

- 1.1** The mortgage market plays a crucial role in the UK economy. Every year, thousands of consumers finance the purchase of their homes with a mortgage, or re-finance existing mortgages. Mortgage debt accounts for over 80% of total UK household liabilities, so choosing a mortgage is one of the most important financial decisions consumers have to take. It can also be a difficult one to get right.
- 1.2** The mortgage market today is very different to how it was before the financial crisis. This reflects both the immediate market reaction to the crisis and the subsequent regulatory response, including our Mortgage Market Review (MMR) which sought to prevent a return to previous poor practices.
- 1.3** The FCA is keen to understand how well certain important aspects of the market are working now, in part to help assess the impact of parts of the MMR such as the impact of advice and intermediation. So in December 2016 we launched a market study¹ into first-charge residential mortgages.
- 1.4** In this report we explain our findings and the way we would like to see the market develop. We welcome your comments.

Our objective

- 1.5** A market study typically involves looking at a market holistically to understand the impact of market forces and structures. It is in-depth, evidence-driven and typically considers the behaviour of consumers, firms and potential new entrants. The primary aim is to identify if and/or how a market could be made to work better going forward, rather than focussing on past firm conduct and our rules.
- 1.6** Our published terms of reference set out the scope of the mortgages market study. In light of previous FCA work in this sector, we have focussed on (i) consumers' ability to make effective choices given the tools available, and (ii) commercial arrangements between firms leading to possible conflicts of interest.
- 1.7** We have sought to identify opportunities for technology to improve how the market works in the longer term, particularly by helping consumers make effective choices. Further, we have looked at the extent to which certain existing consumers servicing a mortgage on a relatively high reversion rate (the interest rate payable once an introductory rate ends) may be experiencing harm because they are unable to switch to a better deal. These customers are sometimes referred to as 'mortgage prisoners'.

1 MS16/2 Mortgages Market Study: Terms of Reference www.fca.org.uk/publication/market-studies/ms16-02-1.pdf



1.8 Our vision for the market is one in which:

- borrowers who can afford a mortgage can choose suitable and good value products and services
- firms have a culture of treating all consumers fairly, and
- competition and proportionate regulation empower consumers to make effective choices before taking out, and throughout the life of, a mortgage

1.9 In this report we describe how well we believe the market is working currently and how we would like to see it develop.

What did we find?

1.10 There are around 8 million regulated, first-charge residential mortgages in the UK. Worth at least £1 trillion, this is one of the largest retail financial markets.

1.11 In 2016 there were 1.9 million mortgage transactions. Around 80% were advised and around 50% were arranged by an intermediary. These figures include customers moving to a new introductory deal with their existing lender (internal switches). Internal switches are a significant feature of the market and more likely than other types of transaction to be carried out without the customer receiving advice.

1.12 Overall, we found a mortgage market that is working well in many respects, but which fell short of our vision in some specific ways. There is no single factor behind this; the picture is complex. The tools available to consumers, commercial incentives for intermediaries and lenders, and aspects of the regulatory framework all play a part. In the next phase of this study we plan to narrow down our focus to concentrate on those specific issues.

What is working well in the mortgage market?

1.13 Much of what we found was reassuring, including:

- high levels of consumer engagement; currently over three quarters of consumers switch to a new mortgage deal within 6 months of moving onto a reversion rate
- a range of products on offer and apparent competition on headline rates between lenders, though we note that interest rate is not the only factor in the price paid by the consumer
- consumers who use an intermediary do so for a range of reasons, in particular valuing their experience and expertise
- little evidence that current commercial arrangements between firms are associated with material harm for consumers:
 - current levels of commission paid by lenders to intermediaries do not appear to be linked with customers paying more for a mortgage

- customers taking out mortgages through an intermediary that has commercial agreements with an estate agent or developer do not, on average, pay more for a mortgage than customers of intermediaries without such links

1.14 In addition, our thematic reviews on advice and distribution² and responsible lending³ conducted since the MMR indicate that consumers are largely provided with suitable products that they can afford.

How could the market work better?

1.15 We found that there are limitations to the effectiveness of the tools available to help consumers choose a mortgage. This makes it difficult for a significant minority (we estimate around 30%) of customers to find the cheapest suitable deal. Also, while many consumers are active, there appears to be a number of longstanding borrowers on a reversion rate who could save money from switching but do not or cannot.

1.16 We believe the market could work better in a number of ways, while preserving important regulatory protections where these are needed. To help achieve our vision, we would like:

- a.** it to be easier for consumers to find the right mortgage
- b.** there to be a wider range of tools providing consumers with a choice about the support (including advice) that they receive
- c.** consumers choosing an intermediary to be able to do so on an informed basis, and
- d.** consumers to be able to switch more freely to new deals without undue barriers

1.17 Our thinking is influenced not only by our findings but also awareness of other markets. Mindful of the regulatory change that mortgage firms have experienced in recent years, we will not seek to make further changes to those interventions that appear to be working well.

Making it easier for consumers to find the right mortgage

1.18 At the moment, someone looking for a mortgage has to search through many different products. Choice is typically a good thing. But there is no easy way for a consumer to identify, at an early stage, those products for which they qualify. This uncertainty significantly limits a consumer's ability to shop around and (to a lesser extent) inhibits intermediaries' ability to find the cheapest suitable mortgage.

1.19 We estimate that around 30% of consumers (in 2015-2016) could have found a cheaper mortgage with the same key features (eg the duration of a fixed introductory rate) as the product they chose. On average, these consumers paid around £550 per year more over the introductory period compared to the cheaper product. The pattern is similar whether customers used an intermediary or went directly to a lender.

1.20 In the next stage of our work, we want to explore with lenders, intermediaries and mortgage sourcing system providers how the market could develop tools that make it easier for consumers to identify at an early stage those products for which they qualify. One approach could involve lenders making the necessary eligibility and

² <https://www.fca.org.uk/publication/thematic-reviews/tr15-09.pdf>

³ <https://www.fca.org.uk/publication/thematic-reviews/tr16-04.pdf>

other qualification criteria available to other market participants consistently at an earlier stage. This could build on some recent innovation, should assist existing intermediaries, and also create other opportunities for new online tools.

A wider range of tools giving consumers more choice about the support (including advice) that they need

- 1.21** Our rules have resulted in almost all customers receiving advice before obtaining a mortgage with a new lender. The provision of advice involves a financial cost that firms must recoup, and adds to the time involved in choosing a mortgage. But we estimate that, while the majority of customers receiving advice obtain suitable mortgages, advice has little impact (on average) on the cost of the mortgage.
- 1.22** The development of new and innovative tools could provide consumers with opportunities to better compare products, get support (including advice), and apply for a mortgage. If consumers have the opportunity to decide how much support they need, and in what form, this could drive more effective decision-making and greater convenience. However, our existing advice rules and guidance may act as a barrier to this.
- 1.23** In the next phase of our work we will talk to industry and consumer groups in more detail about how the advice standards may be inhibiting innovation and what can be done about that. Solutions could include changes to the trigger for advice, exploring what more can be done to enable intermediaries to offer execution-only sales, allowing firms to promote their execution-only channels on a more equal footing, and/or reviewing relevant guidance about what constitutes regulated advice. We are willing to consider amendments to the Handbook to help the market deliver more effective tools for consumers. At the same time we need to ensure that we do not restrict access to advice for those consumers who would benefit from it.

More help for consumers when choosing an intermediary

- 1.24** Intermediaries have a strong commercial incentive to find a mortgage for a customer and to do so as quickly as possible, both of which are typically in line with a customer's needs.
- 1.25** However, the incentive to find the cheapest mortgage of a given type can be weaker. We found that on average a consumer's choice of intermediary makes a difference to the eventual cost of their mortgage. In particular, we have observed links between more expensive mortgages and intermediaries that typically place business with fewer lenders. But there are few tools to help consumers choose an intermediary.
- 1.26** In the next phase of our work we want to give the intermediary sector (including potential entrants) an opportunity to make it easier for consumers to assess the relative strengths of an intermediary. This could involve developing useful metrics (eg concentration of business with particular lenders, or areas of specific expertise such as lifetime mortgages) and a means of making the information easily accessible and useable.

Fair treatment of consumers who do not or cannot switch (the latter sometimes referred to as 'mortgage prisoners')

- 1.27** The mortgage market has evolved into one where customers take out a series of short term deals. Most consumers in the mortgage market appear well engaged, with switching rates higher than in many financial services markets. But a significant minority of consumers stay on reversion rates for an extended period.

- 1.28** Our analysis focuses on those customers that are on a reversion rate, up-to-date with their mortgage payments, and would benefit from switching. It also takes account of how lenders tell us they treat existing customers applying to switch to a new introductory rate. See Figure 6.1 in Chapter 6 for a summary.
- 1.29** First, we estimate that a small proportion of customers (around 30,000) on a reversion rate with firms authorised to lend would benefit from switching but, despite being up to date with payments, cannot. Around 10,000 of these customers hold mortgages with 'active' lenders that continue to lend to new and/or existing customers; the remaining 20,000 are with firms that, although authorised to lend, are no longer active.
- 1.30** Most of these customers that appear unable to switch took out mortgages (often interest-only) before the financial crisis. Major changes to lending practices during or immediately after the crisis, and the subsequent regulatory response aimed at preventing a return to past poor practices appear to have left these customers unable to find a cheaper mortgage.
- 1.31** This is not a case of historic breaches of lending rules, nor a judgement about the use of reversion rates in the mortgage market. And credit risk appetites will fluctuate to a degree over time. Nonetheless, we are concerned about this situation, which has developed in light of a very significant market and regulatory correction and could be harming a number of customers who are paying more than they should.
- 1.32** We would like to resolve this legacy issue and propose to explore possible solutions with industry and consumers. One option would be for active lenders to volunteer to approve applications for an internal switch from all customers currently on a reversion rate that also meet certain criteria designed to identify those customers that (i) have been affected by the changes in lending practices during and/or immediately after the crisis, and (ii) are up-to-date with their mortgage payments.
- 1.33** This would be a solution that enables all affected customers with 'active' lenders to switch (we estimate around 10,000, as mentioned above). An industry-wide agreement would reinforce this practice where it already exists (many lenders tell us they already do this) and would mean other lenders adopting a similar approach.
- 1.34** Second, mortgage accounts can legitimately be sold on to firms that are not authorised to lend. And, given what we know about these mortgage books from other FCA work, it is possible that many of these customers will also face barriers to getting a new deal with a different lender despite being up to date with payments. But we hold insufficient detailed data on these mortgage books to estimate the number of borrowers on a reversion rate that are unable to switch. Instead, we estimate that around 120,000 customers of firms not authorised to lend could potentially benefit from switching. This is in addition to the 20,000 customers unable to switch (mentioned above) that hold mortgages with firms that, although still authorised to lend, are no longer active.
- 1.35** Where firms sit outside the FCA's regulatory remit and/or offer no new products to new or existing customers the solution is more challenging. The FCA's regulatory remit is a matter for Parliament. We will begin discussions on possible solutions for inactive lenders with relevant firms, consumer groups and government.
- 1.36** Finally, around 800,000 further customers remain on a reversion rate for over 6 months, despite appearing able to and likely to benefit from switching. We estimate

these customers could save around £1,000 per year by switching to a new 2-year fixed rate mortgage (during the introductory period). So we intend to explore simple, low-cost ways to encourage less active customers to switch.

Next steps

- 1.37** We will discuss these findings and our vision with firms and consumer groups. Publication of this interim report is intended to give all interested parties an opportunity to understand and comment on our analysis. Chapter 9 contains a series of questions on which we would specifically be interested in stakeholders' views. We are keen to consider all potential means to achieve the desired outcomes.
- 1.38** We are asking for comments on this report by 31 July 2018. Please send feedback to MortgagesMarketStudy@fca.org.uk. Alternatively you can send feedback by post – please see our address on page 1.
- 1.39** Some of the ideas discussed for making competition work better in the mortgage market are intended to be mutually reinforcing. For example, having better quality tools to navigate the market could go some way to improving customers' willingness to look around for a new deal when they move onto a reversion rate.
- 1.40** Of the potential interventions, enabling consumers to easily identify those mortgages for which they qualify may take longest to deliver, given the nature of the issue and the number of firms involved. We expect to be able to progress other measures more quickly, including any required Handbook changes to rules and guidance as well as industry-driven initiatives.
- 1.41** Around the end of the year we intend to publish our final findings, a summary of feedback received and next steps. Delivery of any interventions involving changes to our rules or guidance will require formal consultation.

2 Our approach

This market study focuses on consumers' ability to make an effective choice of mortgage, given the tools available, and the possible conflicts of interest arising from commercial arrangements.

We have analysed over 1 million mortgage transactions, carried out consumer research, surveyed over 1,000 firms, and received detailed input from around 50 firms. Many are regulated by us (lenders, intermediaries) while others (mortgage clubs, mortgage sourcing systems, estate agents, developers) are not.

We are using this report to explain what we have found and describe how we think the market could be improved. After discussing with market participants and listening to their views, we intend to publish our final findings, a summary of feedback received, and next steps around the end of the year.

Why we decided to look into the mortgage market

- 2.1** Mortgage debt accounts for over 80% of total UK household liabilities, so choosing a mortgage is one of the most important financial decisions consumers have to take. It is also a difficult one to get right.
- 2.2** The mortgage market has been impacted by a significant amount of economic change, such as the financial crisis, and regulatory change in recent years, including our Mortgage Market Review (MMR) which sought to prevent a return to previous poor practices. In 2015 we decided it was a good time to review how the mortgage market is working and whether competition might be improved further to bring greater consumer benefits. Integral to this is a review of some aspects of the MMR.
- 2.3** We issued a Call for Inputs (Cfi) in October 2015 asking for views on how well the market is working. This identified some themes that suggested competition may not be working effectively, as reported in our Feedback Statement in May 2016.⁴
- 2.4** We considered these themes in the context of the FCA's strategy and priorities, our other ongoing and planned work in the mortgage sector and market intelligence more generally, and launched a targeted market study in December 2016.⁵

Scope of the study

- 2.5** The focus of the market study is the first-charge residential mortgage market. We want to answer two main questions:
 - 1.** At each stage of the consumer journey, do the available tools help mortgage consumers make effective decisions?

⁴ FS16/3 Mortgages Market Study: Call for Inputs www.fca.org.uk/publication/feedback/fs16-03.pdf

⁵ MS16/2 Mortgages Market Study: Terms of Reference www.fca.org.uk/publication/market-studies/ms16-02-1.pdf

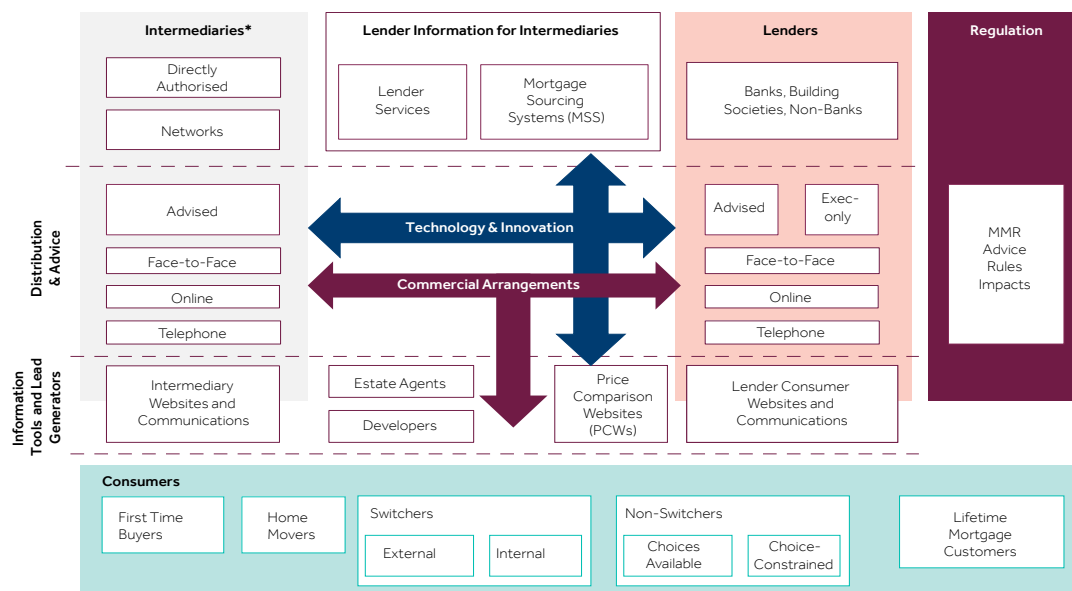
2. Do commercial arrangements between lenders, intermediaries and other players lead to conflicts of interest or misaligned incentives that could harm consumers?

2.6 When referring to tools, we mean any source of assistance used during the customer journey from initial research to a mortgage application, including mortgage advice.

2.7 We have also considered:

- whether our Handbook rules and guidance appropriately encourage firms to help consumers make effective choices, including MMR rules that:
 - require almost all 'interactive' sales to be advised
 - require advisers to recommend a suitable product (rather than the most suitable product that our rules required prior to the MMR)
 - no longer encourage advisers to explicitly consider price (the MMR removed a provision explaining how recommending the least expensive of all those appropriate would demonstrate suitability)
- whether there are opportunities for better technological solutions or any barriers to more effective delivery of information or advice through digital channels
- the extent to which some consumers on a reversion rate do not or cannot switch to a cheaper mortgage

Figure 2.1: The scope of the mortgages market study⁶



* Intermediaries may use mortgage clubs or packagers.

2.8 The scope of the study is set out in Figure 2.1. As shown, lifetime mortgages and further advances are within scope. The relatively small number of lifetime sales and lack of data on further advances have made it difficult to draw strong conclusions. However, we are interested in views on the extent to which our suggested remedies

6 Execution-only intermediated sales are in scope however very few mortgages were completed through this channel.

apply to lifetime mortgages. We have collated findings relating to lifetime mortgages in Annex 5 and have explicitly included a question in Chapter 9.

What is not in scope?

- 2.9** The market study does not focus on buy-to-let, second-charge or commercial mortgages, or home reversion plans. However, insights gained may be relevant to those markets we regulate.
- 2.10** We have not examined in detail the impact of our responsible lending or payment shortfall rules, given previous work in these areas⁷ and the limited influence these rules have on the questions in our Terms of Reference (ToR). Prudential issues are also out of scope.

Sources of evidence gathered to support our analysis

- 2.11** We gathered information from a wide range of sources, including regulatory returns data, additional data from firms, insights from the FCA's new biennial consumer survey (Financial Lives), additional surveys of lenders and intermediaries, and credit reference bureau data. For more detail on our sources of evidence see Annex 2.

Why we are publishing an interim report

- 2.12** We want to discuss our findings and vision for the market with stakeholders, including how any changes can best be delivered. Publication of this interim report is intended to give all interested parties an opportunity to understand and comment on our analysis.
- 2.13** Some of the remedies we discuss should be viewed as mutually reinforcing. Delivery of any of them involving new or amended rules or guidance will require further detailed consultation. However, we are open to considering all potential means of achieving the desired outcomes.
- 2.14** We are interested in your views and welcome feedback on our findings and proposals.

Structure of this interim report

- 2.15** The structure of the interim report is as follows:
- **Chapter 3: Market overview** – the core information about the mortgage sector on which our analysis is based
 - **Chapter 4: Finding a mortgage** – the extent to which useful tools (including advice) are available to help consumers make effective decisions

⁷ FCA Thematic Review TR 16/4 – Embedding the Mortgage Market Review: Responsible Lending Review and FCA Thematic Review TR14/3 – Mortgage lenders' arrears management and forbearance.



- **Chapter 5: Customer choice and value-for-money** – the effectiveness of the available tools, whether some consumers pay more than they need to for a mortgage, and the reasons why
- **Chapter 6: Switching** – consumer behaviour once an initial deal period has ended and why some do not or cannot switch
- **Chapter 7: Commercial relationships** – the extent to which any conflicts of interest exist in various commercial agreements and could cause harm
- **Chapter 8: Summary of conclusions** – drawing together the main findings into four themes
- **Chapter 9: Remedies** – possible ways to improve the way the market works, for discussion

How to comment

- 2.16** We are asking for comments on this report by 31 July 2018. Please send feedback to MortgagesMarketStudy@fca.org.uk.
- 2.17** Alternatively you can send feedback by post – please see our address on page 1.

Next steps

- 2.18** After gathering views from interested parties and engaging in discussions with industry and consumer groups, we intend to publish our final findings, a summary of feedback received, and intended next steps around the end of the year.

3 Market overview

The UK mortgage market has evolved so that customers typically take out a long-term mortgage contract but then switch regularly to get the best short-term deal.

In 2016, lenders completed around 1.9 million new transactions (including internal switches) worth around £300 billion. Of these, we estimate that around 80% were advised and 50% intermediated.

The 6 largest lenders hold around three-quarters of the balances of outstanding first-charge residential mortgages. This has remained broadly stable in recent years. The intermediary sector is far less concentrated.

Around a quarter of borrowers are currently on a reversion rate (eg a lender's standard variable rate) after the end of an introductory deal.

Until recently, there appears to have been little material customer-facing innovation in the mortgage market.

Introduction

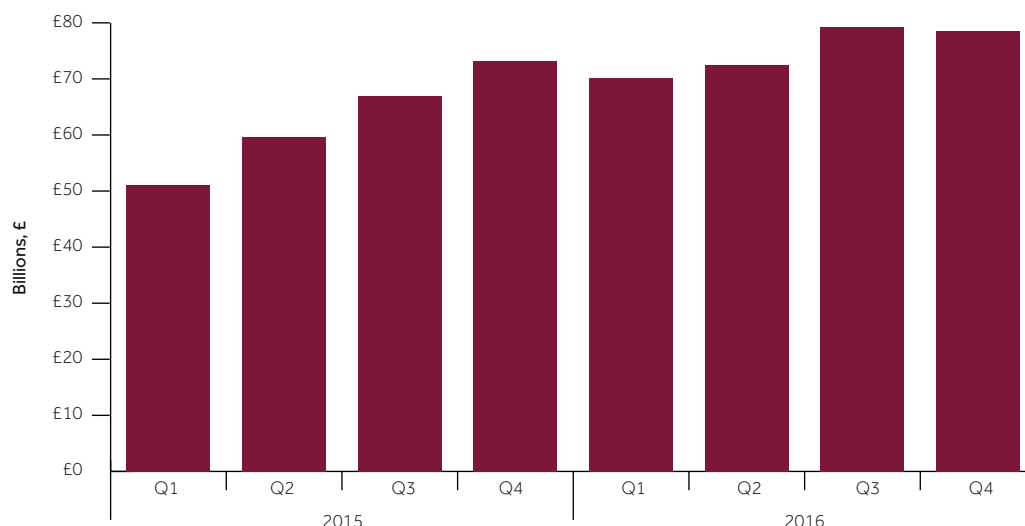
- 3.1** A mortgage is a secondary product many consumers need to buy and retain a home (the primary product). For existing homeowners it can also be a means of releasing money by borrowing against the value of their home.
- 3.2** The market has evolved into one where customers typically take out a long-term contract (eg a mortgage with a term of 30 years) but then switch regularly to get the best deal (eg every 2-5 years).
- 3.3** For many consumers, the value and term of a mortgage can make it a significant financial commitment. In 2016 for first-time buyers the median loan size was around £135,000 with a median initial term of around 30 years.
- 3.4** While a customer may be able to exit a mortgage contract before its term, their ability to do so may depend on the extent of any early repayment charges, the availability of deals and/or factors beyond their control (such as changes in house prices impacting their LTV (loan-to-value)).
- 3.5** In this section we provide an overview of the main features of the UK mortgage sector, using data up to the end of 2016.

The size of the mortgage sector

Market size

- 3.6** The mortgage sector is significant in the UK economy. The regulated residential mortgage sector is currently worth at least £1 trillion, with roughly 8 million outstanding mortgage accounts.⁸ In 2016, gross lending was around £300 billion.

Figure 3.1: Gross mortgage lending between 2015 Q1 and 2016 Q4



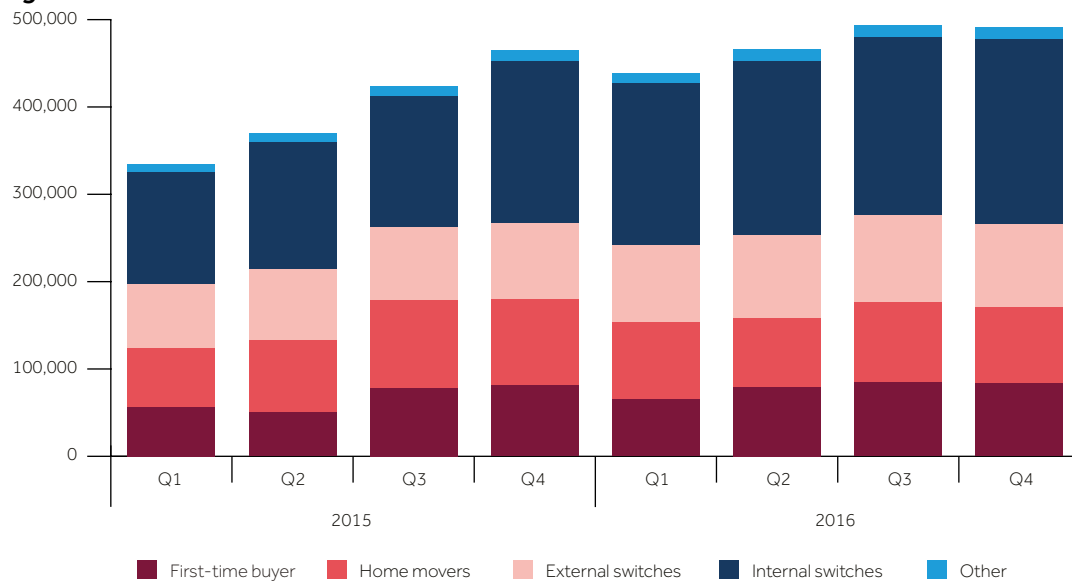
- 3.7** Adding data from firms during the market study to existing regulatory returns gives a comprehensive picture of mortgage transactions, including data not previously collected on customers switching to a new mortgage deal with their existing lender (internal switches). In total, there were around 1.9 million mortgage transactions in 2016.

Transaction volumes and breakdown by channel

- 3.8** The chart below shows that internal switches are a significant feature of the current mortgage market, accounting for around 42% of mortgages arranged in 2016. Customers moving their mortgage to a different lender (external switches) accounted for around 20%. The remainder comprises mortgages for house purchases (first-time buyers and home movers) and others (including lifetime mortgages).

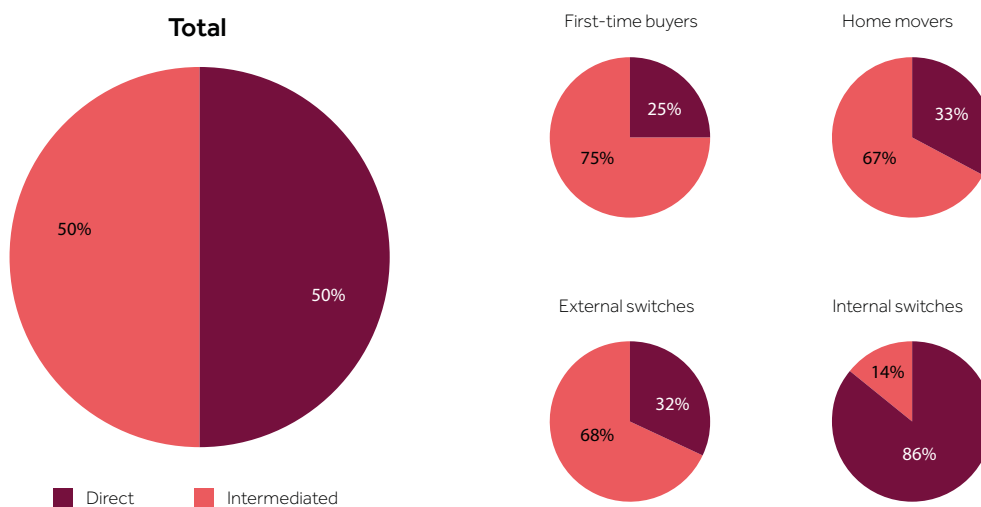
⁸ MLAR; PSD. Does not include mortgages entered into before 31 October 2004 or mortgages administered by a regulated firm on behalf of a beneficial owner which is not regulated.

Figure 3.2: Number of transactions between 2015 Q1 and 2016 Q4



3.9 Figure 3.3 below shows what proportion of these transactions were arranged by the lender (direct) or by a third party brokering the deal (intermediated).

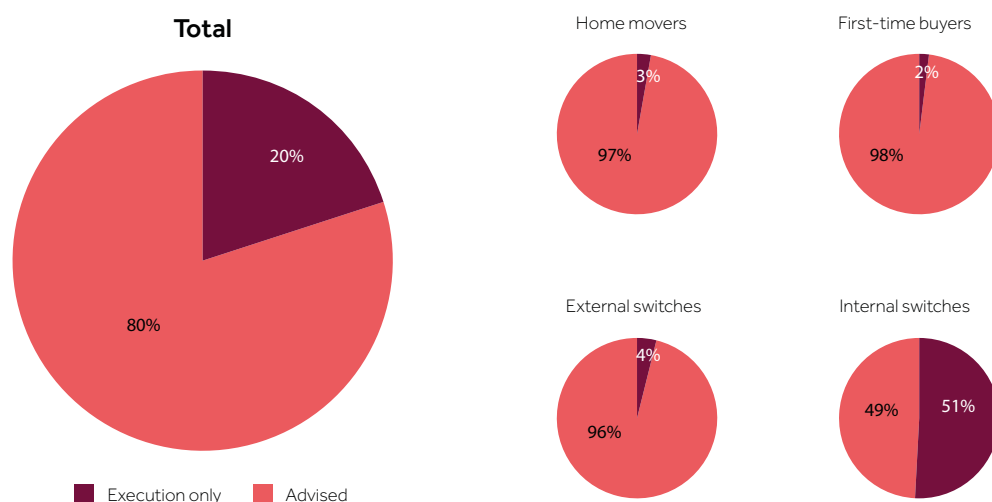
Figure 3.3: Breakdown of mortgage transactions by direct and intermediated in 2016



3.10 Around 50% of all transactions in 2016 were direct.⁹ This figure is higher than that typically reported as a result of the inclusion of internal switching data; the vast majority of these transactions (around 86%) was arranged directly with the lender.

3.11 Around 80% of all transactions in 2016 were advised (ie where regulated advice is given and accepted as part of the sales process). Of the 20% execution-only mortgages, the majority is made up of internal switches of which around half are carried out on an execution-only basis.

⁹ Including internal switches not reported in PSD and based on data provided by a sample of 24 firms representing 85% of the market

Figure 3.4: Breakdown of mortgage transactions by advised and non-advised in 2016**New build and lifetime mortgages**

3.12 Mortgages on new build properties account for nearly 6% of the market, which has been stable since 2015. Lender and intermediary market concentration in new build is higher than for the market overall.

3.13 Lifetime mortgages enable older consumers to borrow money secured against their home while maintaining residence. Lifetime mortgages accounted for just 1% of the total of mortgages arranged in 2016.

Firms in the market

3.14 The central focus of our market study has been on lenders and intermediaries, although our review of commercial arrangements includes firms in related markets.

Lenders

3.15 There were around 100 active lenders in 2016.¹⁰ The 6 largest lenders¹¹ account for around three-quarters of the outstanding balances – market concentration has remained broadly stable in recent years.¹² In the lifetime mortgage market, ten lenders were responsible for almost all lifetime mortgage sales in 2016 meaning the market is much more concentrated (albeit much smaller in size).

3.16 As in many markets, different lenders target different consumer types. For example, larger high street lenders tend to focus on the mainstream market, with challenger and specialist lenders competing for those consumers with less common circumstances. Building societies cover a range of segments, from mainstream national, through regional, to some specialist markets.

¹⁰ Some 180 lenders sold one or more mortgage in 2016, while 94 of these sold more than 100 mortgages.

¹¹ Lloyds, Nationwide, RBS, Santander, Barclays and HSBC are the top 6 lending groups in the mortgage market.

¹² Estimates of market concentration based on the Herfindahl-Hirschman Index (HHI) show that the market for mortgage lending is not particularly concentrated – only fluctuating between 1,000 and 1,200 since 2012. The Competition and Market Authority's Merger Assessment Guidelines (September 2010, CC2/OFT1254) indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated. The HHI scores for the mortgage market indicate that it is around, but not markedly above, that threshold.

Intermediaries

- 3.17** Intermediaries range from larger firms with thousands of mortgage advisers, to firms consisting of a single adviser. A firm can either be directly authorised (DA), or the appointed representative (AR) of a DA firm.¹³ With around 4,000¹⁴ directly authorised intermediaries currently active in the market, the sector is not particularly concentrated.¹⁵
- 3.18** Intermediaries are remunerated for these services by fees paid by the consumer or commission payments paid by the lender, or both. Commission is typically paid as a percentage of the loan value.
- 3.19** The lifetime mortgage market is largely intermediated. However, only a small number of intermediaries arrange lifetime mortgages, with around 10 intermediaries being responsible for approximately 80% of sales in 2016.

Other firms

- 3.20** Many intermediaries are members of mortgage clubs. Mortgage clubs act as a link between lenders and intermediaries, providing an additional distribution channel for lenders. This channel is typically more cost-effective for lenders when dealing with smaller intermediaries, and it gives intermediaries access to a wider range of both lenders and products. The more lenders involved, the greater potential value the club offers to intermediaries, and vice versa. The main activities that mortgage clubs carry out are not regulated activities, though some mortgage clubs hold permissions to carry out other activities.
- 3.21** A number of firms operating in related sectors also play a role in introducing consumers to intermediaries or lenders. Examples include estate agents and developers. Mere introduction is generally not a regulated mortgage activity.

Products and pricing

- 3.22** The personal and financial circumstances of consumers, the property, and lenders' risk appetite will determine how much consumers can borrow, from whom, and at what price. There are also regulatory factors here such as our responsible lending rules, prudential requirements and the FPC's macroprudential levers.

Products and product features

- 3.23** In its simplest form, a mortgage comprises:
- i.** a loan secured on a property
 - ii.** a price for borrowing the funds, usually in the form of an interest rate, and typically
 - iii.** a term over which the loan will be repaid

13 An intermediary firm with 5 or more appointed representatives is considered to be a network.

14 We estimate that some 4,000 directly authorised intermediaries sold one or more mortgages in 2016, while around 240 of these sold more than 100 mortgages.

15 The intermediary market is not concentrated – the HHI is around 250. In 2015 the top 10 intermediary firms accounted for around 45% of intermediated sales.

- 3.24** In the current market, most mortgage products sold in the UK include some form of rate management feature, such as a short-term introductory deal at a fixed interest rate, after which the rate changes to a reversion rate (such as the lender's standard variable rate (SVR) or a rate linked to a benchmark rate).¹⁶ At the expiry of the introductory deal consumers often transfer to a new mortgage product, either with their existing lender (an internal switch) or a new lender (an external switch). Over three-quarters of consumers switch to a new deal within 6 months of moving onto a reversion rate.
- 3.25** There are a large number of products available to consumers from the 100 or so lenders active in the market. This reflects a range of different features available such as the ability to make over and/or underpayments, the portability of the mortgage when moving property, and offset mortgages where interest payments are reduced to take into account savings held with the mortgage lender.
- 3.26** Estimating the total number of products in the market depends on what is considered a product. The number of products available to consumers increased from fewer than 5,000 in 2012 to more than 7,000 in 2016.¹⁷
- 3.27** However, this total number of products cannot be equated with the number of products available to an individual consumer. For example, interest rates for different LTV levels could constitute different products, but LTV is not often something an individual consumer would typically exercise a genuine choice over. For specific LTV bands in April 2016 there were:
- around 1,500 products available between 70 and 75% LTV, and
 - around 300 between 90 and 95% LTV

Price and price structures

- 3.28** The price of a mortgage is typically presented as a combination of interest rate (%) and fees (£) in the form of a monthly payment and the annual percentage rate (APR) of charge.¹⁸ Before they apply for a mortgage, consumers are presented with an illustration¹⁹ setting out the costs of the mortgage, including whether there are any fees or charges, who these are payable to and whether these will be paid upfront or rolled-up into the loan. Figure 3.5 outlines typical rates and fees that consumers are presented with.

¹⁶ For example the Bank of England base rate or the London Interbank Offered Rate (LIBOR).

¹⁷ We compare the number of products available in April 2012 and April 2016. These products must have been available for at least one day. Source: Moneyfacts.

¹⁸ See Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB) 10A, or the Annual Percentage Rate at MCOB 10.

¹⁹ A European Standardised Information Sheet (ESIS, see MCOB 5A) or Key Facts Illustration (see MCOB 5).

Figure 3.5: Types of mortgage fees and charges

Type of fee or charge	How much?	Payable when?
Initial rate	X-Y%	Determines amount of monthly payment for duration of any initial deal period
Reversion rate	X-Y%	Determines amount of monthly payment following expiry of any incentivised period
Product fees eg arrangement; booking; completion	£X-Y	Upfront or added to the loan
Early repayment charge ²⁰	X-Y%	Conditional upon early termination of the contract
Mortgage exit fee	£X	Payable at term end of mortgage or on early redemption
Intermediary fee	£X-Y	Upfront or on completion if applicable
Fees to other third parties eg surveyor, conveyancer	£X-Y	Upfront or on completion if applicable

3.29 Industry-led initiatives in recent years have sought to enhance the transparency and comparability of mortgage fees and charges. Notably, CML and Which? have collaborated to produce a standardised tariff, which has been widely adopted by lenders.²¹

Consumers

Consumer characteristics

3.30 In order to take out a mortgage, consumers need to meet certain criteria set by a lender, for example they need to demonstrate their ability to afford to service the mortgage. As such, mortgage holders are not entirely representative of the overall population. For example, residential mortgage holders:

- are more likely to be working (90% of residential mortgage holders are working, compared to 63% of all UK adults), and
- have higher household incomes compared with all UK adults (25% have household incomes of between £30k and £50k, and 21% have household incomes of between £50k and £70k, compared to 18% and 11% of all UK adults respectively). Some 3% of residential mortgage holders have a household income of under £15k compared with 15% of all UK adults.²²

3.31 Residential mortgage holders are also more likely to consider themselves to be confident and savvy consumers of financial services (58%, compared to 51% of all

²⁰ In the current market, Early Repayment Charges (ERCs) tend only to apply for the duration of the deal period. Our rules require that the charge is disclosed, in cash terms, before the consumer applies. If the charge can vary examples must be given and a maximum charge stated. The charge must be cost-reflective, ie a firm can recover the costs it incurs as a result of the consumer's decision to repay early. It must not seek to profit from a consumer repaying early. The rules allow a firm to calculate the charge as a reasonable pre-estimate of the actual costs on a product or portfolio basis. This assists with the obligation to disclose the charge at the pre-sale stage. Early repayment charges payable on a lifetime mortgage may not be a fixed percentage of the loan but may instead be linked to the value of gilts at the time of repayment.

²¹ <https://www.cml.org.uk/policy/policy-updates/all/transparency-of-mortgage-fees-and-charges/>

²² FCA Financial Lives Survey 2017 (Product holding summary)

UK adults). They also have higher levels of confidence in managing their money (42% have high levels of confidence in managing their money compared with 37% of all UK adults).²³

Vulnerable consumers

3.32 Consumers in vulnerable circumstances may be significantly less able to represent their own interests than the average consumer and more likely to experience harm.²⁴

3.33 Potential vulnerability takes into account a range of characteristics, including those who may suffer disproportionately if things go wrong because they have low financial resilience. It also covers those who may be less able to engage with their finances or with financial services.²⁵ They may have suffered a recent life event (such as redundancy, bereavement or divorce) that lower their financial capability. It may also be that a health-related problem affects their day-to-day activities.

3.34 Some consumers in the mortgage sector meet our proposed definition of potential vulnerability.²⁶ However, compared to all UK adults, residential mortgage holders are less likely to show characteristics of potential vulnerability. 37% demonstrate these characteristics compared with 50% of all UK adults.²⁷

3.35 Although they are more likely to feel burdened by their bills and credit commitments (26% of residential mortgage holders feel their bills and credit commitments are a heavy burden compared to 10% of all UK adults²⁸), residential mortgage holders would generally be better able to cover living expenses without having to borrow any money or seek help from friends/family if they lose their main source of household income.²⁹

Establishing eligibility for a mortgage

3.36 When considering whether to offer a mortgage and what price to charge, lenders will consider the risks posed by a consumer. These factors include:

- **Loan-to-Value (LTV)** – a consumer seeking to borrow more money relative to the value of their home presents a higher risk
- **Affordability** – whether the consumer can afford to service the mortgage, accounting for income and expenditure (including credit commitments, basic essential expenditure and basic quality-of-living costs). This includes consideration of future changes, taking account of the impact of likely future interest rates and the extent to which the customer is borrowing into retirement
- **Employment status** – Nature of employment (or trading history of a self-employed consumer). The more secure the employment the lower the risk
- **Credit profile** – a consumer with an impaired credit history is likely to be higher risk

²³ Financial Lives Survey 2017 (Product holding summary)

²⁴ FCA Occasional Paper No.8 Consumer Vulnerability 2015 <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-8.pdf>

²⁵ FCA Future Approach to Consumers 2017 <https://www.fca.org.uk/publication/corporate/our-future-approach-consumers.pdf>

²⁶ This forms part of our Future Approach to Consumers consultation for which we will be issuing a feedback statement and final publication in summer 2018.

²⁷ Financial Lives Survey 2017 (Product holding summary)

²⁸ This includes all credit commitments including mortgage repayments.

²⁹ Financial Lives Survey 2017 (Question AT4): 24% of residential mortgage holders could cover living expenses for 1 month up to 3 months if they lost their main source of income compared with 17% of all UK adults; 22% could cope for 3 months up to 6 months compared to 14% of all UK adults; 35% of residential mortgage holders are able to cope 6 months or longer which is the same as the UK adult population.

- **Nature of the security** – most lenders restrict the type or location of the property they will lend on

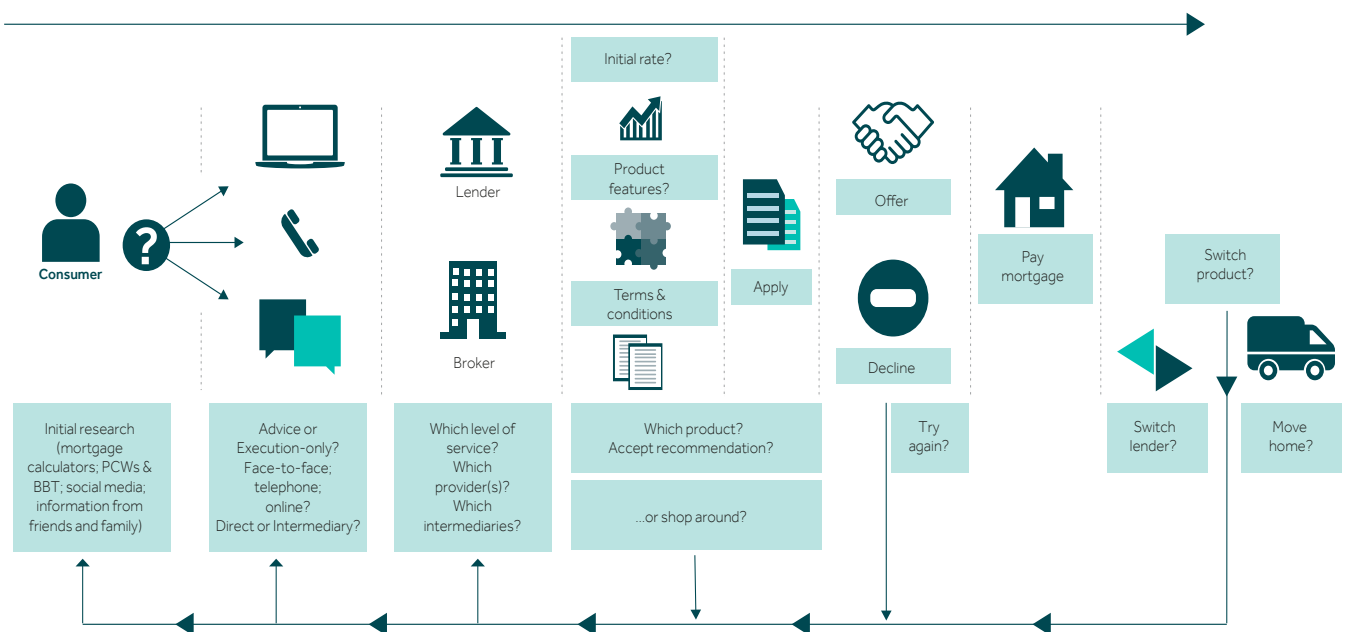
3.37 As a result of this, different consumers have a different range of mortgages to choose from and some may face higher prices for those that are available to them. For example, all else being equal, a 90% LTV loan poses a higher risk to a lender than a 75% LTV loan.

The consumer journey

3.38 In the current market there are some elements of a mortgage sale that are always present, such as an application, offer from a lender, and acceptance by a customer. There are also a number of elements which are present for some customers but not all, such as the receipt of advice or use of an intermediary.

3.39 Consumers therefore have the option of taking a number of possible routes through the stages of buying a mortgage. Figure 3.9 below illustrates one version of the journey, covering some of the main decision points, though the actual route taken varies with individual consumers' circumstances and preferences.

Consumer mortgage buying journey



3.40 We discuss the factors influencing consumers' choices in Chapter 4 and the impact of those choices (largely on the cost of borrowing) in Chapter 5.

4 Finding a mortgage – available tools including advice and intermediation

Choosing a mortgage can be challenging. Some consumers find it difficult to calculate mortgage costs, compare products and/or establish for which products they qualify.

- Some consumers don't shop around or shop around on a limited basis, in many cases only consulting one source of information or tool.
- Information and tools available to consumers are of limited usefulness in helping them make effective decisions, especially if they have more complex or less common circumstances.

Consumers cannot easily identify, at an early stage, the products they qualify for, making it very difficult to narrow down the range of products genuinely available. Intermediaries can help, but also face limits, given the tools available, in how far they can compare mortgages, particularly in assessing likelihood of acceptance.

Consumers choose to go to an intermediary for a wide range of reasons such as convenience, reassurance, market knowledge and for help where their circumstances are unusual. But there are few tools to make it easier for consumers to identify, consider and compare intermediaries that meet their needs.

The Mortgage Market Review changed the landscape for advice. Almost all new sales of (first-charge) mortgages currently involve advice. This reflects the requirement that, save for some exceptions, all new sales involving spoken or other interactive dialogue are advised.

Introduction

- 4.1** There can be a large number of considerations involved in choosing a mortgage. At its simplest, it can involve an existing borrower deciding whether or not to take up the offer of a new deal from their existing lender. More challenging, for example, is the decision facing a first-time buyer with complex circumstances.
- 4.2** This chapter focuses on the availability and usefulness of tools that are designed to help consumers find, compare and access a mortgage. This includes the role of intermediation (and tools available to intermediaries) and advice. Our evidence on the impact of these tools on consumers' borrowing costs is set out in Chapter 5.
- 4.3** We consider various aspects of how consumers find a mortgage and the extent to which their search is supported by the available tools. In particular we consider:
- How consumers set out to find a mortgage

- What consumers consider when searching for a mortgage including:
 - how they assess which products they qualify for
 - how they assess their cost, value and suitability, and
 - how they decide whether to use an intermediary or go directly to a lender, how they choose an intermediary, and how they decide whether or not to obtain advice
- Whether consumers are constrained from searching effectively including whether there are barriers to firms providing effective tools

4.4 We also consider whether there are technological solutions that may enhance consumers' ability to make effective decisions when shopping around and for receiving advice.

4.5 This chapter provides a high-level summary of our analysis. Further detail, including further information on the findings from our consumer research, review of tools, and other related analysis is in Annex 3.

How do consumers find a mortgage?

4.6 Research previously carried out for the FCA by ESRO³⁰ entitled 'Understanding consumer expectations of the sales process' indicates that many mortgage consumers of various types³¹ (eg first-time buyers, home movers, and switchers) undertake a certain degree of pre-application research. An important part of this is gaining a sense of how much they may be able to borrow and how much this is likely to cost them on a monthly basis.

4.7 Our Financial Lives Survey 2017 found that 45% of consumers use only one source of information (from the options given in the survey) to help with their decision making. Information provided by lenders, including their websites, was considered the most useful source of information by 48%.³² Around half use an intermediary to help them decide.

4.8 Our Financial Lives Survey 2017 also found that one-fifth (22%) of those taking out a residential mortgage (or switching product) in the past 3 years³³ did not compare mortgages from 2 or more lenders by looking at the products, prices or terms and conditions. Reasons cited included trust, satisfaction or loyalty towards their existing

30 This research, published in July 2015, was commissioned by the FCA to understand consumer expectations and experiences of the mortgage application process since the introduction of the Mortgage Market Review (MMR) reforms in April 2014. This formed part of the FCA's wider thematic review of mortgage advice and distribution post-MMR.

31 The ESRO Consumer Research did not consider lifetime mortgages.

32 Financial Lives Survey 2017 (Question M39a). Those responding to the mortgage module included the holders of regulated residential mortgages, homebuyers, those porting their mortgage to a new property and those switching to a new lender (external switch) or switching product with the same lender (internal switch). The number of respondents with a Lifetime mortgage was too small for us to undertake any meaningful analysis and so these have been excluded.

33 Throughout this report when referencing Financial Lives Survey data – taking out a residential mortgage (or switching product) includes: first time borrowing, porting a mortgage, external switching, internal switching and moving home and taking out a new mortgage.

lender, believing they are unable to switch to another lender, or the perception that shopping around is not beneficial or takes too much time.³⁴

What do consumers consider when searching for a mortgage?

- 4.9** Figure 4.1 sets out some of the key decisions consumers face as they explore the range of mortgage deals available. For each, we have considered what an effective decision might look like.

Figure 4.1: Key decisions made by consumers as part of finding a mortgage

	What would an effective decision look like?
Which products do I qualify for?	Consumers correctly identify the products for which they qualify so they consider the full range available to them but do not waste time considering products for which they do not qualify.
How much do they cost?	Consumers assess and compare costs of the different products for which they qualify. In comparing costs they consider all elements of price including up-front costs, initial and future monthly costs and any other fees.
Which mortgage offers best value given my needs and preferences?	Consumers identify which products and features meet their needs and add value. Taking account of combinations of price and features they assess which product offers the best value for their particular needs and preferences.
Should I use an intermediary or buy directly from a lender; which intermediary or lender should I choose; and do I need advice?³⁵	Consumers make an informed decision about how best to access the market, given their needs and preferences (for example convenience, face to face interaction, speed of service, complexity of circumstances, help with paperwork etc).

- 4.10** The subsequent sections consider each of these in turn. In particular, we consider how consumers behave when making these assessments and whether the available tools help them make effective decisions.

‘Which products do I qualify for?’

- 4.11** In order to manage risk, lenders have certain criteria they use to decide who they are willing to lend to. We have set out some of these in Chapter 3. As a result a consumer's financial and personal circumstances determine the range of products they might be offered.
- 4.12** Consumers have mixed views about how easily they can identify products for which they are likely to qualify. Two-thirds (66%) of residential mortgage holders agree that they are confident they can find out who will lend to them. For some, however, an inability to easily identify the range of products they qualify for is likely to be one of the main motivations for seeking support and advice.

³⁴ Financial Lives Survey 2017 (Questions M79a; M79b)

³⁵ Advice may be mandatory in certain circumstances such as in the market for lifetime mortgages.

“ I was actually afraid of being self-employed and it being complicated, so we wanted to take advice

Financial Lives Survey 2017 respondent (Mover; Intermediated; Self-employed)

- 4.13** The tools currently available can help financially capable consumers with straightforward, lower risk, circumstances (such as those who have high incomes and are in secure long-term employment) compare products for which they are likely to qualify. However, our review indicates they are less useful for consumers where qualification is less certain (such as those who are newly self-employed, have a low or volatile income, or adverse credit).

“ That fear of them saying we can't tell you until we do a credit check...

Financial Lives Survey 2017 respondent (First-time buyer; intermediated)

- 4.14** Price comparison websites (PCWs) do not typically target specific consumer segments, rather they primarily operate to serve the mainstream market. But more fundamentally PCWs do not have the necessary information from lenders to consistently and accurately support consumers with eligibility and affordability questions. The different tools PCWs provide (for example the product comparison tool and any tool that assesses the products a consumer qualifies for) are often not joined-up, so the number of products presented using these qualification criteria may be inappropriately limited. Further, our research indicated that the limitations of the results from these tools are not made clear to consumers.

Using an intermediary to help establish who will lend

- 4.15** Where consumers go to an intermediary, they can take advantage of their intermediary's expertise and ability to shop around among a range of lenders. However, intermediaries' ability to help consumers also depends on the tools available to them to identify and compare products.
- 4.16** There is some evidence of information tools having begun to emerge recently that will assist intermediaries to assess, at an early stage, whether or not a customer would qualify for a mortgage from particular lenders (or across multiple lenders). These tools do not yet appear widely available. Most intermediaries, even where they use a mortgage sourcing system (MSS), are reliant on their past experience and using specific lenders' information tools to build confidence on likelihood of acceptance. This appears to be a barrier to effective searching that likely makes it harder to identify a less expensive yet suitable product.

Innovation in distribution: Tools designed to help consumers understand which products might be available to them

We have seen the development of new tools designed to help consumers understand which products might be available to them. The tools use consumers' personal information and financial data. This can be entered by the consumer or, with their consent, sourced from their personal current account and credit file. They also look at their mortgage preferences, household composition, changes in circumstances and attitude to risk.

The tool produces a list of products ranked by likelihood of acceptance, as well as a precise indication of how much they can borrow. Such tools are well established in other sectors, such as consumer credit.

However, the success of these tools is still heavily dependent on whether lenders offer tool providers (including intermediaries) access to information to assess product qualification criteria and borrowing amounts for consumers.

- 4.17** In summary, we recognise that many consumers find mortgage products, and the process of obtaining a mortgage, complex and challenging and that consumers have differing needs, characteristics and preferences. Few tools exist to help significantly narrow down the range of options consumers should consider. This is because they lack definitive information on product qualification criteria which is only provided later.
- 4.18** **'How much do they cost?' and 'Which mortgages are suitable and good value'**
In the current market there are a large number of products on offer and, although not all are available to every consumer, consumers need to be able to assess cost to compare different products for which they qualify. They should be able to assess whether a product offers good value for money based on the extent to which its features and price meet their needs and preferences.
- 4.19** Consumers cite attractive rates as an important reason for choosing their lender with 3 in 10 residential mortgage holders choosing their lender for this reason.³⁶ Further, ESRO's consumer research found that consumers have a tendency to focus on the headline rate and how this translates to their monthly payments, rather than the total cost of credit, noting that the majority of consumers have a target monthly repayment amount in mind during their mortgage research.³⁷
- 4.20** Research undertaken by Which? in 2014 demonstrates that consumers' ability to calculate cost, and thereby compare products using price metrics, is limited. When comparing a selection of 5 deals using a typical combination of price metrics (such as APR, product fees, monthly cost), fewer than half were able to identify the cheapest mortgage deal. Only 1 in 5 could identify both the cheapest and most expensive, and fewer than 5% could correctly rank all 5 deals.³⁸
- 4.21** This research also showed that some consumers' confidence may be misplaced with participants who claimed the task was easy (23%) having similarly low rates of success in identifying and ranking the cheapest products (compared to those who thought it was difficult). Our Financial Lives Survey 2017 found that 1 in 3 (32%) residential mortgage holders do not agree that mortgage products are simple to understand.³⁹
- 4.22** Annex 3 provides further commentary and analysis of the difficulties consumers might face when comparing mortgages and the relative importance they place on different product features.
- 4.23** Despite Which? and CML's recent efforts to standardise the way in which lenders refer to product fees, there has been little recent innovation in the way information tools convey information on price or product features. Further, the findings from the recently published ComRes report 'Transparency in Mortgage Websites',

36 Financial Lives Survey 2017 (Question M17)

37 ESRO consumer research 2015

38 <https://www.staticwhich.co.uk/documents/pdf/mortgage-fees-briefing-384449.pdf>

39 Financial Lives Survey 2017 (Question M105)

commissioned by UK Finance, similarly finds there are opportunities to improve digital tools to empower consumers to make informed decisions.⁴⁰

Choosing an intermediary or a lender, and assessing the need for advice

- 4.24** Some consumers may consider whether to get advice or to take out their mortgage execution-only. For others the choice to get advice will follow from other choices, such as the choice to go to an intermediary or to visit a lender in-branch.

Why do consumers choose advice?

- 4.25** Buying a mortgage with the help of an adviser (intermediated or direct) can help a consumer in many ways. For example, advisers can discuss and explore a consumer's preferences, needs and circumstances to help them clarify what type of mortgage they might want and be able to get. Advisers can facilitate, and provide reassurance, throughout the mortgage selection and application process. In some cases the choice may be prompted by the adviser contacting a previous customer to alert them to the potential benefits of switching.

- 4.26** And while advice can be valuable for many consumers, there is more potential for an adviser to help where consumer needs or circumstances are complex than where these are simple. This also depends on the complexity of the mortgage process and products on offer. In a market where products and the mortgage process were simpler, advice services could also be simpler for some consumers.

Innovation in advice

Responses to our request for information indicate little appetite among established intermediaries and lenders to develop online advice services.⁴¹ Commercial incentives for doing this appear limited.

The responses also indicated a perception that we do not see a role for online mortgage advice. However, we received little detail on any specific Handbook provisions that are a barrier. Most respondents appear cautious about regulatory risk in developing online advice. Several firms told us they think it will be difficult to deliver online advice for anything but experienced and low risk consumers switching. This included established and new intermediaries.

The root causes of these views are likely to be varied. Some may be short-term issues given the embryonic state of online advice in the mortgage market. For example, concerns about algorithms' ability to cater for consumers with complex circumstances (eg where a recommendation may hinge on a more nuanced understanding of those circumstances and the consumer's future plans). There may be a need to understand and test how online advice works in a more mainstream setting first.

We also heard concerns that a fully automated model has the potential to cause widespread harm if the underlying algorithm fails to recommend products appropriate to consumers' circumstances.

- 4.27** Those consumers who do not actively choose between advice and execution-only will typically get advice as a consequence of their decision to go to an intermediary, or

⁴⁰ Report for UK Finance members, shared with us by UK Finance. The report is available here: <https://www.cml.org.uk/policy/policy-updates/all/transparency-of-mortgage-fees-and-charges/> (restricted access)

⁴¹ Lifetime intermediaries in particular have little appetite for online advice. This may be due to the more complex nature and length of these transactions, the greater likelihood of customer vulnerability and the need for tax/estate discussion. These together are likely to make this too challenging to deliver.

direct to a lender and then interacting with lender staff in the sale. In these cases the firm's decision to provide advice (or not) through the channel the consumer chooses will determine whether or not the consumer receives advice.

- 4.28** Our analysis suggests that, as intended, the MMR has increased the take up of advice. The MMR introduced an interaction trigger that requires advice to be provided for sales with interaction.⁴² This interaction trigger has been cautiously interpreted and implemented by firms who now channel almost all of their consumers to advice, unless they are switching internally.

Reasons for choosing to buy directly from a lender

- 4.29** For those consumers who used an adviser at a lender, the choice to go to a lender appears largely to be driven by several factors. These include:

- the perception of attractive rates
- consumers' existing relationship with the lender and
- a desire to speak to someone in the branch⁴³

- 4.30** One lender's research shared with us also indicates that consumers who opt to stick with their existing provider do so because they value convenience. They find the prospect of not having to shop around or submit account information, and reduced processing time highly appealing. We also found evidence supporting the value placed on the convenience of staying with an existing lender in our Financial Lives Survey 2017.

“ We were under the impression we had to move quickly so it was good that they could give us appointments at short notice

Financial Lives Survey 2017 respondent (Internal switcher; Direct)

Reasons for choosing to use an intermediary

- 4.31** Some consumers use an intermediary because it is the default option presented to them, for example by a PCW in some cases, or because they are encouraged to use an intermediary, for example by an estate agent.

- 4.32** Consumers who use an intermediary value their services for a range of reasons, for example, because they are seen to provide access to a wide range of products and to help them to get a good deal. Three-quarters (76%) of those who have taken out a residential mortgage (or switched product) in the last 3 years and arranged this through a mortgage intermediary agree that the intermediary helped them to consider options they had not thought of, nine-tenths (89%) agree they understood their needs, and three-quarters (75%) agree they got a better deal than they would have got on their own.⁴⁴ ESRO's consumer research also reflects that the expertise and experience of intermediaries is highly valued by consumers.⁴⁵

“ We didn't want to spend all our time going round banks... time and effort

Financial Lives Survey 2017 respondent (First-time buyer; intermediated)

⁴² There is an exception for contract variations where the customer is not borrowing more and where information is already provided in a non-interactive way. These can have some interaction and remain execution-only. See MCOB 4.8A.10R.

⁴³ Financial Lives Survey 2017 (Questions M60; M17.)

⁴⁴ Financial Lives Survey 2017 (Question M55)

⁴⁵ ESRO consumer research 2015

Choosing between different intermediaries

- 4.33** There are a number of reasons why consumers choose a particular intermediary firm. The most common reasons cited as influencing their choice by those who have taken out a residential mortgage (or switched product) in the last 3 years, and arranged this through a mortgage intermediary, include recommendations from a friend or relative (29%) or having used the intermediary before and being happy with the service (26%).⁴⁶
- 4.34** Of those who have taken out a residential mortgage (or switched product) in the last 3 years and arranged this through a mortgage intermediary, around a quarter (23%) said they chose the intermediary because they were recommended to them by an estate agent. Our Financial Lives Survey 2017 also indicates that, of those who used an intermediary recommended by an estate agent, around one in four felt they had to do so.⁴⁷ While sample sizes here are small, the findings fits with earlier research by ESRO where consumers report estate agents encouraging them to receive in-house advice to improve their chances of getting viewings and making offers on properties.⁴⁸
- 4.35** There is evidence to suggest that consumers have varying preferences on the aspects of the services intermediaries provide. For example, being able to obtain an offer quickly is of importance to some.⁴⁹ Alternatively, some are averse to paying upfront fees for advice.⁵⁰
- 4.36** There are websites that can help consumers identify a local intermediary to help them. For example, one lender launched a tool in 2016 to help consumers find intermediaries in their local area. Other websites allow comparison of the offerings of different intermediaries.
- 4.37** However, even with these tools there is a lack of information to make it easier for consumers to consider and compare options based on the nature, quality and costs of services. And while some intermediaries have developed business models to serve consumers with more complex circumstances, the tools offer only limited opportunities for intermediaries to differentiate themselves. As such, it is not easy for consumers to identify intermediaries which meet their needs.

How does finding a mortgage differ for lifetime mortgage customers?

One lifetime lender's research also indicates that there are several features of lifetime mortgages that confuse consumers. Some find it difficult to understand the meaning of specific terms such as 'enhanced' (a lifetime mortgage which takes your health into account), and 'interest roll-up' for example. Also, with switching rare in the lifetime market compared with non-lifetime mortgages, there are fewer opportunities to learn in this market.

Lifetime mortgage tools provided by equity release lenders and intermediaries are simple and provide high-level information based only on eligibility and the amount that can be borrowed.

46 Financial Lives Survey 2017 (Question M48)

47 Financial Lives Survey 2017 (Questions M48 & M42).

48 ESRO consumer research 2015

49 Mortgages conjoint analysis 2017

50 Research undertaken by a lender that responded to our request for information.

Three PCWs offer services for equity release/lifetime mortgages, either in addition to comparison services for mortgages more generally or as a specialist PCW. Our findings for PCWs more generally hold equally for those PCWs also offering comparison services in this market.

This may reflect the distinctive nature of the products and that regulation mandates advice in this market.

As with non-lifetime mortgages, the lack of information on whether a borrower qualifies for lifetime products could also make it harder for consumers (and to a lesser extent intermediaries) to assess and compare lifetime mortgages and their prices. However, unlike non-lifetime mortgages there are fewer products on the market for consumers to consider.

We discuss lifetime mortgages in more detail in Annex 5.

What are the barriers to providing effective information and tools?

- 4.38** Firms tell us there are barriers associated with providing effective information and tools. Barriers can be broadly categorised as those relating to a lack of incentives, technology constraints, and regulation.
- 4.39** Lenders and intermediaries report that they do not develop more interactive tools, tailored to consumer circumstances, for fear that they might inadvertently trigger the requirement to comply with our advice rules. Many lenders report that this restricts their ability to react to consumer demands for information and guidance in a non-advised digital environment (including use of livechat, SMS, email, instant messaging etc). They fear that providing more balanced information on the merits of advice versus execution-only services could be deemed to breach the rule about not steering consumers to execution-only. Lenders are also reluctant to provide tools to help consumers applying via execution-only to narrow down their options. The requirement to obtain a consumer's acceptance of loss of regulatory protections when proceeding without advice also complicates the execution-only process.
- 4.40** Some lenders mentioned that innovation and tool enhancement has been impacted by uncertainty arising from continual and ongoing regulatory change (including the MMR and, more recently, the Cfl on competition in the mortgage sector and this market study).

Conclusions

- 4.41** Information and tools currently available are of limited use in helping consumers make effective decisions. In particular, at the moment, there is no easy way for them to tell upfront for which products they qualify. This makes finding a mortgage more difficult.
- 4.42** Whilst intermediaries are in a stronger position to shop around for mortgages than consumers, they are also inhibited in how far they can compare mortgages, particularly in assessing the likelihood of acceptance because of limits to the information tools available to them (eg MSSs, individual lender's tools).

- 4.43** Consumers have a range of reasons for choosing advice and whether to go to an intermediary or direct to a lender. Most consumers entering the market receive advice; few go execution-only. Many appear to receive advice as a result of choosing to go to an intermediary or by interacting with a lender. And this appears linked with the MMR changes, resulting in intermediaries and lenders predominantly channelling consumers (with the exception of those switching internally) towards advice.

5 Consumer choices and value for money

We estimate that a significant minority of consumers (30%) purchase a mortgage despite there being an alternative mortgage with similar features for which the consumer was eligible and that was unambiguously cheaper than their chosen product. On average the difference in borrowing cost was around £550 per year over the introductory period of the mortgage.

The remaining 70% are not necessarily all buying the cheapest available mortgage in terms of overall cost. For some of these consumers there will also be alternative mortgages available that could meet their needs as effectively and that are cheaper overall given their specific circumstances (eg where a lower interest rate offsets a higher product fee for a particular mortgage value).

Going to an intermediary rather than direct to a lender leads consumers on average to a cheaper mortgage if they remortgage promptly— consumers going to an intermediary are more likely to choose 2-year fixed rate introductory deals which currently offer the cheapest initial payments.

In 31% of intermediated sales there was a cheaper alternative available on the market generally. In two-thirds of these (21%) there was a cheaper alternative available through intermediaries. So some intermediated consumers miss out because cheaper mortgages are only available direct.

Choice of intermediary matters. The cost of mortgages that similar consumers buy varies materially depending on the intermediary.

Advice has minimal impact on borrowing cost, suggesting that some borrowers get advice they don't need, incurring time and probably financial costs.

Introduction

- 5.1** This chapter analyses how borrowing costs vary depending on whether consumers purchase a mortgage through an intermediary or direct from a lender, and on whether they receive advice.
- 5.2** Recent thematic projects found that a majority of mortgage recommendations post-MMR are suitable and that firms have, by and large, implemented our responsible lending rules. We have not carried out any fundamental new analysis of suitability or affordability. Instead, we have sought to complement the work of our recent Thematic Reviews on Advice and Distribution, and Responsible Lending by focussing more on the cost of borrowing.⁵¹ All else being equal, paying more for a mortgage than is necessary is clearly a potential financial harm to consumers.

51 See TR15/9: Embedding the Mortgage Market Review: Advice and Distribution (<https://www.fca.org.uk/publication/thematic-reviews/tr15-09.pdf>) and TR16/4: Embedding the Mortgage Market Review: Responsible Lending Review (<https://www.fca.org.uk/publication/thematic-reviews/tr16-04.pdf>).

5.3 This chapter draws on 3 analyses.

- Dominance analysis which assesses whether consumers (who were not switching internally) could have obtained a mortgage with equivalent features but at a lower cost (ie having one or more rates or fees that are lower with none that are higher). It does not look at whether the consumer could have got a more suitable mortgage.
- Matching analysis which assesses impacts of intermediation (as opposed to going direct to lenders) on first-time buyers and home-movers and also assesses impacts of extending regulatory advice under the MMR to those who now get advice but would not without the MMR.
- Broker choice analysis compares the average cost of 2-year fixed mortgages across specific intermediary firms taking into account variations due to consumer differences.

5.4 These analyses draw on an exceptionally broad data and information base on mortgage transactions, products and credit history of borrowers. Notwithstanding this, the analysis is limited by the data that are available in some respects, in particular internal switches or sales of lifetime mortgages are not included. Also, some softer factors are not captured in the dominance analysis. These include preferences borrowers and intermediaries may have for particular lenders, due to past experience or brand recognition. It also excludes eligibility criteria that are not quantifiable and comparable easily across lenders. However, where possible, we have taken steps to ensure our analysis is robust to the data limitations.

5.5 Further information on the dominance and matching analysis is available in Annex 4, and Occasional Papers 33, 34 and 35.

Could consumers be getting a cheaper mortgage?

5.6 Overall we estimate that 30% of mortgage transactions in our sample (covering first-charge mortgages in 2015 and the first half of 2016 excluding internal switches) were ones where there was a cheaper equivalent alternative mortgage in the market for which the consumer was eligible.

5.7 A mortgage transaction is only included in the 30% (is dominated) if there was an alternative mortgage available that was cheaper with none of its price elements (rates or fees) higher. Such an alternative mortgage is better value regardless of the consumer's preference on trade-offs between product fees and interest rates.

5.8 This does not mean that the remaining 70% necessarily bought the cheapest suitable mortgage available to them. This is because some of them will have bought a mortgage where there was an alternative suitable mortgage they would have qualified for, that had a different fee and rate structure and some element of the cost was higher (eg higher interest rate or higher fee), but where the overall cost for a given balance would have been lower.⁵²

52 As a check of how findings might change if we broadened the concept of cheaper, we also ran an analysis where we compared mortgages on overall cost with fees and rates could be traded-off one another. This increases our central estimate of those who could materially save to 45%-50%.

- 5.9** For the 30% who could have bought a cheaper equivalent mortgage, we estimate they could have saved on average £550 per year over the introductory period of their mortgage.⁵³ This amounts to a 13% saving on their annual mortgage payment, and an average saving of 2% of their post-tax household income.
- 5.10** There are about 7 million borrowers with mortgages like those in our sample. If 30% of these were paying £550 per year in excess cost, then in principle consumers are overpaying by up to £1.15 billion per year in aggregate. In practice, however, possible savings would be significantly lower because lenders
- i. have limited capacity to lend at the cheapest rates they currently offer, and
 - ii. would be likely to increase their cheapest rates to offset the loss in revenue as far as possible, if fewer customers were paying above average rates
- 5.11** In addition some consumers will not select the cheapest suitable deal – sometimes for valid reasons (eg convenience). Where an individual consumer values speed of service, brand recognition or lender reputation over cost, or where their eligibility depends on criteria not in our data, customers may have knowingly chosen a mortgage that was not the cheapest. In these circumstances the potential savings would be an over-estimate in our analysis. However, we have run checks where possible and found that these possible explanations should have little material effect on our harm estimates overall.⁵⁴
- 5.12** Figure 5.1 summarises our findings. Over half of the 30% purchased a mortgage where the potential savings were strongly dominated in the sense of missing out on over £250 per year or over 5% saving on their annual mortgage payment. This shows that the findings are not driven by large numbers of borrowers missing a chance to make very small savings.

Figure 5.1 – Proportion of consumers who could have saved and by how much

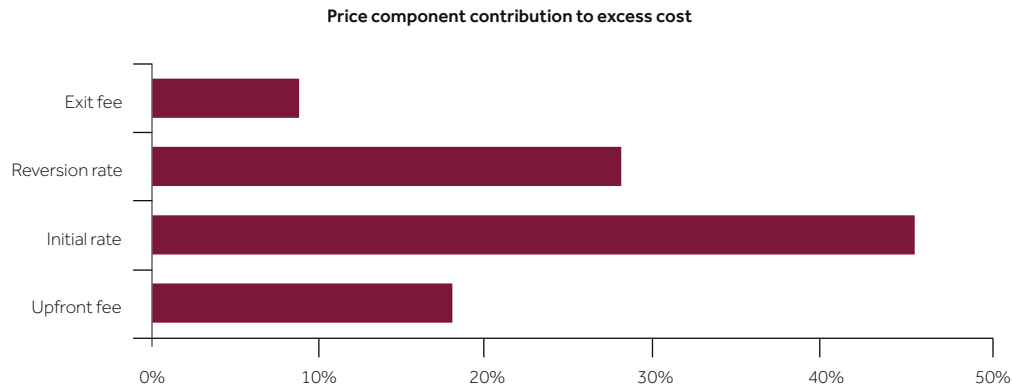
Proportion of mortgage customers buying a dominated mortgage	
Proportion that bought a dominated product	30%
Proportion that bought a strongly dominated product (ie excess cost over incentivised period is over £250 per year and over 5% of the annual mortgage payment)	18%
Excess costs by buyers of dominated products (compared to the average cost of cheaper equivalent deals available)	
Average excess cost in £ per year over the introductory period	£550
Average excess cost as a % of annual mortgage payment	18%
Average excess cost as % of post-tax household income	2%
Median borrower excess cost in £ per year (Range around median that contains 50% of borrowers)	£330 (£185-£584)

53 To calculate overall cost, we use APR over the introductory period. This assumes the borrower will switch at the end of the introductory period, so is not influenced by the reversion rate. For robustness, excess costs are also estimated using a second cost metric. This is APR calculated over a 5-year period to facilitate comparisons across borrowers with different introductory periods. With this metric, consumers with mortgages with an introductory period shorter than 5 years are assumed to stay on the reversion rate after the introductory period ends. In practice, however, the per year cost estimates vary little between the 2 metrics, so unless stated we present introductory period costs throughout.

54 See Occasional Paper 33 for more details.

5.13 For those who could have purchased a cheaper alternative, we break down the excess costs into differences in the price components of the mortgage. Figure 5.2 presents the price components that account for the excess costs (here a 5-year cost metric is used to incorporate additional costs from the reversion rate).

Figure 5.2 – How different price components contribute to excess costs

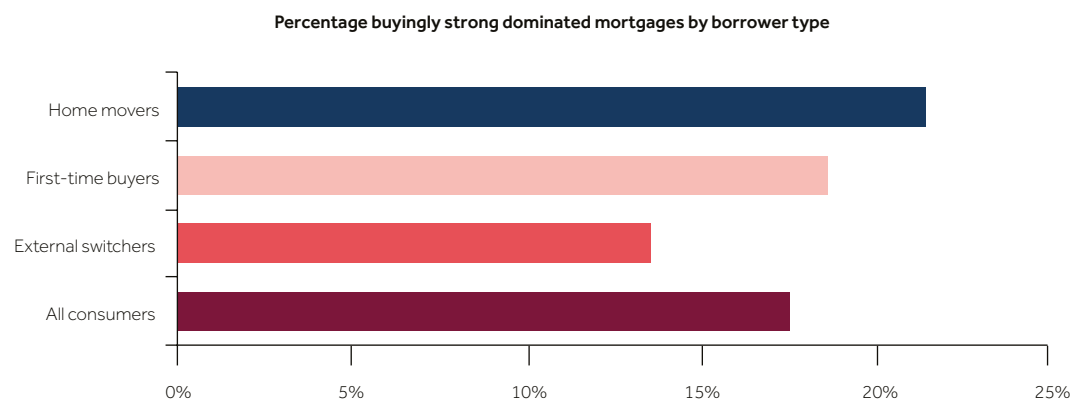


5.14 Figure 5.2 shows that a higher initial rate contributes most in additional costs (accounting for almost half of all the excess costs incurred). Surprisingly perhaps, given the salience of the initial rate, this suggests that many consumers may not be shopping around effectively on the initial rate. Also, in around 90% of cases where a purchase is dominated, there is another product available with a lower initial rate.

Which consumers are paying more?

5.15 Figure 5.3 sets out the proportion of customers by borrower type paying excess costs of over £250 per year or missing out on a saving of 5% or more on their annual mortgage payment. Home movers, followed by first-time buyers, are those who are most likely to miss out on greater-than-average savings.

Figure 5.3 – How strong dominance varies by borrower group

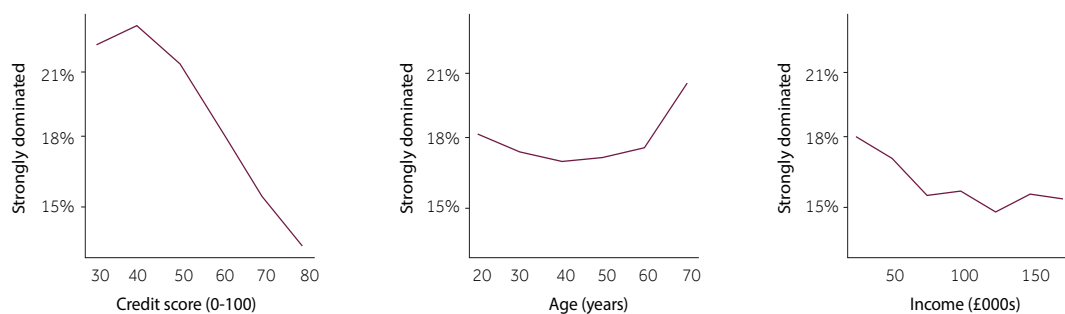


5.16 This is intuitive when considering how property transactions can affect borrowers. Those switching are rarely involved in a property transaction, while first-time buyers have one property transaction (a purchase) to focus on, and home movers often have both a sale and a purchase to manage. The time pressures associated with the property transaction(s) may also drive consumers' focus away from price and more toward securing a mortgage quickly and reliably.

5.17 Those who buy direct from a lender have a slightly smaller chance of buying a dominated product than those purchasing from an intermediary. We estimate that 29% of direct sales and 31% of intermediated sales are dominated. However, if one compares purchased products only with alternative products that can be sold by an intermediary, the proportion of intermediated sales that are dominated (ie where there is a cheaper alternative mortgage sold by intermediaries) falls to 21%. So, as one might expect, intermediaries appear to search more effectively (than consumers who buy direct) for the best price among the products available within their distribution channel. However, intermediated consumers may lose out because some of the better deals are only available direct.

5.18 In addition Figure 5.4 shows that poorer value mortgage choices are highest for those with the lowest credit scores in the sample.⁵⁵ With age we see a sharp worsening of mortgage selection for those over the age of 60.⁵⁶ With income the pattern is less dramatic but shows that those with lower income also tend to do worse.

Figure 5.4 – How strong dominance varies by credit risk, age and income⁵⁷



5.19 Occasional Paper 33 shows that similar patterns also hold for the excess costs. In other words those with lower credit score, over 60s and lower income tend to miss out on larger savings as a percent of borrowing cost. These associations appear robust. They persist after controlling for other demographic factors, whether or not those customers purchase their mortgage intermediated or direct, and whether or not they get advice.⁵⁸

Why do some consumers pay more than they need to?

Demographics

5.20 Poorer mortgage price outcomes for those with lower credit score, lower income and higher age above may be due to different mechanisms. Each of these characteristics is associated with weaker financial capability for example, which can make it more difficult for consumers to search, assess and compare products or to communicate needs and to query an intermediary's recommendations.

5.21 These three characteristics are also associated with vulnerability ie those with lower income, a poorer credit history or being elderly are (all else being equal) more likely

⁵⁵ As the dominance comparison only compares products with the same product features where these have been offered to consumers with the same or lower credit score, this pattern here is not due to those with lower credit score not purchasing mortgages with lower fees or rates sold to those with higher credit scores.

⁵⁶ Note, as lifetime mortgages are not included in the data analysis, this result applies to older borrowers transacting non-lifetime mortgage products.

⁵⁷ A lower credit score representing higher credit risk. Note also that credit scores here have been normalised to lie between 0 and 100.

⁵⁸ Note also that these effects are unlikely to be due to there being fewer available products for lower credit score, higher age or lower income borrowers. This is because dominance is assessed relative to other available products. For example in the extreme case of there being no available alternative mortgages then the sale could not be dominated.

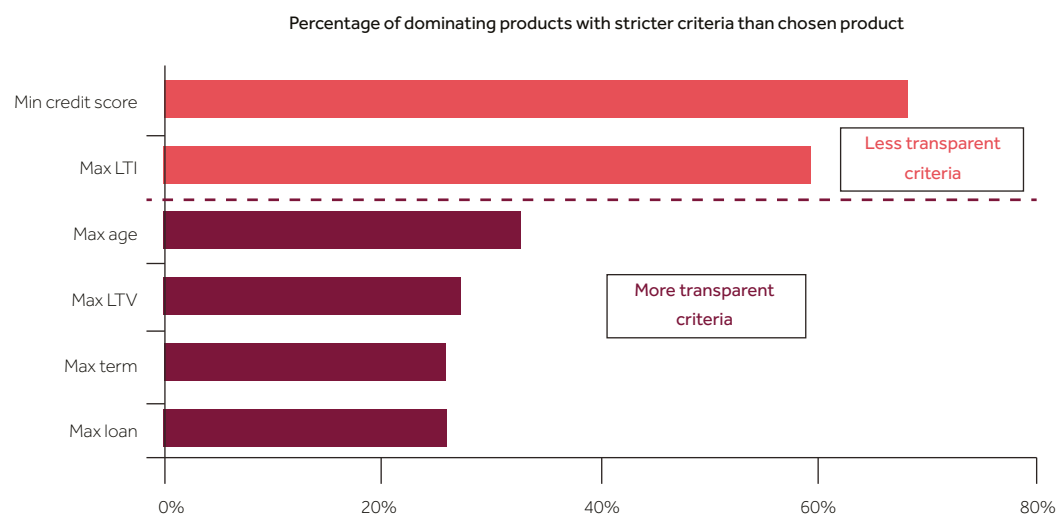
to be vulnerable. So, the evidence suggests that borrowers who are relatively more vulnerable may be more likely to miss out on a cheaper mortgage and pay more.⁵⁹

5.22 Another possible explanation for the relatively worse outcomes for those with lower credit score, over 60s and lower income could be related to the lack of information on the products available for these groups of consumers, making it more difficult to identify and compare products. We consider this now in relation to eligibility.

Eligibility and transparency

5.23 We found evidence to suggest a lack of information on eligibility criteria is associated with poorer choices of mortgage. Among the alternative cheaper equivalent mortgages for which the consumer would have qualified, Figure 5.5 presents the proportions that had more strict eligibility criteria than the chosen mortgage.

Figure 5.5 – Eligibility criteria of dominating mortgages compared to chosen option



5.24 It shows that in dominated purchases only about 25% to 30% of the cheaper equivalent alternatives had a lower maximum limit in age, LTV, term or loan amount. So for these eligibility criteria consumers tended to buy a mortgage that was quite close to the maximum limits. In contrast, with maximum loan-to-income (LTI) and credit score, borrowers chose products that were much further from the limits.

5.25 Lenders typically charge higher prices to riskier consumers to cover the higher expected costs of lending to them, so mortgages with less demanding eligibility criteria tend to be more expensive. So it makes sense for a consumer to buy a mortgage where they just meet the eligibility criteria to keep borrowing costs as low as possible. Otherwise, they are likely to pay a premium for unused buffers they have in one or more of the eligibility criteria.⁶⁰

5.26 This means the consumer behaviour illustrated in Figure 5.5 in relation to the maximum loan, LTV and age criteria makes sense. Here consumers typically buy a mortgage where they just meet these criteria. In contrast, with LTI and credit score, consumers are leaving larger buffers and so paying more.

⁵⁹ This evidence alone is not sufficient to conclude that vulnerability of borrowers plays a role in the underlying mechanisms that lead to poorer price outcomes.

⁶⁰ An example would be a consumer with an LTV of 55% buying a mortgage product with maximum LTV of 80% that is more expensive than an otherwise similar mortgage they could get with a maximum LTV of 60%.

5.27 This difference can be explained by transparency. Where eligibility criteria are not very transparent, a consumer or their intermediary can be less confident they will meet it and be accepted. In this case, it makes sense to be more cautious and to choose a lender they can be more confident will accept them, especially if speed is key. Maximum loan amounts, LTV and age are clear from the outset or are made clear before a mortgage application is made, and have small buffers in Figure 5.5. In contrast, it is often unclear what LTI limit applies in practice⁶¹ and lenders' credit score limits are not shared. For these, consumers and intermediaries are more cautious and so we see the larger buffers.

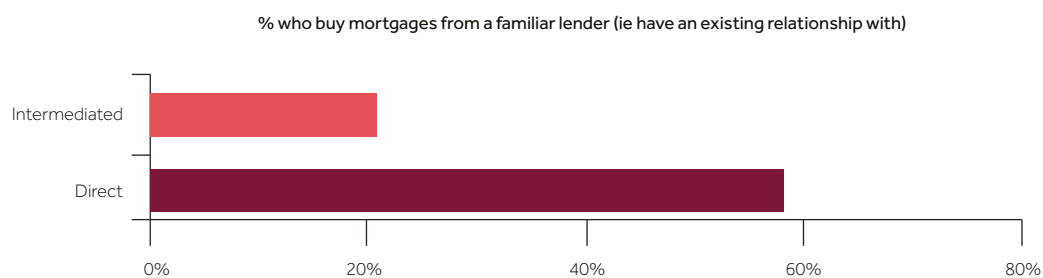
5.28 We would also expect the conclusion to apply to eligibility criteria not in Figure 5.5 that are not transparent. For example, criteria in relation to self-employment can be complex and varied across lenders and not very transparent. As with LTI and credit score, consumers who are self-employed are likely to play it safe on these criteria, and so miss out on alternative mortgages they could get with lower costs.

Lender familiarity

5.29 We also found evidence that preferences for familiar lenders, among both consumers and intermediaries, may partly explain poorer mortgage choices in terms of cost. This could link to the eligibility transparency finding because one response to uncertainty about eligibility criteria is to prefer a lender the consumer or intermediary knows better (where familiarity leads to more confidence about acceptance).

5.30 Figure 5.6 shows that those who buy their mortgage directly from a lender are much more likely (than consumers who buy through an intermediary) to choose a mortgage from a lender they are familiar with, ie already have a product with. Occasional Paper 33 also shows that those who choose a familiar lender are 3.7 percentage points more likely to buy a strongly dominated mortgage. So, consumers favouring more familiar lenders when they buy direct may lead some to miss out on a cheaper mortgage.

Figure 5.6 – The choice of a lender a consumer has an existing product with varies strongly by direct and intermediated channels



5.31 Consumers who buy a mortgage from an intermediary can also be affected by the intermediary directing applications to lenders that are more familiar to that intermediary.

5.32 As stated above, in 31% of intermediated transactions consumers buy a mortgage where there is a cheaper alternative equivalent product available. However, if we exclude products sold only directly by lenders, then the proportion of intermediated transactions that are dominated falls significantly to 21%. If we further limit

61 Whilst some lenders have explicit LTI limits, in many cases the binding LTI constraints arise from lenders' affordability assessments, which are typically not very transparent ie it is not very clear to a borrower in advance if they will pass the lender's affordability assessment before applying.

consideration of other products to those of the lenders that receive most of the intermediary's business⁶², then dominance rates fall significantly again, to 13%.

- 5.33** This suggests intermediaries are reasonably strong at picking a product that does not have a cheaper alternative among the lenders they are most familiar with (in 87% of sales). However, there are better value mortgage products among lenders they are less familiar with. So intermediaries' preference for familiar lenders could lead to some of their consumers missing out on cheaper alternative mortgage products.
- 5.34** Note that this is separate from the issue of whether or not intermediaries' panels of lenders affect consumer outcomes, which we explore in Chapter 7. The groups of lenders considered here as familiar to intermediaries (ie to which the top 75% of sales are directed) are generally smaller than intermediaries' panels.
- 5.35** Interestingly, Figure 5.7 also shows that when intermediaries recommend a product from a lender that is less familiar to them, the consumer is more likely to miss out on a cheaper alternative equivalent mortgage product. So when intermediaries are searching for products from outside their more familiar group of lenders, it appears they are not exploiting the larger number of available lenders to shop around more and to find better value.

Figure 5.7 – How dominance varies for sales to familiar (the top 75%) and unfamiliar lenders (other lenders)

Intermediary sales to:	% of dominated	% of strongly dominated
lenders accounting for the top 75% of intermediary's sales	27%	17%
other lenders	32%	18%

- 5.36** Instead, we suspect intermediaries are likely to be searching for a less familiar lender that will accept a consumer who has less common circumstances and who is more difficult to place among the familiar lenders. Likelihood of acceptance is likely to be less clear for these consumers than others, making it more difficult for the intermediary to shop around and find a good price.

How are price outcomes affected by going intermediated rather than direct?

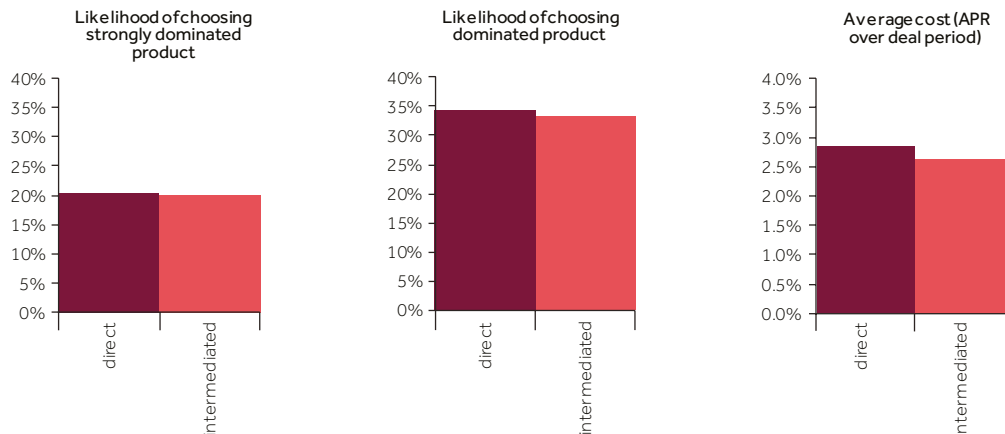
- 5.37** In the matching analysis, we analysed how the distribution channel (intermediation vs. direct) affects price outcomes for first-time buyers and home movers. As set out in Figure 5.8, this shows:
- Intermediation reduces the average cost of a mortgage⁶³ by about £600 per year on average, this is during the introductory period of the mortgage in the current market. This saving is partly explained by effects intermediation has on non-price outcomes, presented below, that show intermediaries are more likely to recommend mortgages with shorter fixed rate deal periods (which were cheaper on average during the time period analysed) and mortgages with longer terms (lowering average cost over the deal period).

⁶² Those jointly accounting for that intermediary's top 75% of sales

⁶³ APR over the introductory period

- intermediation makes little difference to whether or not a customer misses out on a cheaper mortgage of a given type; rather the saving is generated from a customer being more likely to select a 2-year, fixed rate mortgage.

Figure 5.8 – Intermediation impacts on price outcomes on FTBs and movers



5.38 We also looked at how these effects on price outcomes differed for different consumer groups (first-time buyers/movers, by income, credit history and age) and found broadly similar effects, regardless of consumer characteristics.

Does the choice of intermediary matter for mortgage cost?

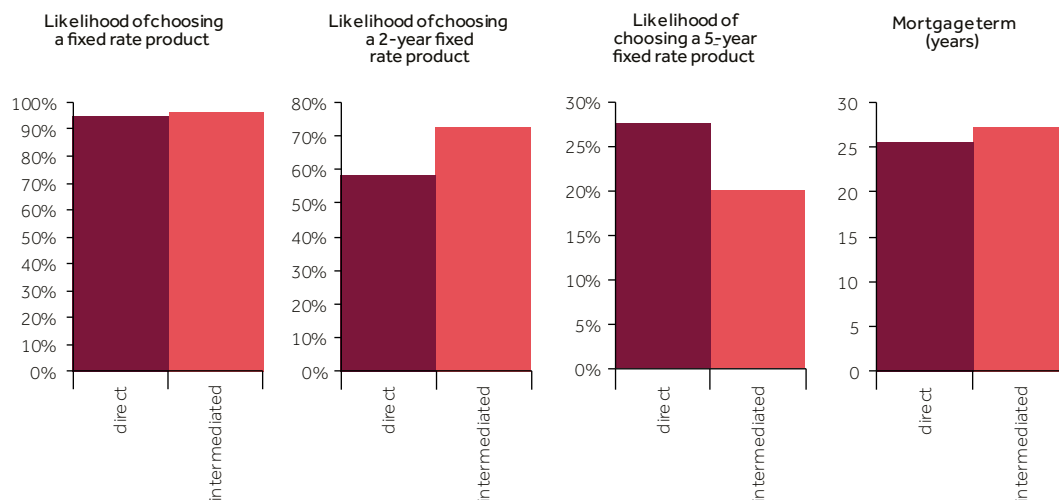
5.39 We estimate that borrowers can pay different prices for their mortgage depending on which intermediary they choose. Looking at the cost of 2-year fixed rate mortgages sold by different intermediaries to consumers with similar characteristics, we find a 27bps average difference in price between the mortgages sold (excluding the top and bottom 10% of intermediaries in terms of mortgage cost to avoid extremes exaggerating the difference).

5.40 This analysis is limited to impacts on the cost of borrowing, and there may be other factors that explain the difference in costs (eg quality of service). Nonetheless, in cash terms this amounts to about £800 difference on the average loan amount over the 2-year introductory period. See Occasional Paper 35 for more details.

How are non-price outcomes affected by going intermediated rather than direct?

5.41 In the matching analysis, we analysed some effects of intermediation on non-price mortgage features. Figure 5.9 presents these. It shows that intermediation has little impact on the proportion choosing a fixed rate product. In part because there is little scope for this – almost all borrowers (almost 95%) choose a fixed-rate product.

Figure 5.9: Average effect of intermediation on the post MMR advised population: non-price outcomes



5.42 Intermediation has a noticeable effect on the length of the fixed-rate period chosen, shortening the average length of it. It also increases the probability of buying a 2-year fixed rate by 14 pp. Intermediation also affects the mortgage term increasing it on average by 1.7 years. The shorter fixed period and longer term are likely to partly explain the effect of intermediation in reducing average mortgage cost.

How does advice affect the outcomes of those who now get advice post MMR but would not have otherwise?

5.43 Here we present a short summary of the impact of advice on first-time buyers and home-movers who would not have got advice had the MMR not been implemented.⁶⁴ There is more in detail in Occasional Paper 34.

5.44 First, the MMR appears to have had a dramatic effect on the choice of distribution channel. It strongly increased the probability that a consumer would go to an intermediary, from 2% to 60%. However, for those switching (who are not in our sample of the impacts of advice) the picture is likely to be different, given our data indicating high levels of internal switching without advice post-MMR.

5.45 We also find that advice has very little impact on the average cost of the mortgage purchased. In one sense, this is not surprising given that our rules on advice focus predominantly on suitability and not explicitly on price. So there is arguably little reason to expect advice (in the regulated sense) to drive better price outcomes.

5.46 Like intermediation, those receiving advice are more likely to buy a fixed-rate product (11 pp more likely), and much more likely to buy a 2-year fixed product when they do buy a fixed-rate product (16 pp more likely). The length of term chosen by customers receiving advice is slightly longer on average (0.7 years).

5.47 The effects of advice on both price and non-price outcomes are likely to be partly due to the increase in intermediation among those who previously would not have got

⁶⁴ This is done using data on first-time buyers and home movers who did not get advice before the MMR.



advice. The effects on the length of fixed rate and mortgage term are likely to be due to more consumers going to intermediaries and having their outcomes affected in that way.

Suitability

- 5.48** Our Thematic Review on advice and distribution in 2015 (TR15/9)⁶⁵ found that a majority of mystery shops and files reviewed resulted in suitable recommendations. However, it also found some evidence of drivers of poorer consumer outcomes, for example, some firms not taking reasonable steps to obtain sufficient relevant information about consumers' needs and circumstances before making recommendations.
- 5.49** The effects of advice and intermediation identified here in shortening fixed periods and lengthening mortgage terms on average could lead to better or worse outcomes for consumers in terms of how well the products meet consumers' needs. This depends on particular consumer circumstances and, without additional information on these, it is impossible to conclude a clear effect on suitability from our analyses in this market study.
- 5.50** Incentives on those selling mortgages also matter as these can potentially bias the recommendation away from what is best for the consumer. Intermediaries have incentives to sell shorter fixed-rates to generate additional revenue from another sale earlier. For sales through direct channels, incentives are less clear, as for some consumers (eg lower risk), revenue will grow the longer the consumer stays with the lender. In Chapter 7 we analyse in more detail how incentives from commercial arrangements, procuration and retention fees may affect outcomes.

Conclusions

- 5.51** We estimate that a significant minority of consumers purchase a mortgage despite there being an alternative mortgage with similar features for which the consumer was eligible and that was unambiguously cheaper than their chosen product. Typically the difference in price was several hundred pounds per year over the introductory period of the mortgage.
- 5.52** Weak financial capability, a lack of transparency on some eligibility criteria, a preference for more familiar lenders among both consumers and intermediaries may be possible drivers of missed savings.
- 5.53** The choice of specific intermediary affects how much consumers pay. Choosing an intermediary, rather than going direct, also reduces the average cost of a mortgage over the introductory period by about £600 per year (during the introductory period). This appears to be associated with intermediaries being more likely to recommend (than advisers working for lenders) shorter period fixed-rate mortgages and longer mortgage terms by intermediaries, which tend to lower average cost.

65 <https://www.fca.org.uk/publications/thematic-reviews/tr15-9-embedding-mortgage-market-review-advice-and-distribution>

- 5.54** The MMR has greatly increased the likelihood that first-time buyers and home-movers who would not have got advice before go to an intermediary and receive advice. The impact of advice on borrowing costs on these consumers is minimal. So, those who are in a position to choose a suitable mortgage without advice may be receiving advice that they don't need and so unnecessarily incurring time and financial costs.

6 Switching

Many consumers take out a mortgage with a short-term introductory deal after which the interest rate reverts to a higher rate. At this point it is usually in a consumer's interest to switch mortgage to get a new introductory deal. Switching also drives competition between lenders to offer attractive rates to the benefit of other consumers. Analysing data from 2016, we observe that

- engagement is high. Over three quarters of consumers switch within 6 months of moving on to a reversion rate
- consumers are more likely to switch to a new product with their existing lender than to a new lender, and our analysis indicates the gains are comparable once switching costs are included
- a minority of consumers may not be able to switch, or do not switch, after moving on to a reversion rate – this can lead to harm through higher than necessary mortgage repayments. Of the 2 million regulated residential mortgages on a reversion rate throughout the second half of 2016 we estimate that:⁶⁶
 - close to half would not benefit from switching – for example they were near the end of their mortgage or on a good rate
 - around 800,000 would have benefitted from switching, foregoing a potential saving, on average, of £83 every month
 - around 30,000 consumers would have benefitted from switching but it appears were unable to do so despite being up to date with payments (often referred to as 'mortgage prisoners'). This number is relatively small because many lenders tell us they do not carry out any new credit or affordability checks on existing customers applying to switch to a new mortgage deal
- We consider it likely that other consumers, with mortgages in portfolios that have been sold to firms not authorised for lending, who do not lend or offer new products,⁶⁷ also face barriers to switching. We estimate that around 120,000 consumers could potentially benefit from switching.

Introduction

- 6.1** Currently, most mortgage products sold in the UK comprise a short-term introductory deal (often at a fixed interest rate) after which the rate changes to another (reversion) rate, often an SVR or a rate linked to a benchmark rate.⁶⁸ Moving to a reversion rate

66 Numbers have been rounded to the nearest 10,000. No analysis was possible in 160,000 cases due to missing data

67 These mortgages are administered by a regulated firm on behalf of the beneficial owner which is not authorised to conduct mortgage business

68 For example the Bank of England Base rate or the London Interbank Offered Rate (LIBOR)

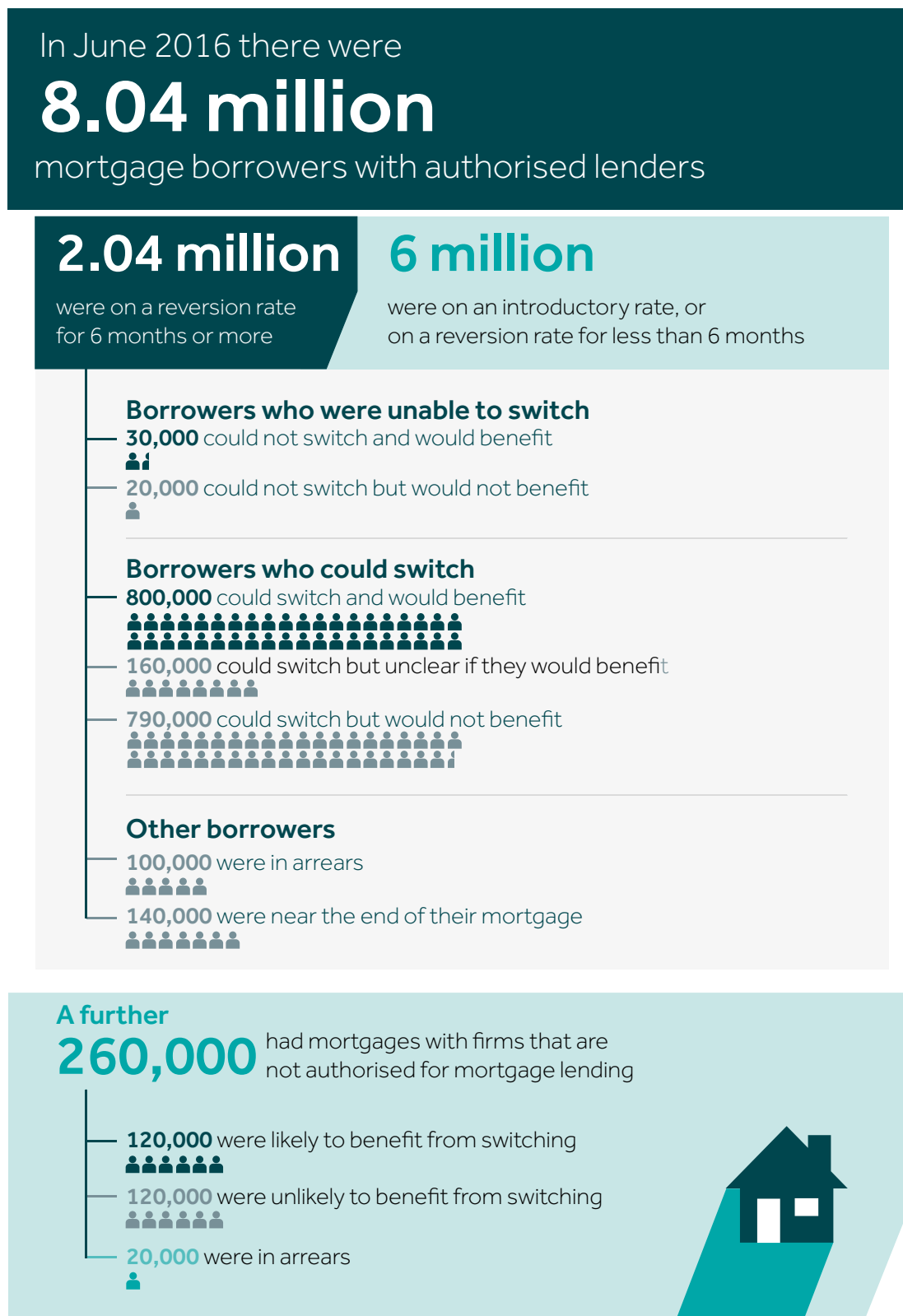
often involves an increase in interest rate and mortgage payments. At this point it is usually in a consumer's interest to switch to a new mortgage product, which the mortgage contract usually allows them to do free of charge (or at minimal cost), either with their existing lender (internal switch) or a new lender (external switch).⁶⁹

- 6.2** If the market works well, consumers can and do switch to minimise their mortgage payments. This behaviour can also drive competition amongst firms and lead to benefits for all consumers. However, market dynamics can change over time, for example lenders' appetite for credit risk can harden. This can result in higher risk consumers on a reversion rate being unable to find a new introductory deal (that would reduce their mortgage costs) despite being up to date with payments and not tied to their existing lender. Meanwhile, some consumers are simply less active and do not switch. Consumers that do not switch can experience harm through higher mortgage payments.
- 6.3** This chapter seeks to understand consumers' switching behaviour and identify where harm may be occurring. While consumers on an introductory rate may benefit from switching during the introductory period (taking into account exit charges)⁷⁰, failing to switch after the end of an introductory deal is more likely to lead to harm and it is switching at this stage that we focus on.
- 6.4** The findings presented in this chapter are based on extensive analysis of 2016 data on mortgage accounts and transactions, including regulatory returns and responses from firms to our Request for Information, as well as results from our targeted intermediary survey. Our analysis excludes lifetime mortgages; customers with a lifetime mortgage do not move onto a reversion rate in the same way and the data we have on switching in this market is very limited.
- 6.5** We consider separately, at the end of the chapter, the position of consumers who have mortgages that have been sold to firms that are not authorised for mortgage lending. We have limited data in these cases, and our approach therefore differs from the more in-depth analysis we have been able to undertake for mortgages reported by firms active in the market. Further detail on the methodologies used is set out in Annex 6.

69 Most mortgage products in the current market allow the borrower to switch without paying an early repayment charge once the introductory deal ends. A mortgage exit fee (to cover the costs of redemption) may be payable if switching the mortgage to a new lender. Fees may apply when taking out a new product.

70 Early Repayment Charges (ERCs) allow a firm to legitimately recover the costs it incurs as a result of consumers' decisions to repay early. ERCs typically apply to fixed rates and other incentivised rates such as a discounted variable rate, or a mortgage with cashback. In the current market, ERCs tend only to apply for the duration of a fixed, or otherwise incentivised, deal.

Figure 6.1: Summary of customers who do not or cannot switch



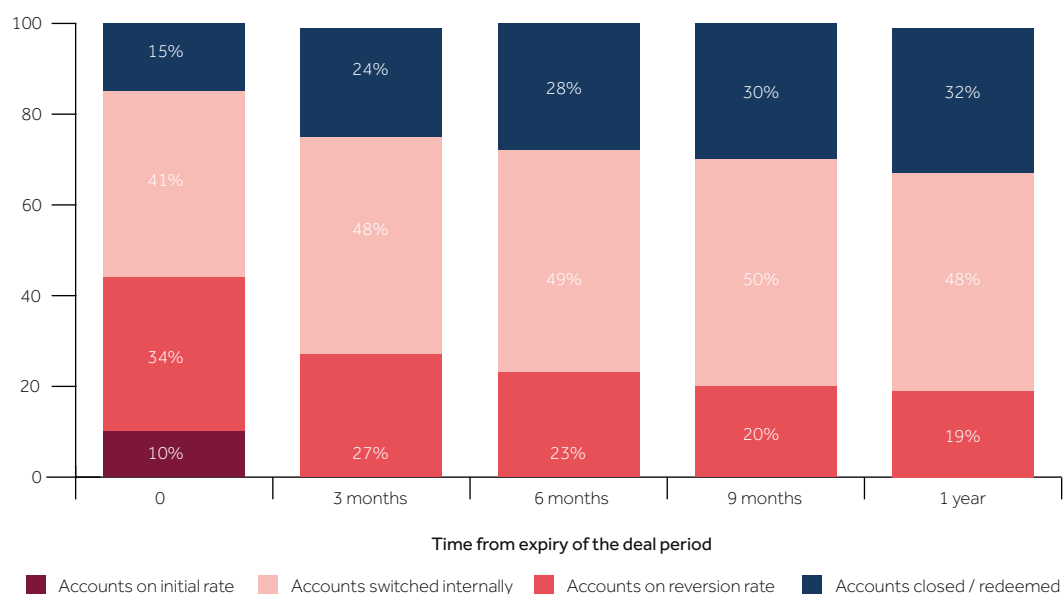
Background to our switching analysis

Switching patterns in the mortgage market

6.6 Overall we find that levels of switching (at the end of the introductory period) are high in the mortgage market. This indicates that the market works well for many.

6.7 Switching behaviour in the mortgage market indicates that consumers are more active and engaged with their mortgage compared to some other retail financial products.⁷¹ Figure 6.2 shows switching over time from the expiry of the introductory deal period for mortgages maturing in 2015. In the 6 months following the expiry of an introductory deal, over three quarters of consumers switched to a new mortgage deal either with their existing or another lender (or redeemed their mortgage). The remaining 23% stayed on the reversion rate. After 6 months, the number of consumers on a reversion rate does decline further, but more slowly. We consider those that switch within 6 months of moving onto a reversion rate as being active and engaged.

Figure 6.2: Switching rates, over time, from the end of the introductory period⁷²



6.8 The high level of engagement in the mortgage market is likely driven by a number of factors including:

- **The increase in recent years in the difference between introductory rates and reversion rates for new borrowing, which increases the net benefit of switching**
While the average SVR has stayed relatively stable, the rates for 2-year fixed deals have roughly halved.⁷³
- **Lenders' increasing focus on retaining existing consumers** Although we do not have longer-term trend data for internal switching (only for the periods 2015 and

⁷¹ For instance, in the 2015 cash savings market study we found that 80% of easy access accounts had not been switched in the last 3 years.

⁷² Source: aggregate data on products maturing in Q1 2015 (period '0'). Based on a sample of 25 firms (data from one lender incomplete in 2016Q1). Some firms reported some mortgages on the initial rate at the end of the quarter that the rate expired. Totals may not add up to 100% due to rounding.

⁷³ The average SVR increased from 4.22% to 4.44% between 2012 and 2016. Over the same period, the average introductory rates for 2-year fixed deals decreased from 4.16% to 2.23% (Bank of England statistics).

2016) anecdotal evidence indicates that the volume of internal switches is growing markedly.

- **Many lenders and intermediaries contact their customers prior to the end of their current deal to prompt them to switch**

“ [Our lender] sent us a letter near the end of our deal... it gave me a bit of a kick to start thinking about my mortgage... The broker's call and his explanation of our position also helped encourage me to start looking for deals.

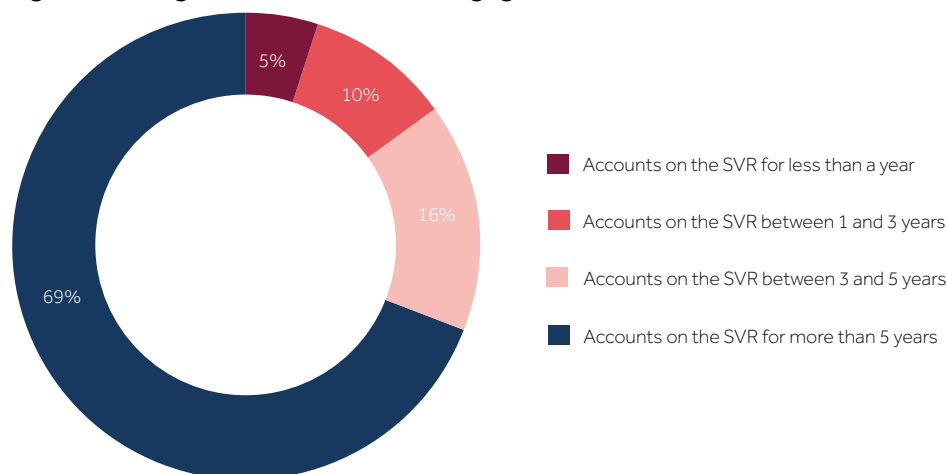
Financial Lives Survey 2017 respondent (External Switcher; Advised; Direct (previously intermediated))

Consumers on a reversion rate

- 6.9** Some consumers may rationally decide to pay a higher reversion rate for a short period of time. For example, they may be planning to move home and want to retain flexibility to repay their mortgage without paying an early repayment charge (ERC). A small proportion of consumers stay on the reversion rate long after the introductory period ends. In some cases this will be rational where these rates are low and comparable to introductory rates. However these consumers may be experiencing harm if, as a result of this inactivity, they pay more than they would pay if they switched.

- 6.10** Figure 6.3 shows, looking at the back-book of a sample of 25 firms (representing 85% of the regulated residential mortgage market), that 69% of consumers on a reversion rate in 2016 had been on it for at least 5 years.

Figure 6.3: Regulated residential mortgage accounts on reversion rate in June 2016⁷⁴



- 6.11** Using regulatory reporting data for all firms authorised for mortgage business, we find that of approximately 8 million mortgages in June 2016, just over 2 million (25%) stayed on a reversion rate for the whole of the second half of 2016.⁷⁵ For the purposes of our analysis we describe these mortgages as on a reversion rate 'long-term'.

- 6.12** Around 100,000⁷⁶ of these accounts were in arrears by one monthly payment or more. Given these consumers are not up to date with payments we do not include them in the subsequent switching analysis described below. However, we consider customers

⁷⁴ Illustrated by time spent on the reversion rate, 2016 (Source: request for information to a sample of 25 firms)

⁷⁵ FCA product sales data PSD007; Reversion rates include managed reversion rates, such as SVRs, and non-managed reversion rates, such as tracker rates.

⁷⁶ All estimates in this chapter are rounded to the nearest 10,000.

in arrears when discussing remedies in Chapter 9, noting we expect lenders to treat such customers fairly. In MCOB 13, we set out how we expect firms to treat customers in payment shortfall. This includes making reasonable efforts to agree with the consumer how that shortfall can be cleared and consideration of forbearance options given the customer's individual circumstances.

- 6.13** Not all consumers paying a reversion rate in H2 2016⁷⁷ would benefit from switching or experience harm from not doing so. The rest of the chapter sets out the steps that we have taken to isolate different mortgages (and consumer groups) that may be experiencing harm from the remaining consumers on a reversion rate in H2 2016, that is, the roughly 2 million consumers, less those in arrears.

Number of consumers paying a reversion rate for the whole of the second half of 2016	2,040,000
Number of these consumers in arrears by at least 1 month	100,000
Number of consumers in the subsequent switching analysis	1,940,000

Consumers close to paying off their mortgage

- 6.14** In H2 2016 140,000 consumers (on a reversion rate for the whole of 2016 and not in arrears) were close to paying off their mortgage.⁷⁸ Lenders usually apply a minimum loan size and/or minimum repayment term which can prevent consumers that are approaching the end of their mortgage term, or have a low outstanding balance, from switching their mortgage. A change in the interest rate also has limited impact on the monthly payments for small value loans with short repayment terms, and is unlikely to outweigh the monetary and non-monetary costs of switching to a new product.⁷⁹ We therefore consider this population as unlikely to be experiencing significant harm.

Number of consumers close to paying off their mortgage (experiencing little or no harm)	140,000
Number of consumers in the remaining switching analysis	1,800,000

Consumers who may be unable to switch

- 6.15** To identify the consumers who would benefit from switching, but who appear unable to do so, we designed a model to assess which consumers on a reversion rate in H2 2016 (after deducting those near the end of their mortgage and those in arrears) could have expected to find a new mortgage in June 2016. We define consumers as unable to switch if they would not be offered a new deal by their existing lender or other lenders in the market.
- 6.16** First, we identify those consumers who appear unable to switch to a new deal externally because the new lender treats them as a new customer and applies affordability and credit risk criteria that these consumers cannot meet. Then, as many lenders tell us they allow existing borrowers to switch without new affordability or

⁷⁷ That is, the whole stock of outstanding regulated residential mortgages. This includes the accounts where the incentivised period ended recently, as well as the accounts that reached the end of any incentivised period long ago.

⁷⁸ We use an outstanding balance lower than £10,000, or a remaining term of less than 2 years as proxies to identify consumers that are near the end of their mortgage.

⁷⁹ This might not necessarily be the case for interest-only customers.

credit checks, we reduce our estimate of those who may be unable to switch to reflect the fact that many can switch internally. Finally, we assess the extent to which those consumers who may be unable to switch would benefit from switching.

6.17 The distribution of rates paid by consumers who appear unable to switch has 2 peaks: one around the most common legacy reversion rate (2.5%) and the other around the current average SVR (4.6%-4.8%). As consumers who cannot switch do not qualify for introductory deals, we have based our assessment of whether these consumers would benefit from switching by comparing the rates they pay with the lowest standard variable rate currently offered in the market. In the period of analysis this is 3.69%.

6.18 Most consumers paying 3.69% or less are unlikely to benefit from switching as the rates they pay are often comparable to those payable on introductory deals (for example because they are benefitting from legacy terms and conditions). While those consumers with mortgages on rates equivalent to, or higher than this would potentially benefit from switching. Importantly, given most rates consumers pay lie in the two bands above, the results are not particularly sensitive to small changes to our chosen 3.69% rate; moving it by a few basis points would not change the number of consumers who would benefit from switching significantly as the rate we use is not close to either peak in the distribution.

Who are the consumers that may be unable to switch and may be experiencing harm?

They were:

- on a reversion rate which was greater than 3.69% for at least 6 months (throughout the second half of 2016) and
- up to date with payments but
- do not appear to meet the lending criteria for new customers of any new lender and
- cannot switch with their existing lender

As a result they may be unable to switch away from a relatively costly reversion rate to a cheaper deal either with their own lender or another lender.

6.19 We estimate that 30,000 consumers on the mortgage books of firms authorised for lending are unable to switch and are experiencing harm.⁸⁰ Around 10,000 of those were with active authorised lenders (who may not treat existing customers any differently to new customers). The remaining 20,000 are in portfolios of mortgages that are closed to new business (the consumer has a mortgage with a lender that does not typically offer new deals to existing borrowers), albeit the mortgages are owned by a firm authorised for mortgage business.

6.20 We recognise that the Mortgage Credit Directive (MCD) requires lenders that are taking on new consumers to undertake a full affordability assessment even where the consumer is not borrowing more. This may have made it more difficult for these 30,000 consumers to switch to a new lender, but even when the FCA previously allowed lenders to waive these requirements under certain conditions (including where the consumer was not borrowing more), very few lenders took advantage of it.

⁸⁰ We estimate that a further 20,000 may be unable to switch but we consider they did not experience harm as they were already paying a relatively good rate.

However lenders have more flexibility to help their existing borrowers as our rules allow lenders to offer new products to existing borrowers, providing they are not borrowing more, without undertaking new affordability or credit checks. That most lenders tell us they use the flexibility our rules provide to make new products available to existing borrowers is an important aspect of the analysis which reduces our estimate of the numbers of consumers with active lenders who may otherwise be unable to switch.

Characteristics of consumers who may be unable to switch

- 6.21** Our analysis suggests that of the estimated 30,000 consumers who would benefit from switching but may not be able to do so, around 90% took out their mortgage or last switched to a new lender before 2008, and 96% did so before 2009.⁸¹ They are more likely to be self-employed, and have an interest-only mortgage. This aligns with the idea that these consumers have characteristics that are now considered higher risk by lenders and cannot now switch because of (i) major changes to lending practices during or immediately after the crisis, and (ii) the subsequent regulatory responses aimed at preventing a return to past poor practices.

Number of consumers we estimate would benefit from switching but are unable to do so and are experiencing harm	30,000
Number of consumers we estimate are unable to switch but would not benefit from doing so and so not experiencing harm	20,000
Number of consumers in the remaining switching analysis	1,750,000

Consumers that appear able to switch but do not

- 6.22** The final step of our analysis is identifying the extent to which each of the remaining 1.75 million consumers that appear to be able to switch would benefit from switching. We do this by comparing the stream of payments that each consumer would make until the end of the term of their mortgage under their current reversion rate to the stream of payments under a scenario where they switched to a new 2-year fixed deal with their existing lender in June 2016. Further detail on this methodology is set out in Annex 6.

- 6.23** Due to a lack of data, we were unable to undertake this analysis for 160,000 consumers. Of the remaining 1.6 million, we estimate that around 800,000 consumers who did not switch, would have benefitted from switching. This is around 10% of all regulated residential mortgages.

Number of consumers who appear able to switch, would benefit from doing so, and may be experiencing harm	800,000
Number of consumers who appear able to switch but would not benefit from doing so, and so not experiencing harm	790,000
Number of consumers for whom we were unable to assess any benefit	160,000

81 This does not include consumers who may have switched internally since these dates.

How much is inactivity costing consumers?

- 6.24** The proportion of inactive consumers in the mortgage market is low compared to other financial markets, but we estimate that roughly 10% of regulated residential mortgage consumers are inactive.
- 6.25** We estimate that on average each inactive consumer could have saved around £1,000 per year in the first 2 years and around £100 per year for the rest of the term of their mortgage by switching in June 2016.⁸² Unsurprisingly, those with an interest-only mortgage could have saved the most, saving on average over £2,000 per year in the first 2 years.⁸³ These figures assume consumers switched only once and to the most popular available product that they qualified for, with their existing lender, rather than shop around for the best deal available to them. We estimate almost all consumers who would benefit from switching once could have increased their savings further by switching more than once.

800,000 consumers could have saved around £80 per month on average by switching

Comparing the benefit of an internal switch to an external switch

- 6.26** We compared the overall savings for consumers switching internally to the overall savings for similar consumers switching externally. Overall the average APR obtained by those who switched internally is only a few basis points higher than that obtained by borrowers who switched externally after accounting for switching costs.

Figure 6.4: Distributions of APRs for External Switch and Internal Switch transactions in 2015–2016

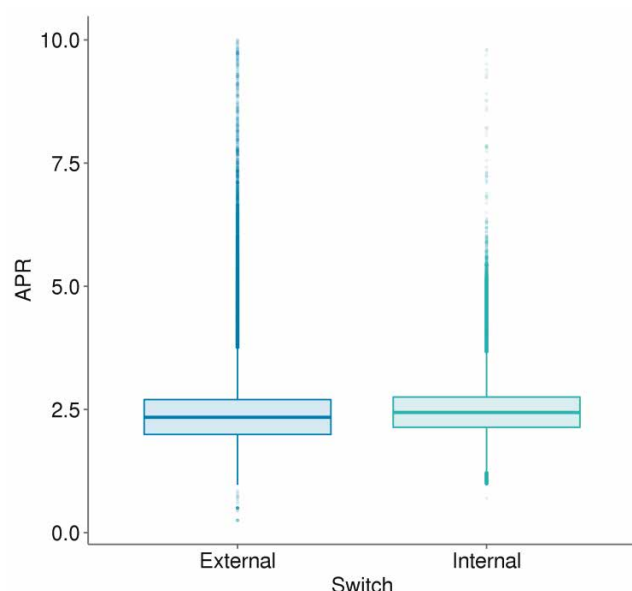


Figure 6.4 shows the distribution of APRs for external and internal switches occurring in the same period.

The squared box represents the range of APRs obtained by 50% of consumers who switched either internally or externally.

The dots at the extremities represent outliers.

“ The fact that they were nearly the same rate meant there was little point in moving since it saved a lot of hassle. If it had been a big difference we may have looked more at moving to a new lender

Financial Lives Survey 2017 respondent (Internal Switcher; Direct; Advised)

⁸² As set out in Annex 6, we obtain comparable estimates when we use a tracker benchmark.

⁸³ For the sake of comparability, in the counterfactual benchmark scenario we do not make any judgement as to whether consumers would be better off with a different repayment method.

6.27 We believe the APR comparisons show that lenders are competing for engaged borrowers, both to attract new business and to retain existing borrowers.

6.28 This finding supports our approach to assessing the benefits of switching for the inactive population by using a benchmark rate offered by the existing lender and our definition of consumers that cannot switch (by taking into account whether a borrower can switch product with their existing lender).

Why don't consumers switch when they would benefit from doing so?

6.29 There are a range of potential reasons for this inactivity:

- Non-monetary switching costs. Some consumers may perceive the time and hassle of switching as a price not worth paying.
- Lender retention strategies. Lenders have very different approaches to dealing with existing customers on reversion rate. Some treat all customers in a similar way while others target customers they perceive to be more likely to switch to another lender.
- Customer perception. Some might perceive that they are unable to switch (when they are in fact able to switch either to a new lender, or with their current lender) and have not received, noticed, or acted on any prompts from their lender or intermediary.



there's no clear call to action... [letters from lenders] should say something like 'your mortgage is about to end, act now!'

Financial Lives Survey 2017 respondent (Porting; Intermediated; Self-employed)

How do consumers that appear inactive compare to the rest of the population?

6.30 We find that, the characteristics of inactive consumers differ slightly from other residential mortgage holders but that the differences do not help explain the reasons why these consumers appear to be inactive.⁸⁴

Changes in the market may impact consumers' inactivity

6.31 Developments in the market and in the economy more broadly might impact on the number of consumers that are inactive. In particular:

- The population of consumers paying relatively low legacy reversion rates is likely to shrink over time, as these reversion rates were typically linked to contracts extended pre-crisis.
- Borrowers on reversion rates have not recently experienced an environment of materially increasing rates, reducing incentives to engage with the market. However, should the base rate rise further, consumers may see their monthly payments increase and may be prompted to consider switching.

⁸⁴ For example the median LTV for inactive consumers (49%) is slightly higher than for other residential mortgage holders (41%) and inactive consumers have slightly higher average income (median income of £43k compared to £37k)

Consumers who have mortgages with firms not authorised for lending

- 6.32** In the UK, some mortgage books have been sold to firms that are not authorised to conduct mortgage business. This can arise, for example, if a lender's business model involves securitising mortgage books and selling them to investors. Some closed books resulted from the sale of the assets (mortgage books) of failed lenders, post crisis. The administration of these accounts must be carried out by a regulated firm.
- 6.33** The owner of such mortgage books does not have permission to arrange new mortgage contracts and does not typically offer internal switches. So, these consumers can only switch to a better rate if they meet lending criteria in the open market. These firms (not authorised for lending) do not have to submit account-level data to us. We cannot therefore identify consumers in this group who may be unable to switch, or assess the extent to which individual consumers might benefit from switching, because we do not have information on individual mortgages and consumer characteristics. However, anecdotal evidence suggests that some consumers in these mortgage books may be unable to switch so we have sought to estimate how many additional consumers might also benefit from switching.
- 6.34** We are aware of 260,000 accounts in mortgage books owned by firms not authorised for lending. We note that:
- some of these portfolios appear to, on average, benefit from relatively low legacy tracker rates (about 35% of the accounts are in portfolios with an average rate between 2.25% and 3.25%), but
 - consumers in other portfolios are, on average, paying relatively high rates of interest⁸⁵
- 6.35** We estimate that around 120,000 borrowers are paying an interest rate which is greater than our benchmark rate of 3.69%⁸⁶ and could benefit from switching. They may be unable to switch if they do not meet the lending criteria of active lenders, but we cannot currently estimate how many.⁸⁷ We understand that around 20,000 are in arrears.⁸⁸

Number of consumers who have mortgages with firms that are not authorised for lending and do not offer new products	260,000
Number of consumers in arrears	20,000
Number of consumers with a mortgage in a portfolio where the average rate is greater than 3.69% and could benefit from switching	120,000
Number of consumers with a mortgage in a portfolio where the average rate is 3.69% or less and are less likely to benefit from switching	120,000

⁸⁵ Some consumers may not be able to switch to mainstream high street lenders, for example because they have adverse credit histories, but they may be able to switch to lenders that accept higher risk borrowers but charge a premium to reflect this risk.

⁸⁶ We used the lowest SVR in the market as at H2 2016 as benchmark for this analysis (3.69%).

⁸⁷ Our assumptions and analysis are impacted by significant data limitations including a lack of data at a consumer level, use of different sources of data at different reporting dates and the possibility that the sale of mortgage books to firms occurred between the time periods reviewed.

⁸⁸ Arrears balance is at least, or greater than, 1.5% of the outstanding balance.

Intermediary survey of consumers' ability to switch

- 6.36** To complement our analysis of consumers who may be unable to switch we also conducted a survey via 6 intermediary firms. The survey collated information on the outcomes of enquiries to switch (where there was no additional borrowing) over a 3-week period.
- 6.37** Individual advisers populated a survey for each consumer enquiry, summarising the outcome, for example internal or external switch, and the reasons and circumstances underlying any recommendation, or the adviser determining that they were unable to place the business. This provided us with unique quantitative and qualitative insights based on actual consumer experiences.
- 6.38** Results from the survey aligned with our other data analysis. In summary, the survey showed that only a very small number (2%) of existing borrowers who would benefit from switching were unable to switch either internally or externally.⁸⁹ And the most common reasons cited in intermediaries' responses relate to consumers' employment status, their level/security of income, or interest-only mortgages.
- 6.39** The original concept for the survey was suggested by MoneySavingsExpert.com who also facilitated the participation of several intermediary firms. Although the survey is the work of the FCA, we are grateful for the input from MoneySavingsExpert.com.

Conclusions

- 6.40** The mortgage market has evolved into one where many consumers take out a mortgage with a short-term introductory rate which typically reverts to a higher interest rate. This creates an incentive to switch to a new deal. However, it is apparent that some consumers who would benefit from switching either do not or cannot. Most of the consumers that appear unable to switch took out mortgages (or switched most recently) before or during the financial crisis.
- 6.41** There is more we can do to help some of these consumers. While the MCD inhibits what we can do in relation to external switching, we estimate that the gains from an internal switch are comparable.

89 Sample of 348 cases; 7 consumers couldn't switch

7 Commercial relationships

There is little evidence that commercial arrangements between lenders, intermediaries and other players in the mortgage market currently lead to poor consumer outcomes.

Current levels of commission paid by lenders to intermediaries do not appear to be linked with customers paying more for a mortgage. Moreover, more generous retention procurement fees create incentives for intermediaries to recommend that consumers stay with their existing lender, but we do not find evidence that this currently results in harm for consumers.

The use of a panel in itself does not have a negative impact, but intermediaries that place business with fewer lenders sell on average more expensive products compared to those placing business with more lenders.

Customers taking out mortgages through an intermediary that has commercial agreements with an estate agent or developer do not, on average, pay more for a mortgage than customers of intermediaries without such agreements.

Finally, lending on new build properties is more concentrated than the wider residential market. But intermediary firms that have arrangements with developers do not sell more expensive mortgages than those intermediaries without them.

Introduction

- 7.1** The mortgage market is characterised by varied and complex relationships between different types of firms. Commercial arrangements may drive positive outcomes, for example by enabling a better or quicker service or by reducing operational costs. However, they can also cause conflicts of interest.
- 7.2** This chapter focuses on 2 aspects of the relationship between lenders and intermediaries:
- the effects of procurement fees paid by lenders to intermediaries and
 - the effects of the use of panels⁹⁰
- 7.3** We also briefly present our findings on the relationships that lenders and intermediaries have with estate agents, developers, price comparison websites (PCWs), providers of ancillary services and mortgage sourcing systems (MSSs). More detail on these findings can be found in Annex 7.

⁹⁰ Due to data limitations, the analysis in this chapter does not typically cover lifetime mortgages.

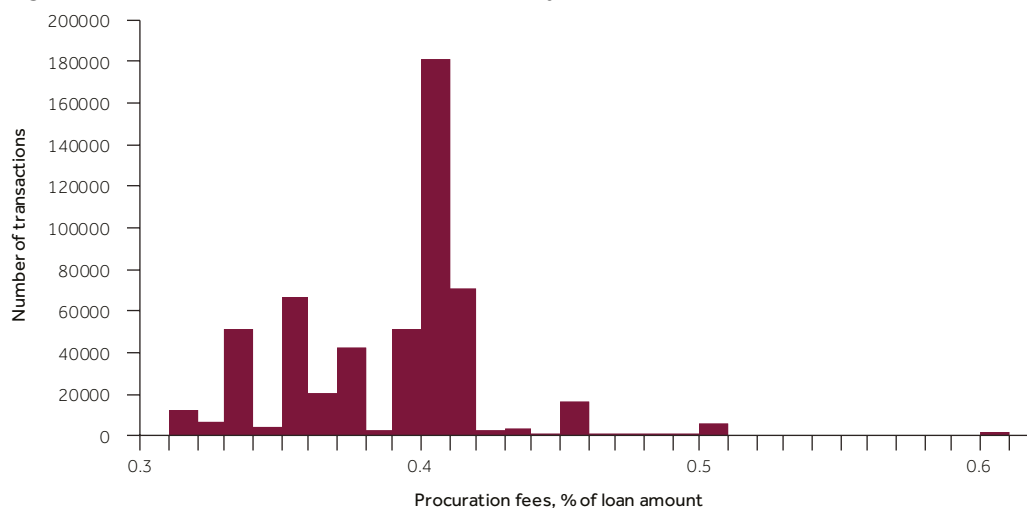
Do procuration fees paid by lenders to intermediaries drive business to higher priced mortgages?

7.4 Intermediary firms typically receive fees or commission from lenders for each mortgage product sold to consumers. These are called procuration fees, and are usually a percentage of the loan amount. Some lenders also set a minimum and/or maximum amount payable. Remuneration for individuals in intermediary firms can also be formed of salaries, bonuses and other incentive payments.

Current variations in procuration fees

7.5 Different lenders pay different levels of procuration fees. In our sample, the median level of procuration fees paid is around 0.4% of the loan amount. The difference between the 10th and the 90th percentile (respectively 0.33% and 0.41%) is around 0.08%. Figure 7.1 shows the distribution of procuration fees in our sample.

Figure 7.1: Procuration fees between January 2014 and June 2016⁹¹



7.6 The median loan size in our sample is £147,000. For such a loan size, recommending a product with a high procuration fee rather than a low one could lead to around £120 extra procuration fees per sale.⁹²

7.7 Procuration fees paid by specialist lenders that cater for borrowers with non-standard circumstances are typically higher than procuration fees for mortgages for mainstream borrowers. Lenders told us that it typically takes longer to prepare an application for these borrowers and therefore higher procuration fees are intended to reflect the cost of this extra work. We have found no evidence to suggest that contracts between lenders and intermediaries explicitly stipulate for variations in procuration fees depending on LTV or volume of business generated by an intermediary. However, some lenders pay different procuration fees to different intermediaries.

⁹¹ Procuration fees as a percentage of the loan amount based on 2-year fixed products with capital and interest repayment method sold to first-time buyers, home movers and external switchers between January 2014 and June 2016.

⁹² The difference between 10th and the 90th percentile of the levels of the procuration fees is around 0.08%, which in monetary terms results in £120 difference calculated on the median size of a mortgage of £147,000. Specialist lenders offer procuration fees as high as 0.6% of total loan amount. These levels fall into the upper quartile of the distribution of procuration fees.



- Responses show that some lenders will pay higher procurement fees for better quality applications. This refers to, for example, the proportion of applications that lead to completion or the number of fraudulent applications.⁹³
- Some lenders may also base pricing on the importance of an intermediary to the lender's distribution.

7.8 Procurement fees can have a positive impact on consumer outcomes. For example, income from procurement fees may allow intermediary firms to decrease or eliminate fees charged upfront to consumers, which may facilitate access to intermediaries. But where differences in procurement fees across lenders equate to significant amounts of money, intermediaries face a potential conflict of interest because they may be tempted to recommend a product with a higher fee rather than the one that might be better in terms of price and/or suitability for the consumer.⁹⁴

7.9 Controlling for borrower, product and property characteristics, we have analysed whether, for new business, intermediaries recommending more expensive products generally receive higher procurement fees. This involves 3 main stages:

- identifying the levels of procurement fees paid by lenders and how these vary across lenders and intermediaries
- calculating how the average price of a mortgage varies across intermediaries for like-for-like consumers, and
- assessing whether intermediaries selling expensive products are also those recommending products with high procurement fees

7.10 For a more detailed description of the methodology, please see Occasional Paper 35.

Remuneration and incentives for staff in intermediary firms

7.11 Remuneration structures vary widely across firms, depending on business models and the employment status of their staff. Such structures range from salaried advisers with bonus schemes to self-employed advisers receiving the entire procurement fee.

7.12 A small number of intermediaries in our sample have eliminated the financial incentives for recommending products that derive directly from higher procurement fees by equalising the amount that their salaried advisers receive from them.

7.13 Some principal firms told us that they do not have oversight of their ARs' remuneration structures. Firms are reminded of their obligations for the compliance by their ARs with the applicable rules covering conflicts of interest. For example, principal firms should consider whether they need to take any additional steps to ensure the actions of their ARs are compatible with their obligations as an AR and allow the principal firm to meet their regulatory responsibilities.⁹⁵

93 Additionally, a small number of lenders' agreements specifically require intermediaries to deliver quality applications but this is not directly related to levels of procurement fees.

94 FCA Principles 1, 6 and 8 and MCOB 2.3 require firms not to conduct business under arrangements that might give rise to a conflict of interest with their customers. These general rules are also applicable in the context of procurement fees.

95 <https://www.fca.org.uk/news/news-stories/considerations-for-principals-who-have-appointed-representatives-or-introducer-appointed-representatives>

Setting procurement fees

- 7.14** Lenders typically monitor rivals' procurement fees and some set levels to ensure that their procurement fees remain competitive. In our survey of intermediaries 55% of respondents said they believe lenders set their procurement fees with reference to fees paid by their competitors.
- 7.15** Anecdotal evidence suggests that lenders are aware that (materially) higher procurement fees have the potential to increase sales and secure a position on intermediaries' panels. However, they are also aware that creating potential fee biases can lead to poor consumer outcomes and do not consider procurement fees an appropriate way to increase or decrease sales. Any benefit from such a move eg for a new entrant, may be quickly eroded if the procurement fee returns to more typical market levels. One lender said that 'Changing procurement fees for short term gain is not a strategy we would adopt as the intermediary market tends to be sensitive to movements (especially any reductions) in procurement fees'.
- 7.16** Across the market, procurement fees rose around the end of 2014 and the beginning of 2015. Some firms told us that this happened as a result of the MMR and lenders focussing more on intermediated sales.

Little evidence that current levels of procurement fees are linked with customers paying more for a mortgage

- 7.17** While we recognise that there is potential for procurement fee bias where intermediaries face products with large differences in procurement fees across lenders, we find little evidence that intermediaries selling more costly mortgages is linked to high procurement fees.⁹⁶
- 7.18** In those few cases where there does appear to be a link, we have carried out analysis to compare outcomes which may be affected against a small sample of firms that we know equalise procurement fees and a similar pattern occurs. Therefore we do not consider that higher procurement fees adversely affect consumers. It seems likely that other factors play a more significant role. This could include the lack of transparency of eligibility criteria that makes it difficult for intermediaries to match borrower circumstances with lending criteria, or softer characteristics of the borrower unobservable in the data.

Do retention procurement fees affect intermediaries' product recommendations?

- 7.19** Retention procurement fees are commissions paid on internal switches. They are often one element of a lender's retention strategy. While a small number of lenders have paid retention procurement fees for a number of years, the number that do has recently been increasing. The large majority (90% in both 2015 and 2016) of internal switches is done directly with the lender and around 10% is intermediated.
- 7.20** Intermediaries may have incentives to recommend a higher number of short-term deals from lenders that pay higher retention fees, as they may expect these

96 As part of the Mortgage Market Review the FSA looked at procurement fees. The FSA concluded that there was potential for procurement fees bias. However, in the mainstream market procurement fees were flat. The FSA also said that there was more scope for bias in the niche market segments (self-cert and credit-impaired), where procurement fees have been higher. See <https://www.fca.org.uk/publication/discussion/fsa-dp09-03.pdf>, paragraph 5.43



consumers to return to them to arrange an internal switch. We have looked at whether retention procurement fees lead intermediaries to recommend a high proportion of 2-year fixes with particular lenders.

- 7.21** In 2015 and 2016 a few lenders piloted retention fees with a selected number of intermediaries. 13 lenders in our sample (and more outside our sample) pay or are planning to introduce retention fees.⁹⁷ We acknowledge that the analysis was undertaken when the practice was becoming increasingly common.
- 7.22** Retention procurement fees are typically around half that of procurement fees on new mortgage contracts. As with procurement fees for new mortgages, anecdotal evidence suggests that lenders are aware of the level of the retention procurement fees paid by rivals and rivals' retention procurement fees are taken into account when setting their own. We find that high retention procurement fees seem to drive higher levels of intermediated internal switches.
- 7.23** The large majority of intermediated internal switches (79% of all internal switches in 2016) were made with one lender that also pays market leading retention procurement fees.
- 7.24** However, we have not found evidence suggesting that this currently results in consumers paying higher prices. This aligns with some of the analysis described in Chapter 6 which finds that, for customers looking to switch, the cost of switching (ie the cost of borrowing plus any switching costs) does not materially differ between intermediated internal and external switches in the current market.
- 7.25** Retention procurement fees could also conceivably lead intermediaries to recommend a high proportion of 2-year fixed products. In 2016, 70% of intermediated sales (including internal switches) were 2-year fixed-rate products.⁹⁸ The proportion of 2-year fixed-rate products for the lender that pays highest retention fees is 87%. This suggests that high levels of retention fees may currently provide an incentive for intermediaries to recommend a high proportion of 2-year fixed products.
- 7.26** However, while the greater variation across lenders' retention procurement fees (in percentage terms) compared to procurement fees suggests that high retention fees have the potential to influence intermediaries' recommendations, we do not find evidence that this is currently leading to higher prices for consumers.

Does the use of panels have a negative impact on consumers?

- 7.27** Feedback to our Call for Inputs suggested that panels may represent a barrier to entry or expansion for lenders.
- 7.28** A panel is a list of firms with which one firm expects to do business. Panel arrangements can be beneficial to consumers, as they can reduce operational costs and lead to a more efficient service, due to familiarity between the intermediary and lenders. However, panels can potentially lead to harm, for example if they lead to new

⁹⁷ The practice of paying retention procurement fees is relatively new and our analysis was undertaken when the practice was emerging.

⁹⁸ Based on our sample

entrants being excluded from the market (inadvertently or otherwise). We have looked at both intermediaries' panels of lenders and vice versa.

Intermediaries' panels of lenders

Prevalence of panels and exclusivity

7.29 We estimate that intermediary firms who operate a panel of lenders account for at least two-thirds of all intermediated sales. Around 6% of intermediary firms that responded to the survey told us they operated a panel in 2016. However, in addition, in 2016 over 90% of directly authorised intermediaries submitted business through a mortgage club⁹⁹ which typically operate a panel (5 out of the 6 largest mortgage clubs operate a panel).

7.30 In our review of contractual arrangements between lenders and intermediaries in the mainstream mortgage market (which focussed on larger value contracts) we have not found evidence of exclusivity agreements.¹⁰⁰ Rather, we have seen several contracts that explicitly rule out exclusivity. We did identify a small number of examples of exclusivity, in certain limited circumstances, in the much smaller lifetime market.

Number of lenders in the panel

7.31 There is potential for harm to consumers if intermediary firms have a small number of lenders in a restricted panel because they may recommend more expensive products (ie if they forego the opportunity to recommend from a wider range of lenders).

7.32 According to our survey responses, 73% of intermediary firms that operate a panel have more than 20 lenders in the panel. Large intermediaries tend to have relatively large panels. The largest mortgage clubs typically operate a panel of between 40 and 70 lenders.

7.33 For intermediary firms from whom we requested more detailed information, Figure 7.2 compares the number of lenders in the panel and the number of lenders used. Figure 7.3 includes the number of lenders used by intermediaries that do not operate a panel. The table suggests that the number of lenders used to place business varies, but does not seem to depend on whether intermediaries operate panels.

7.34 Almost all of the intermediaries in our sample allow advisers to make off-panel recommendations. This may result in intermediaries using more lenders than they have in the panel. However, survey results show that in practice the share of off-panel recommendations tends to be minimal, at less than 5% of a firm's mortgage business. The process for submitting business off-panel varies across intermediaries and can be quite time consuming. We heard of isolated instances where advisers need to provide a rationale for their decision and that this needs to be centrally approved before they can proceed. Therefore for those intermediary firms who do operate a panel, the construction of their panel of lenders may create a disincentive to use lenders not included in the panel.

⁹⁹ See Chapter 3 for a description of mortgage clubs

¹⁰⁰ Exclusivity refers to a situation where one or both parties agree to only sell the products of the other party, for example if a lender agrees to only sell mortgages through one intermediary firm. This may be an issue if it excludes firms from having access to the market.

Figure 7.2: Number of lenders used by intermediary firms using panels compared to intermediary firms that do not use a panel

Number of intermediary firms from our sample	Operate a panel of lenders?	Lender panel size	Number of lenders used in 2015 and in 2016
4 intermediary firms	Yes	39 or more lenders	48 or more
2 intermediary firms	Yes	Around 20 lenders	Between 27 and 34
1 equity release intermediary firm ¹⁰¹	Yes	Less than 10	Between 8 and 11
4 intermediary firms	No	NA	40 or more
2 intermediary firms	No	NA	Around 20
1 equity release intermediary firm	No	NA	Around 10

7.35 Irrespective of whether they operate a panel, intermediary firms vary widely in the number of lenders they use. Some intermediaries use few lenders while others place their business with more than 60. Even when the same number of lenders is used, some intermediaries vary in how evenly they spread applications across lenders. And for networks, the overall picture may obscure the practices of individual advisers.

7.36 Figure 7.3 shows the number of lenders used by each intermediary that sold at least 100 mortgages in 2015. Around 4% of intermediaries used 5 or fewer lenders, while 15% used between 6 and 10.

Figure 7.3: Number of lenders used by each intermediary (with at least 100 sales)

	Number of lenders used					Total
	1	2-5	6-10	11-15	>15	
% of intermediary firms	3%	1%	15%	43%	38%	100%

7.37 Based on our data analysis, we found that intermediary firms that use a small number of lenders recommend more expensive products on average compared to intermediary firms who use a greater number. The price difference could be around £400 for the first year of the incentivised period of the median loan amount. See Occasional Paper 35 for more details on the methodology.

Intermediaries' panel review and strategy

7.38 Strategies for running and reviewing panels vary across the market. Some intermediary firms prefer to operate a more limited panel, whereas others wish to include as many lenders as possible, subject to minimum criteria. Many intermediary firms review their panel relatively frequently or on an on-going/ad-hoc basis.

7.39 Intermediaries have a range of approaches for choosing new additions to their panel. The most common aim appears to be for the panel to provide a solution for the majority of an intermediary's customers. Covering as many consumer circumstances as possible makes commercial sense as it maximises the chance of finding any individual customer a mortgage and therefore generating a procurement fee. Most of the panels we observe have a range of lenders, from the big banks to challengers or specialist lenders. Some of the larger intermediary firms have 1 or 2 lenders to serve

101 Both equity release firms appear to be looking at the whole market, or close to it.

certain segments of the market, for example borrowers with non-standard credit history or who are self-employed.

- 7.40** We have not found evidence of significant numbers of lenders not being accepted onto panels, or the systematic exclusion of one lender or certain types of lender. In the instances where a lender was not accepted onto a panel, it appears that intermediary firms communicated this information transparently.¹⁰²

Panels themselves do not have a negative impact, but placing business with fewer lenders does

- 7.41** We do not find evidence that panels have a negative impact per se, rather they appear to formalise many intermediaries' strategy of placing business with familiar lenders. However, we do have concerns that the intermediary firms that use only a small number of lenders may not be getting the best outcomes for their customers.

Lenders' panels of intermediaries

- 7.42** We also considered whether lenders' panels of intermediaries represent a barrier to entry or expansion for intermediaries. We find that panels are large and lenders typically do not restrict their panel of intermediaries, accepting business from intermediaries subject to due diligence and quality of business checks. However, some lenders, particularly if they are smaller or relatively new entrants, may choose to work with selected intermediaries to ensure they can support volumes of business.
- 7.43** Where lenders removed intermediary firms from their panel, reasons included the firm submitting fraudulent/suspicious applications or the firm not submitting any or enough business to the lender during the review period. Some lenders cited poor quality submissions.
- 7.44** The vast majority of the intermediaries in our sample do not consider panels of intermediaries to be a barrier to entry. One intermediary firm said that some lenders may restrict some products to certain distributors or geographical regions which may result in some intermediaries not being able to access these products.

Do other commercial relationships that lenders and intermediaries have with other market players result in detriment?

- 7.45** We have also looked at whether relationships that lenders and intermediaries have with other market players are resulting in poor outcomes for consumers:
- the cost of a mortgage for consumers using an intermediary with links to an estate agent is not significantly different to that paid by customers using an intermediary without such links
 - the cost of a mortgage for consumers using an intermediary with links to a developer is not significantly different to that paid by customers using an intermediary without such links
 - in contracts between PCWs and lenders and intermediaries we identified a small number of narrow most-favoured nation clauses, which restrict lenders' ability to

102 See Annex 8 for more details on intermediaries' panel strategy.

offer cheaper prices through their own websites compared to the prices offered on the PCW. We do not consider that the narrow MFNs we have seen in the mortgage sector are currently restrictive of competition, in particular because they are not widespread. We also found that agreements between PCWs and lenders do not affect the way products are displayed on the PCWs' comparison tools and that agreements between intermediary firms and PCWs are not very common across the market

- we did not find evidence that the cost of a mortgage is affected if arranged via an intermediary with links to a company that provides ancillary services
- overall we do not think that commercial relationships between lenders and MSSs have a significant impact on intermediaries' advice or that lenders are significantly impeded from entering the market due to MMS. However, it is not clear to what extent the earlier phases of product design and development are influenced by the way MSSs display products.

7.46 More information on our analysis and methodology are in Annexes 7 and 8.

7.47 We did find a small number of arrangements and practices that potentially raise competition issues. We do not plan to prioritise further analysis or action at this time, but reserve the ability to do so in the future should we think it appropriate and would like to draw firms' attention to these and suggest they consider their potential impact on competition.

- Exclusivity clauses and firms seeking to restrict their counterparty's ability to contact certain groups of consumers. We would like to remind firms of their obligations under competition law, in particular the rules on the use of exclusive distribution and non-compete and non-solicitation clauses.
- One aspect of our review of contracts was aimed at understanding better the structure of procurement fees, including between lenders and mortgage clubs and intermediary firms. In some cases lenders specify contractually what proportion of the procurement fee a mortgage club is able to or must retain, typically 0.01-0.02%. Even where this is not contractually specified, firms told us that in practice retaining a proportion of the procurement fees is the market norm for organising remuneration between clubs and intermediary firms. It is not clear how this practice is working in the interest of consumers. It could weaken price competition between mortgage clubs and/or limit opportunities for new clubs with alternative pricing models.
- Firms sharing information between them, either as stipulated in contracts, or as an additional service that firms, for example mortgage clubs or sourcing systems, provide to their clients allowing them to compare their products against those of their competitors. We note that the benefits of benchmarking can generally be achieved with the exchange of anonymised, historic and aggregated data and that firms should be mindful of their obligations under competition law and the rules on information exchanges when sharing information.

Conclusions

- 7.48** Overall we found little evidence that commercial arrangements between lenders, intermediaries and other players in the mortgage market currently lead to poor consumer outcomes. However, there are a small number of contract clauses that we have identified to which we draw firms' attention.

8 Summary of conclusions

Although the market is working well in many respects, it falls short of our vision in some ways. Specifically:

- navigating the market is currently difficult – many customers miss out on making significant savings on the cost of their mortgage
- tools to support customers are currently of limited effectiveness
- choice of intermediary matters, but there is little support available for customers to help choose an intermediary on an informed basis
- some customers remain on a reversion rate for 6 months or more and appear to benefit from switching, but it seems they cannot or do not

Introduction

- 8.1** In this chapter we bring together the key findings of the market study which are the basis for our discussion of potential remedies in Chapter 9.
- 8.2** Overall, we found a mortgage market that is working well in many respects. But we also found ways in which it could work better. There is no single factor behind this; the picture is complex. The tools available, the commercial incentives for intermediaries and lenders, and aspects of the regulatory framework, all play a part.

What is working well in the mortgage market?

- 8.3** Much of what we found was reassuring, including:
- high levels of consumer engagement, currently over three-quarters of consumers switch to a new mortgage deal within 6 months of moving onto a reversion rate
 - a range of products on offer and apparent competition on headline rates between lenders, though we note that interest rate is not the only factor in the price paid by the consumer
 - consumers who use an intermediary do so for a range of reasons, in particular valuing their experience and expertise.
 - little evidence that current commercial arrangements between firms are associated with material harm for consumers:

- current levels of commission paid by lenders to intermediaries do not appear to be linked with customers paying more for a mortgage
- customers taking out mortgages through an intermediary that has commercial agreements with an estate agent or developer do not, on average, pay more for a mortgage than customers of intermediaries without such links

8.4 In addition, thematic reviews on advice and distribution¹⁰³ and responsible lending¹⁰⁴ conducted after the Mortgage Market Review was implemented indicate that consumers are largely provided with suitable products that they can afford.

In what areas could the market work better?

Navigating the market is currently difficult – many customers miss out on significant savings on the cost of their mortgage

- 8.5** At the moment, someone looking for a mortgage has to search through many different products. Choice is typically a good thing. But there is no easy way for a consumer to be confident at an early stage of the products for which they qualify. This is a significant constraint to shopping around effectively.
- 8.6** The limited information upfront on eligibility from lenders also affects intermediaries, who have to also rely on market knowledge and experience to judge the products for which a customer may qualify. This lack of information restricts intermediaries' ability to look across the entire market and may play a part in intermediaries favouring fewer, more familiar lenders which could in turn lead to customers missing out on the cheapest suitable mortgage.
- 8.7** We estimate that around 30% of consumers (in 2015-2016) could have found a cheaper alternative mortgage for which they were eligible with the same key features (eg duration of introductory fixed rate). On average, these consumers paid around £550 per year more over the introductory period of their mortgage than they needed to.
- 8.8** Importantly, the remaining 70% are not necessarily all buying the cheapest suitable mortgage available. For some of these consumers there may still be comparable mortgages for which one element of the cost (eg fee) is higher but, given their circumstances, is offset by a lower interest rate.
- #### **Tools to help consumers choose a mortgage are currently of limited effectiveness**
- 8.9** We estimate that intermediation currently reduces the average initial cost of borrowing by about £600 per year over the introductory period.
- 8.10** This saving appears to be driven by intermediaries recommending a greater proportion of 2-year fixed-rate mortgages (and slightly longer mortgage terms) rather than finding a cheaper product of a given type.
- 8.11** We also estimate that, on average, receiving advice has little impact on the cost of the mortgage a customer chooses. The provision of advice involves a financial cost that firms must recoup and adds to the time involved in choosing a mortgage. So those

103 <https://www.fca.org.uk/publication/thematic-reviews/tr15-09.pdf>

104 <https://www.fca.org.uk/publication/thematic-reviews/tr16-04.pdf>



consumers able to find a suitable mortgage without advice on average get advice they may not need, incurring time and (depending how the cost of advice is recouped by a lender) financial costs.

- 8.12** New business models in intermediation and/or tools could provide consumers with opportunities to better compare products, get support (including advice), and apply for a mortgage. If consumers have the opportunity to decide how much support they need and in what form, this could drive more effective decision-making and greater convenience. But, aspects of our advice rules and guidance may act as a barrier to this.

Choice of intermediary matters, but there is little support available to help consumers choose an intermediary

- 8.13** Intermediaries have a strong commercial incentive to find a mortgage for a customer and to do so as quickly as possible, both of which are typically in line with a customer's needs.
- 8.14** However, the incentive to find the cheapest mortgage of any given type can be weaker. We found that on average a consumer's choice of intermediary makes a difference to the eventual cost of their mortgage. In particular, we have observed links between more expensive mortgages and intermediaries that typically place business with fewer lenders. But there are few tools to help consumers assess the relative strengths of an intermediary.
- There are barriers to switching for some consumers**
- 8.15** The UK mortgage market has evolved such that customers typically take out a long-term contract but then regularly switch to get the best short-term deal. And consumers appear well engaged; over three-quarters switch to a new introductory rate within 6 months of the previous one coming to an end. But a significant minority of consumers stay on reversion rates for longer.
- 8.16** We estimate that a small number (around 30,000) of consumers holding mortgages with firms authorised to lend would benefit from switching but, despite being up to date with payments, cannot. Around 10,000 of these customers hold mortgages with 'active lenders' that continue to lend to new and/or existing customers; the remaining 20,000 are with firms that although authorised to lend are no longer active. Major changes to lending practices during or immediately after the crisis and the subsequent regulatory response aimed at preventing a return to past poor practices appear to have left these customers unable to find a cheaper mortgage.
- 8.17** Mortgage accounts can legitimately be sold on to firms that are not authorised to lend. There are also customers with mortgages in the books of firms not authorised to lend that may be in similar circumstances. But we hold insufficient detailed data on these mortgage books to estimate the number of customers on a reversion rate that are unable to switch. Instead, we estimate that around 120,000 may benefit from switching. This is in addition to the 20,000 customers unable to switch (mentioned above) that hold mortgages with firms that, although still authorised to lend, are no longer active. These firms offer no new products to new or existing customers.
- 8.18** Around 800,000 further customers remain on a reversion rate for over 6 months, despite appearing able to and likely to benefit from doing so. Some of these customers may value the flexibility in the short term but it is not clear why many would not switch, suggesting there are barriers to some customers switching.

9 Discussion of potential remedies: How could the market work better?

Our vision for the market is one in which:

- borrowers who can afford a mortgage can choose suitable and good value products and services
- firms have a culture of treating all consumers fairly, and
- competition and proportionate regulation empower consumers to make effective choices before taking out, and throughout the life of, a mortgage.

To achieve our vision, we would like:

- it to be easier for consumers to find the right mortgage
- there to be a wider range of tools providing consumers with a choice about the support (including advice) that they receive
- consumers choosing an intermediary to be able to do so on an informed basis, and
- consumers to be able to switch more freely to new deals without undue barriers

We have set out below how this could be achieved and would like to discuss this with stakeholders in the next phase of this study.

Delivery of remedies involving rule or guidance changes will require formal consultation. But not all elements may require rules or guidance, so we are also inviting contributions from stakeholders to help deliver some of the potential remedies. Around the end of the year we intend to publish our final findings, a summary of feedback received and next steps.

Introduction

- 9.1** In this chapter we set out our current thinking on potential remedies to improve how the market works in light of our findings.
- 9.2** In the next phase of the study we plan to narrow our focus to concentrate on a small number of specific issues. We will discuss our findings and vision with stakeholders, including how it can best be delivered. We are open to considering all potential means to achieve the desired outcomes.
- 9.3** In the final report we will set out our final findings, a summary of feedback received and intended next steps, including in which areas the FCA and/or industry should lead and a more definitive implementation timeframe.

Vision for the market and principles for potential remedies

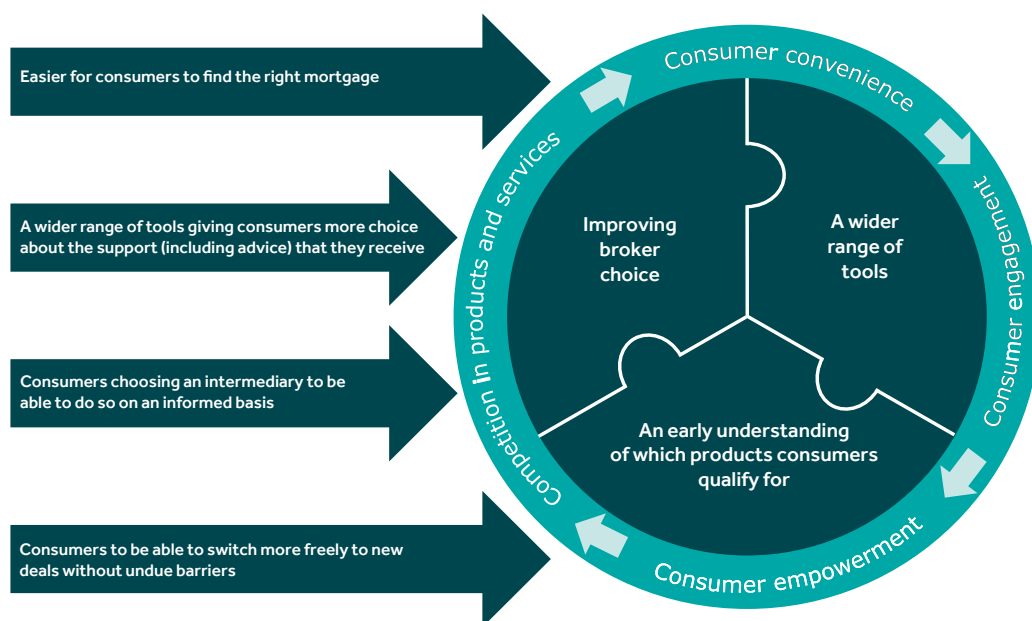
9.4 We have identified a number of areas where there is scope to improve how well the market works to support the vision set out above. To help achieve our vision, we would like:

- it to be easier for consumers to find the right mortgage;
- there to be a wider range of tools providing consumers with a choice about the support (including advice) that they receive;
- consumers choosing an intermediary to be able to do so on an informed basis; and
- consumers can more freely switch to new deals without undue barriers.

9.5 Some of the potential remedies we have identified are mutually reinforcing, so no potential remedy should be viewed in isolation. For example:

- the development of effective online tools will be aided by the availability of sufficient eligibility and other qualification criteria, but changes to our advice rules and guidance might also be needed
- consumers will be able to assess the strengths of different intermediaries more easily if they are able to begin the journey on a more informed basis
- consumers having better sight of which products they qualify for should help shopping around when switching

Figure 9.1: The combined effect of potential remedies



Q1: Do you have any views on our vision for the market?

Making it easier for consumers to find the right mortgage

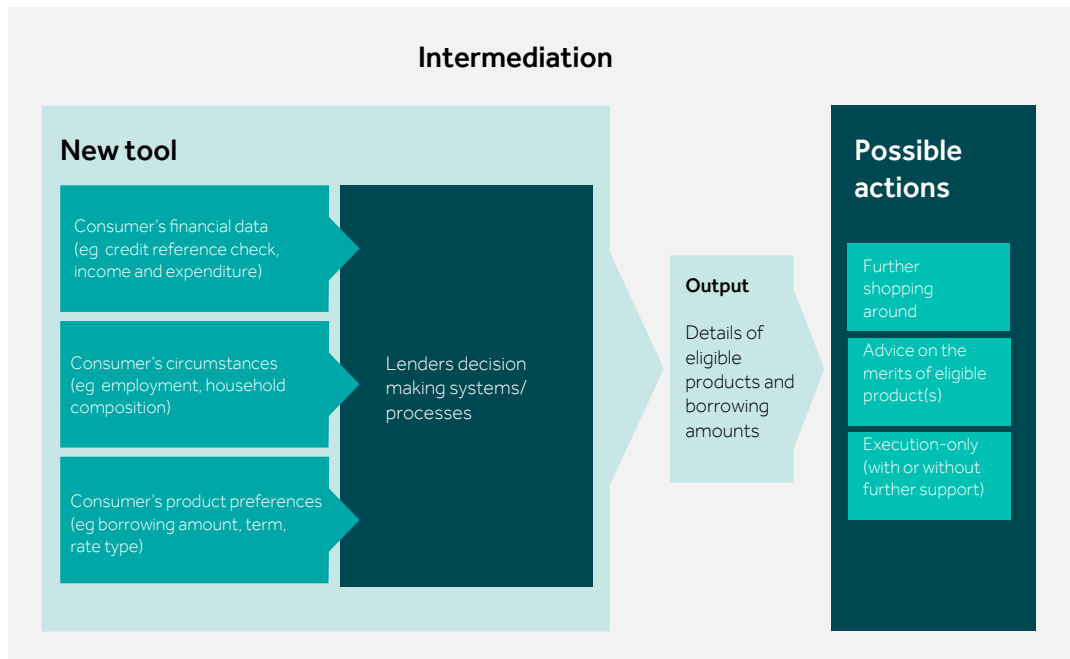
- 9.6** By improving consumers' ability to access, assess and act upon eligibility information early on in the process, we believe the current sales process (both direct and via an intermediary) could be improved.
- 9.7** We believe there are considerable opportunities for firms to
- enhance the services they offer
 - innovate, and
 - simplify the mortgage buying process for consumers,
- 9.8** An example could be enabling customers to understand upfront whether they qualify for particular products, allowing them to shop around on a more informed basis, and providing additional means of applying for a mortgage.
- 9.9** We want to foster an environment where innovation that meets consumers' needs can flourish without undue regulatory barriers. As noted, we have not seen innovation in mortgage distribution to the same extent as in other markets.¹⁰⁵ But it is encouraging to note that there has been some recent progress among intermediaries developing tools and lenders partnering with them. We want to ensure that innovation already under way is not curtailed by FCA intervention.
- 9.10** We hope the recent progress in this market will lead to new or existing intermediaries developing tools that allow consumers to understand at an early stage the products for which they will qualify.
- 9.11** If such innovation is successful, it could allow consumers to better compare products, get support, and apply for a mortgage (see Figure 9.2).¹⁰⁶ However, this is dependent on lenders providing intermediaries with the information necessary to build these tools. We note that the ComRes research commissioned by UK Finance, published in March, recognises similar challenges.¹⁰⁷

105 Firms looking to innovate further can use, and have used, the services offered through the FCA's Innovate team
<https://www.fca.org.uk/firms/fca-innovate>

106 We acknowledge that some aspects of our rules, including those introduced to implement the MCD, could pose barriers to these tools being used to transact. For example, the provision of a European Standardised Information Sheet (ESIS) in a 'durable medium' and in good time before the consumer is bound by any contract or offer.

107 Report for UK Finance members, shared with us by UK Finance. The report is available here:
<https://www.cml.org.uk/policy/policy-updates/all/transparency-of-mortgage-fees-and-charges/> (restricted access)

Figure 9.2 – illustrative example of a tool used by a consumer or intermediary



9.12 It is important to emphasise that the convenience of these tools could also support more traditional methods of sale. For instance, a tool used by either an intermediary or a consumer could complement telephone or face-to-face advice where required. In the case of a consumer-facing tool, the presentation of products after the fact-find could then include routing to particular intermediaries (eg in the case of exclusive deals).

9.13 We are not suggesting that a single tool, as described in Figure 9.2, would be right for every consumer. For example, some consumers will prefer or need face-to-face or telephone support at the outset. And there are risks that tools don't adequately support consumers with complex circumstances who might not qualify for any products, or that some applications might require manual review. Where this is the case, these tools could have the potential to provide tailored feedback to consumers on why they are not eligible, such as not having a large enough deposit or having a poor credit score, and suggest ways in which they can improve their chances of being approved (which may involve telephone or face-to-face support). In any case, the eventual development of such tools could be phased, with mainstream, or more straightforward, consumer circumstances addressed before functionality is extended to more complex consumer circumstances.

9.14 The provision of information by lenders to intermediary firms in order to develop such tools should also incentivise lenders to improve their own direct offerings and make better information directly available. At present, consumers who go to a lender directly on an execution-only basis are to some extent reliant on the limited eligibility and affordability information provided online by that lender.

9.15 As well as improving consumers' decision making when buying a mortgage, we think that innovative tools could also help consumers make comparisons across products.

For example, the industry could develop tools that combine customer and product data to show:

- how monthly payments are impacted by the relationship between different product rates and fees (and whether any fees are paid up-front or rolled into the loan)
- the effect of interest rate changes on mortgage payments (possibly linking with third party forecasts of base rate changes)
- for existing mortgage customers, whether and when they might save money by switching

Could mortgage lenders make sufficient information available (in consistent format) to established and emerging intermediaries to support the development of tools that, early on in the sales process, give consumers a much clearer understanding of the products for which they qualify?

We want to further understand:

- firms' appetite for this kind of development
- how recent progress can be built upon
- what commercial and technical barriers exist and how these can be addressed
- if regulatory barriers exist, whether these can and should be removed

We will establish early contact with the trade bodies and firms we engaged with throughout this study. We will discuss with the industry the likely timescales for development.

Q2: Do you think tools of the kind outlined could help consumers find more easily the best mortgage for them ?

Q3: What do you think would be necessary for this approach to work and what do you see as the main challenges?
(eg what would be required to ensure that lenders can provide intermediaries with the means of identifying (earlier) products for which consumers qualify? Are there any technical barriers to further development? What is needed to give consumers meaningful outputs, even if they don't qualify for products?)

Q4: Could there be any unintended consequences? (eg do our ideas in this area present any risks to consumers or industry? Does this dampen incentives to innovate?)

A wider range of tools giving consumers more choice about the support (including advice) that they need and offering greater convenience

- 9.16** We want consumers to buy good value, suitable products. To do this, the level of support consumers need or want will vary according to factors such as their circumstances, knowledge or experience. We want a market that provides a range of tools in response to these different wants and needs. For example, catering for those consumers who need or want assistance (including advice), and those who would benefit from choosing a mortgage with less support.
- 9.17** To make it easier for consumers to find the right mortgage, changes to our advice rules and guidance may be required. We have previously heard from firms, in general terms, that our advice rules do present problems. By setting out our vision, we hope we can pinpoint issues more specifically.
- 9.18** By way of example, if consumers were better able to understand the products for which they are likely to qualify, this would go some way to empowering them to make their product choices. The development of new tools to support this could lead to new intermediary models, such as online arrangement of execution-only sales.
- 9.19** It is important to stress that our rules do not prohibit intermediary-arranged execution-only sales. However, we know that less than 1% of new execution-only mortgage sales are arranged by an intermediary. And, even if an intermediary wanted to, the interaction trigger makes it difficult to do so given that existing intermediary models rely on interaction with consumers. A consumer might not get the value they would expect from an intermediary if they don't receive assistance with their application or expertise in an execution-only sale.

We want more consumers to have greater choices of tools (including advice) to help choose a mortgage more effectively

Improved access to eligibility and other qualification criteria could improve consumers' ability to self-serve without advice.¹⁰⁸ Equally, some consumers might choose to use an intermediary that does not provide advice, but provides other services, for example as described in Figure 9.2.

We are open to revisiting our advice rules if they pose a barrier to our vision for the mortgage market. Our provisional view is that the removal of certain regulatory barriers to the development of more effective competition in intermediation is likely to be the most effective way to achieve this, although strengthening the requirements on firms when giving advice is an alternative approach. Given the potential risks inherent in removing any regulatory protections, we are inviting views on how best to proceed.

One way of helping to ensure that customers who don't need advice don't have to take it would be to remove the requirement in our rules for almost all interactive sales to be advised.¹⁰⁹ This could enable consumers to buy a mortgage execution-only (with or without some form of intermediated support).

¹⁰⁸ Apart from those for whom it is mandatory. See MCOB 4.8A.7R and MCOB 8.6A.4R.

¹⁰⁹ MCOB 4.8A.2R(1)

But we need to consider how to balance the benefits to those consumers who would be able to select affordable, suitable, good-value products without the cost and inconvenience of advice, against the costs to those customers who might obtain poorer outcomes as a result of choosing not to take advice.

If fewer consumers were to receive advice, fewer would benefit from an assessment of suitability and recourse to the Ombudsman in the event of unsuitable advice. Although we did not find evidence of advice delivering much value in terms of product price, we did not look at non-price aspects of suitability in this work. The value added by advice could change in a more volatile interest rate environment where the risks of self-selecting a poor value or unsuitable product could be more acute.

We could also consider clarifying or relaxing our rule that is designed to prevent firms steering consumers away from advice.¹¹⁰ Although not the main intention, the rule has led firms to avoid marketing their execution-only channels. But we would only want to consider this if there are effective means of fostering execution-only sales across both lenders and intermediaries.

Finally, we could also consider modifying our guidance¹¹¹ to encourage development of new tools to help consumers find the right mortgage product, for example, by adopting a narrower view of what constitutes steering consumers towards particular mortgage products.

9.20 A related point here is the time and cost of delivering advice. The provision of advice involves a financial cost that firms must recoup and adds to the time involved in a customer choosing a mortgage. Online advice, properly delivered, could in principle be quicker and lower cost without harming consumer outcomes. But we have also heard about challenges and concerns from firms on whether and how it could be delivered. We could mitigate some of these concerns, for example, through new or amended rules or guidance that limit the provision of online advice to consumers perceived to be lower risk (eg experienced remortgagors). We are not inclined to distinguish online advice in such a way as we have not seen evidence to support doing so, but would welcome alternative views.

Q5: **Do you think consumers would benefit from more choice on the tools they use (including advice) and the support they receive in the way outlined above?** (if so, which categories of consumer? Or if only some consumers should have more choice about whether or not to receive advice, which categories of consumer are these? What else could we do to encourage the development of online advice?)

Q6: **What do you think would be necessary for this approach to work and what do you see as the main challenges?** (eg should we trial an approach to give consumers more information about whether to receive advice? Are there other regulatory barriers to the development of tools to help consumers choose a mortgage more effectively?)

Q7: **Could there be any unintended consequences?** (eg do you have any views on the impact of reduced regulatory

110 MCOB 4.8A.5R

111 PERG 4.6

consumer benefits for those consumers who would no longer seek advice? Could there be any unintended consequences to increasing provision of online advice? If so, how might these risks be mitigated)

The role of Innovate

- 9.21** Ultimately, it will be for firms to consider whether and how to develop innovative tools (including online advice models). The FCA's Innovate Department¹¹² can play an important role here. Innovate provides assistance to firms which are using innovation to improve consumer outcomes. It can help such firms better understand our rules, processes and guidance.
- 9.22** We would encourage both new and established firms looking to bring innovative propositions to market to contact the respective Innovate teams as per their requirements:
- **Advice Unit**; provides regulatory feedback to both established and new entrant firms developing automated models to deliver lower cost advice and other services that help consumers make their own mortgage choices.
 - **Direct Support**; provides a dedicated contact for innovator businesses that are considering applying for authorisation or a variation of permission and need support when doing so, or do not need to be authorised but could benefit from the FCA's support.
 - **Regulatory Sandbox**; provides a live market environment that allows firms to test innovative products, services and business models, while ensuring that appropriate safeguards are in place.

Helping consumers choose an intermediary on an informed basis

- 9.23** As explained in Chapter 5, a consumer's choice of intermediary matters in terms of the cost of a mortgage but there is little information available to help consumers assess the relative strengths and weaknesses of different intermediaries.
- 9.24** For consumers to benefit from other potential remedies, such as improvements to the effectiveness of intermediation that could come about with better and earlier information on eligibility, it will be important that their initial contact with the market is done on an informed basis.
- 9.25** If more consumers are able to make an informed choice of intermediary, this could drive up quality among intermediaries and improve competition between them. Those intermediaries better meeting customer needs could then be rewarded with more business.
- 9.26** This might also have an effect on referrals to intermediaries from estate agents and/or developers. Consumers would be better placed to identify whether the intermediary to which they are being referred offers the level and quality of service that they want. This could complement recent proposals by the Ministry of Housing, Communities and

¹¹² <https://www.fca.org.uk/firms/fca-innovate>

Local Government aimed at creating more transparency around referral fees. These include standardising the presentation of referral fees and ensuring that customers are made aware of any potential referral fee before they decide whether to purchase.

- 9.27** This is likely to involve both identifying relevant information to compare the strengths of intermediaries and also ensuring consumers are able use that information effectively.

We want to explore ways in which to enable consumers to compare the strengths of different intermediaries and shop around on a more informed basis

This could include tools that allow consumers to compare intermediaries on the basis of factors such as:

- fees
- areas of expertise/relevant markets and products covered
- whether a panel is used and, if so, the lenders on it
- distribution/concentration of business to particular lenders
- number of complaints

These factors are illustrative, although our findings do point to the benefits of intermediaries considering a wider range of lenders. Any proposal will also need to consider how best to ensure the information gains traction with consumers.

In the next phase of our work, we will give the mortgage intermediary sector (including potential entrants) the opportunity to propose ways to achieve this. We welcome views from industry and others on relevant metrics and how to ensure the information gains traction with consumers.

Q8: Do you think consumers should be given more help to assess intermediaries' strengths and weaknesses in the way outlined above?

Q9: What do you think is necessary for this approach to work and what do you see as the main challenges? (eg what information is needed for this to be of practical value to consumers, such as the price, service and quality factors? How can we ensure the information gains traction with consumers?)

Q10: Could there be any unintended consequences?

Fair treatment of those consumers who do not or cannot switch

- 9.28** Fair treatment of existing customers is one of the FCA's cross-sector priorities.¹¹³ As explained in Chapter 6, switching rates in the mortgage market are high. But we want

113 FCA Business Plan 2018/19, <https://www.fca.org.uk/publication/business-plans/business-plan-2018-19.pdf>

to make it easier for consumers to switch where they would benefit from doing so in 2 specific cases:

- a. consumers who took out a mortgage or last switched before the financial crisis, who are on a reversion rate and up to date with payments, but cannot switch to a new introductory deal, and
- b. consumers who are less active and have been on a reversion rate for an extended period of time

Consumers who would benefit from switching to a better mortgage deal but are unable to do so

- 9.29** Our analysis has shown that some consumers, who took out a mortgage or last switched before the financial crisis, are on a reversion rate, up to date with payments and would benefit from switching to a better mortgage deal, but are unable to do so. While the number of these borrowers appears relatively small (compared to both the entire population of mortgage holders and those currently on a reversion rate) the financial impact on these individuals can be material.
- 9.30** Almost all (96%) of the 30,000 customers holding mortgages with authorised lenders that appear unable to switch took out their mortgage (or last switched) externally before 2009. Their choices appear to have become constrained in light of the significant change in lending practices during and immediately after the financial crisis, resulting from the initial market response and the impact of the responsible lending requirements of the MMR. This may also be the case for consumers unable to switch holding mortgages with firms that are not authorised to lend.
- 9.31** The regulatory perimeter constrains our approach to remedies for customers who have mortgages with unauthorised firms. We need to consider different approaches depending on (i) whether a customer's mortgage is in a book held by a firm authorised to lend, and if so (ii) whether the lender is active and has a range of products for new and/or existing customers.
- 9.32** Looking at active lenders, most lenders in our sample for this study (representing approximately 85% of the entire market by outstanding balance) tell us that they do not place any barriers in the way of their existing customers looking to switch, where they are up to date with payments and not looking to borrow more. These lenders use the flexibility provided by our responsible lending rules (allowing them to waive affordability checks for their existing customers in such circumstances¹¹⁴) and in addition they do not carry out any other form of credit risk checks.

Active lenders

We have not seen evidence that reversion rates themselves are an inherent source of harm. But **we are inviting views on whether and how to enable customers on an active lender's reversion rate to switch to a better deal in certain circumstances**, specifically if they:

- took out a mortgage or last switched prior to the tightening in lending criteria during and immediately post-crisis

114 MCOB 11.6.3R and MCOB 11.7.1R

- are up to date with payments (and therefore demonstrating they are able to afford the mortgage at the current interest rate)
- are not looking to borrow more, and
- have applied for an internal switch (following the lender's usual process)

As such, the application of the remedy will not be limited to the specific number of consumers we've identified as unable to switch. Rather, it should enable all customers falling within the above criteria to be treated on a similar basis to customers that are currently able to demonstrate affordability successfully. For example, our methodology considered the benefit from switching in terms of the cost of a mortgage but some individual consumers on a low reversion rate might benefit from switching to a higher fixed rate to insure against rising interest rates.

We want to explore further whether this could be achieved through a voluntary agreement with the industry. After considering feedback to the interim report, we will provide an update through the final report.

We have also considered whether more could and should be done to allow these customers to move between lenders. Although desirable in principle, there appear 2 factors that point away from acting. First, the MCD requires a firm to carry out an affordability assessment when taking on a consumer from another lender. Second, our evidence shows little difference in financial benefits from switching internally versus externally once the additional costs of switching externally are considered.

Q11: Do you think it should be made easier for consumers with active lenders to switch?

Q12: Which consumers should be covered in our approach? (eg do you have views on whether any intervention in this area should be limited to consumers who took out a mortgage or last switched prior to a tightening in lending criteria post-crisis? If so, what would be an appropriate date? Also, should we include other groups of customers such as who have fallen into financial difficulty as a result of being unable to afford payments on a reversion rate, but would otherwise satisfy the remedy constraints/criteria? Or should we leave customers in arrears to be considered under our rules and guidance in MCOB 13 which set out how we expect firms to treat customers in payment shortfall fairly given the customer's individual circumstances?)

Q13: What do you think is necessary for this approach to work, and what do you see as the main challenges? (eg How could any changes be effectively communicated to the relevant consumers?)

Q14: Could there be any unintended consequences?

9.33

Where firms are no longer lending, or a mortgage book has been sold to entities not authorised for mortgage lending, we have far fewer options to improve the ability for consumers to switch to a new rate.

Inactive lenders (those authorised for mortgage lending and those not)

We will begin discussions on possible solutions for inactive lenders with relevant firms, consumer groups and government.

Although a firm might be authorised for mortgage lending, it may have stopped lending to new and/or existing customers. The FCA's regulatory remit is a matter for Parliament.

Long-term inactive customers

- 9.34** We want to make it easier for less active consumers who have been on a reversion rate for an extended period of time to switch products with their existing lender, if it is in their interests to do so. However, we need to be mindful of a number of factors.
- 9.35** Lenders' retention strategies and intermediaries' contact strategies are developing. More lenders now pay retention procurement fees. This in itself might lead to more existing borrowers being encouraged to switch.
- 9.36** Research carried out during our recent interest-only mortgages thematic review showed that customers may become more engaged with their lenders if communications are personal, relevant and highlight the benefit of making contact.¹¹⁵ The type of technological innovation that could support giving consumers early sight of which products they qualify for might lead to consumers becoming more engaged throughout the mortgage lifecycle. For example, a lender (or, perhaps longer term, an intermediary) with access to a customer's mortgage account could better understand the extent of any overpayments and eligibility for a new deal, enabling them to tailor the timing and content of that customer contact. Indeed, playing these data back to consumers on a regular basis might be an effective means of educating consumers on amortisation, the features of their mortgage, and the points at which they might consider switching.
- 9.37** In today's market, we also see lenders offering products to their existing customers that, in price terms, are close to deals available from other lenders once switching costs have been taken into account. Any intervention in this area would need to take this into account.
- 9.38** We are also conscious that an increase in the number of consumers who switch once on a reversion rate could lead to lenders increasing prices for new customers to offset lost revenue. This impact should be limited given that the majority of mortgage consumers already switch. However, we welcome views on this point, including the impact on vulnerable customers if we were not to act.

¹¹⁵ <https://www.fca.org.uk/publication/thematic-reviews/tr18-1.pdf>

One way this might be achieved could be to ask lenders to contact affected customers, a year or so after moving onto a reversion rate, giving them a simple and straightforward means of moving to a cheaper mortgage.

But a remedy of this kind would need to take into account pre-contractual disclosure requirements, in particular those mandated by the MCD, as well as other relevant rules.

We would also need to consider whether any communication encouraging customers to switch should contain additional information about the risks and benefits of doing so.

We welcome ideas from lenders, intermediaries and consumer groups about proportionate and effective ways of engaging with these consumers.

Q15: Do you think we should do more to encourage long-term inactive customers to switch in the way outlined above?

Q16: What do you think is necessary for this approach to work in the mortgages sector and what do you see as the main challenges? (eg is this something that could be delivered by the industry or would it require new or amended rules or guidance to prove effective? What would be an effective alternative where no suitable product is offered by the customer's existing lender? Do you have any views on how affected consumers could be offered a better deal?)

Q17: Could there be any unintended consequences? (eg any impact this could have on prices for new customers)

Changes to regulatory reporting

9.39

We gather and use a wide range of data, information and intelligence from across our organisation, firms and elsewhere to help us meet our statutory objectives. Our work has shown the potential value of information about 2 market segments that we do not routinely collect through product sales data.

- Sales data about internal product switches. This is a significant part of the market. Information firms hold on internal switches is of interest to us from both conduct and competition perspectives.
- Performance data about mortgage books that have been sold to unregulated entities. The absence of data here limits our understanding of potential consumer detriment. As the purchasing firms are unregulated, we would only be able to place a reporting obligation on the regulated administrator.

Amending our Handbook to collect this information on a regular basis would be subject to consultation. We will be considering this over the coming months.

Remedies – timeline and general questions

- 9.40** Over the next few months we will be engaging with industry, consumer groups and other interested parties to discuss potential remedies. In our final report around the end of the year we intend to publish our final findings, a summary of feedback received and next steps.
- 9.41** Delivery of any remedies involving changes to rules or guidance will require formal consultation. The nature and timing of any consultation will depend on feedback to the interim report. Industry-led progress on areas that contribute towards our vision will also be a factor, for example enabling consumers to easily identify the mortgages they qualify for. Although some of this may take time, we will consider what other aspects of our vision can be addressed in the interim.

Q18: Do you have any comments on our timelines?

Q19: Do you have any views on the relevance of our findings on first-charge residential mortgages to other mortgage markets that we regulate and which were not within the scope of the market study – for example, second charge?

Q20: Do you have any views on the extent to which these potential remedies (with further enhancement or refinement) are relevant to lifetime mortgages (in light of our assessment of lifetime mortgages in Annex 5)?

Other potential approaches

- 9.42** Over the course of our work, we have considered other potential interventions we currently think are less likely to be effective than those set out in this report. However, we would welcome views on this.
- 9.43** **Making it simpler and easier for consumers to find the right mortgage**
One of the factors that can make it difficult for consumers to find the right mortgage is the complexity of pricing structures (eg different combinations of upfront fees and ongoing interest rates) and the practice of offering low introductory rates followed by a higher reversion rate.
- 9.44** However, we do not think interventions to constrain mortgage price structures to make them less complex would be desirable because:
- As explained above, encouraging innovation in tools to help consumers choose the right mortgage could help overcome some of the problems caused by the complexity of mortgage price structures by finding ways in which the information can be better presented.
 - We have not seen evidence that reversion rates are an inherent source of harm. So, we instead have outlined targeted interventions to encourage the minority of borrowers who remain on reversion rate for an extended period to switch.

A wider choice of tools to help consumers get the right product

9.45 We found that a significant minority of consumers could stand to save by buying a cheaper equivalent mortgage. We also found that advice has little impact on mortgage price.

9.46 Our advice rules do not require firms to consider price when assessing whether product(s) are suitable for a consumer's needs and circumstances. We have given some thought to altering this given our finding that advice has minimal impact on borrowing costs, and continue to welcome views. However, there are several reasons why we have not proposed this alternative in this chapter.

- Earlier in this chapter we outlined potential remedies designed to help consumers choose the right mortgage and, where used, intermediary. Our suggestions for amending our rules and guidance to help consumers choose the right tools (including advice) could complement these. These approaches could have a mutually reinforcing effect in increasing innovation and driving greater competition in intermediation. If successful, this could drive better outcomes in relation to price without the need to introduce further regulation requiring that price be considered by firms when giving advice.
- Intermediaries tell us that they account for price in their recommendations, and a rule change would make less sense for direct sales (where there may only be one suitable product).

Reducing barriers for those consumers who do not or cannot switch

9.47 We could consider including consumers who are on a reversion rate (and meeting other proposed criteria) but behind on their mortgage payments within scope of any potential remedy to help those who cannot switch. These consumers, like those we have defined as unable to switch, will struggle to get access to a better deal, despite some potentially being in arrears solely due to their current (higher) mortgage repayments. But if our existing payment shortfall rules and guidance can help such customers recover their positions, then they could fall within the proposed cohort of customers we have outlined above.

9.48 In MCOB 13 we set out how we expect firms to treat customers in payment shortfall fairly. This includes making reasonable efforts to agree with the consumer how that shortfall can be cleared, and consideration of forbearance options given the customer's individual circumstances. This could include concessionary payments for a period of time to allow a consumer to overcome a period of short-term financial difficulty.

Q21: Do you have any views on these options or any other alternatives?

Appendix 1

Abbreviations used in this paper

ADR	Advice and distribution review
APR	Annual percentage rate
AR	Appointed representative
bps	Basis points (1 basis point = 0.01%)
Cfi	Call for Inputs
CMA	Competition and Markets Authority
DA	Directly authorised
ERC	Early repayment charge
FCA	Financial Conduct Authority
FTB	First-time buyer
FOS	Financial Ombudsman Service
FPC	Financial Policy Committee
HHI	Herfindahl-Hirschman Index
HMT	Her Majesty's Treasury
LTV	Loan-to-value
MCD	Mortgage Credit Directive
MCOB	Mortgages Conduct of Business sourcebook (a module of the FCA Handbook)
MFN	Most-favoured nation
MHCLG	Ministry of Housing, Communities and Local Government
MMR	Mortgage Market Review
MSS	Mortgage sourcing system
OP	Occasional Paper

PCW	Price comparison website
pp	Percentage point
PRA	Prudential Regulation Authority
PSD	Product Sales Data
Rfi	Request for Information
RLR	Responsible Lending Review
SVR	Standard variable rate
ToR	Terms of Reference

We have developed this work in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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