Feedback Statement

10/1

Financial Services Authority

Mortgage Market Review:

Feedback on DP09/3

March 2010

Financial Services Authority

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This Feedback Statement reports on the main issues arising from
Discussion Paper 09/3: *Mortgage Market Review*

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1 Overview

Purpose

1.1 In this paper we summarise the feedback we have received to our proposals on the regulation of the mortgage market, which we published in October 2009 in our Discussion Paper DP09/3: *Mortgage Market Review*.[1]

1.2 We subsequently moved quickly to consult on two of the issues raised in the *Mortgage Market Review* Discussion Paper and, in January 2010, published a Consultation Paper on strengthening our arrears rules and extending our approved persons regime.[2] Additional policy proposals will be consulted on separately in the third and fourth quarters of 2010. In the meantime, this Feedback Statement gives us the opportunity to report on the responses we have received so far.

1.3 This paper does not set out new policy proposals beyond those that were published in the *Mortgage Market Review* Discussion Paper.

Background

1.4 We have conducted a review of the UK mortgage market to identify the causal drivers for poor outcomes and to develop appropriate regulatory responses to address them. Our analysis suggested that a significant shift in our regulatory approach to the mortgage market may be required in line with the FSA's new approach to supervision and risk assessment.

1.5 We were, therefore, keen to engage early with stakeholders potentially impacted by our proposals so as to gauge their views and inform our analysis. The first step in this process was our Discussion Paper DP09/3: *Mortgage Market Review*, which we published in October 2009.

1 http://www.fsa.gov.uk/pages/Library/Policy/DP/2009/09_03.shtml
2 CP10/2 Mortgage Market Review: Arrears & Approved Persons (http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_02.shtml).

1.6 As we stated then, the review is not a response to current market conditions. Rather, it looks across the economic cycle, the good times and the bad, with two broad aims in mind.

1.7 The first is to have a mortgage market that is sustainable for all participants. This means:

- that lenders have sustainable business models that are adequately capitalised, while at the same time remaining competitive, innovative and competent at what they do;
- a regulatory regime that is predictable, clear and transparent – where regulation is not a source of volatility and minimises the pro-cyclical impacts on house prices, while helping to minimise mortgage fraud and other forms of financial crime; and
- the costs and risks of lending and borrowing are kept within the market and are not borne by wider society.

1.8 The second broad aim is to have a flexible market that works better for consumers. This means:

- that it offers a range of products that meet the needs of different consumer types to allow individuals, who can afford it, the opportunity to buy their own home;
- that consumers clearly understand the costs and risks of mortgage borrowing;
- that consumers understand the implications and risks of considering property as an investment option rather than primarily as a home; and
- that distribution helps to achieve good outcomes for consumers and provides a professional service, with the number and complexity of products reflecting consumers' needs, rather than firms' and where incentives in the distribution chain work for the consumer.

1.9 Our ambition was to bring about a wide-ranging debate about the future of the mortgage market. To that end, our proposals covered a wide range of topics, including prudential reforms, responsible lending, product regulation, distribution and advice, disclosure and consumer behaviour, arrears and repossessions, unfair charging practices and the extension of our regulatory scope.

1.10 We are very grateful to respondents for having taken up the challenge and for having engaged constructively with our proposals. The views expressed continue to be the subject of ongoing and detailed discussions with stakeholders and will inform our thinking as we develop our proposals further.

Key themes from responses

1.11 We received 178 responses from a wide variety of stakeholders, including lenders, intermediaries, trade associations, individual consumers, consumer representatives, professional bodies, the government and other entities and individuals. Most respondents provided comments on all the questions we asked, while some preferred to respond to a subset only.

1.12 The following section highlights the key themes from the feedback we received.

Prudential reform

1.13 Respondents largely agreed with our assessment on prudential reform and our proposal not to impose additional measures beyond those proposed as part of the overall prudential reform agenda. We are aware that the level and pace of regulatory change currently occurring at both a national and international level is unprecedented and are conscious of the potential impact on both firms and consumers in the mortgage market.

1.14 We have encouraged major firms to take part in the Basel/CEBS quantitative impact study (QIS).[3] This aims at assessing the overall impact of the proposed changes to the current Basel II prudential framework on firms' capital positions.

1.15 Respondents expressed a variety of views about non-deposit taking lenders (non-banks). Although there was widespread support for more direct intervention in response to the risks they pose, there were diverse views about the form this should take and whether the prudential regimes for non-banks and banks should be more closely aligned and/or non-banks' business models should be more closely supervised.

Conduct of business reform

1.16 Respondents did not support imposing an LTV/LTI/DTI cap on consumer protection grounds. There was support for the proposal to prohibit mortgages sales to borrowers with multiple high-risk characteristics but nonetheless the majority of respondents were still opposed to a ban.

1.17 Our proposal to make income verification a requirement for all mortgages generated a polarised reaction. Those that supported the proposal argued everyone should be able to verify income, even if the income sources are diverse or the income streams irregular. Support was particularly strong from consumer bodies, but also from smaller lenders, intermediaries and some trade associations.

1.18 Objections were raised mainly by large lenders, who argued that the proposals would impact negatively on the self-employed, which will trigger an increased usage of fraudulent income documentation. They also felt that it would increase administrative costs, as some mortgages should be considered 'low risk' and would, therefore, not require income verification.

1.19 The overwhelming majority of respondents agreed that lenders should be ultimately responsible for assessing affordability. Some concern was expressed that this could be misinterpreted as implying that consumers held no responsibility for their borrowing decisions.

3 The Basel Committee on Banking Supervision (BCBS) consultative document *Strengthening the Resilience of the Banking Sector* (http://www.bis.org/publ/bcbs164.pdf?noframes=1, p12.), which the FSA as a member of the BCBS has endorsed, committed members to carrying out a Quantitative Impact Study (QIS) of the proposed changes to the Basel prudential framework in the BCBS July and December 2009 documents. For further details on the QIS please see http://www.bis.org/bcbs/qis/.

1.20 We would like to clarify that this was not what we intended. Our proposal on income verification, requiring consumers to provide the lender with relevant income documentation, is one of several proposals to ensure that consumers engage properly with the financial decisions they make.

1.21 Our proposals to extend the approved persons regime and to raise the sales standards for non-advised sales met with agreement, although views diverged on how the latter could best be achieved.

1.22 Respondents also agreed in general with our view not to read-across to the mortgage market the proposals developed by the Retail Distribution Review (RDR) on adviser charging.

1.23 Respondents supported us in our interest in preventing the over-extension of credit, acknowledged the importance of our financial capability work with consumers and agreed with our proposal to collect transactional arrears data from lenders on a continuous basis.

1.24 Respondents' views were more divided on the merits of our proposal to review charging practices and to bring about greater clarity by defining certain mortgage-related terms used in the industry.

Scope extensions

1.25 In November 2009 HM Treasury consulted on extending our scope to include second charge and buy-to-let mortgages. This consultation also set out proposals to protect borrowers when lenders sell on mortgage books to third parties.[4] This consultation closed in mid-February and we await the outcome.

Next steps

1.26 We have already published the first *Mortgage Market Review* consultation paper on arrears and approved persons.[5] That consultation period ends on 30 April 2010 and we aim to publish a Policy Statement, setting out our rule changes, in June 2010.

1.27 Beyond this we expect to publish two further consultation papers this year. One in Q3 which will cover the work streams that we are pushing forward as highest priority – income verification and affordability assessments, non-deposit taking lenders and product regulation (lending thresholds and prohibiting loans with multiple high-risk characteristics). And a second in Q4 on distribution (selling standards, intermediary affordability assessments and professionalism) and disclosure. We also plan to publish an Occasional Paper in Q3, setting out the results of our analysis of the causes of arrears based on the transactional data obtained with the help of the Council of Mortgage Lenders, referred to in Chapter 3 of the *Mortgage Market Review* Discussion Paper.

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4 Mortgage regulation: a consultation, HM Treasury, 2009. (http://www.hm-treasury.gov.uk/consult_mortgage_regulation.htm)

5 CP10/2 Mortgage Market Review: Arrears & Approved Persons (http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_02.shtml).

1.28 We indicated in the Discussion Paper that where we are confident in our position and where we have support we intend to move quickly. Although we are planning to consult this year, we have always been clear that final implementation dates will depend on how quickly the market recovers. As such we will not rush into making or implementing rule changes without first fully assessing the potential impact on the market.

1.29 Europe is also a critical dependency for our work. We know that the European Commission continues to scrutinise the case for intervention on responsible lending and borrowing. We will need to have close regard to these developments as we take our work forward.

Who should read this Feedback Statement?

1.30 This statement will be of interest to all firms selling, arranging, administering or advising on FSA-regulated mortgages. It will also be of interest to government, trade bodies, consumers and consumer representatives.

Structure of this paper

1.31 In DP09/3, we asked for comments on our analysis of the mortgage market and the proposals we put forward. Chapter 2 of this statement summarises the feedback we received on each of the 33 questions in the *Mortgage Market Review* Discussion Paper.

2 Summary of feedback to questions in DP09/3

2.1 This chapter summarises the feedback we received to each of the 33 questions in the *Mortgage Market Review* Discussion Paper.

> Q1: Do you agree that the prudential reforms will ensure that banks and building societies are adequately capitalised for the risks inherent in mortgage lending and should support a more stable mortgage market through the economic cycle?

2.2 The majority of respondents agreed that the prudential reforms outlined in the Discussion Paper will ensure that firms are adequately capitalised. There is, however, widespread concern that, in total, the proposals may prove disproportionate and may have a sustained negative impact on the mortgage market and the wider economy by limiting the supply of loans and driving up prices.

2.3 Lenders were most concerned about the impact of prudential reform on the wider economy. Respondents urged us to assess the cumulative impact of all the proposed changes. Several building societies expressed doubts that a 'joined up' assessment would be carried out in view of the proposals set out in the Sourcebook for Building Societies Consultation Paper.[6]

2.4 A few respondents noted that it is too soon to be able to assess whether the changes will ensure firms are adequately capitalised and will be conducive to a sustainable mortgage market. Others believe that higher capital requirements will not lead to a more stable mortgage market. They believe closer vetting of senior managers and closer ongoing supervision are needed, as well as more stringent conduct of business requirements.

2.5 Perhaps due to the nature of the question, we received no comments from consumers or consumer representatives. Intermediary firms expressed diverse views, from fully supporting the prudential reforms to believing they will have an overall negative effect. Two respondents noted that reducing pro-cyclicality will require accounting changes that allow the calculation of provisions to reflect the expected loss on a loan portfolio over the entire economic cycle.

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6 CP09/17 A Specialist Sourcebook for Building Societies (http://www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_17.shtml).

Q2: Do you agree with our analysis of the implications of applying higher capital requirements to high-risk loans (on top of the prudential reforms) and that to do so would not be likely to protect borrowers from the risks of taking on such loans?

2.6 Most respondents agreed that applying higher capital requirements to high-risk loans, as well as the prudential reforms, would be inappropriate. Respondents supported this because they either agreed with our conclusion that these would not be effective measures to protect consumers from taking out high-risk loans, or because higher capital requirements would themselves be too detrimental to borrowers or the market. The latter concern was particularly prevalent among respondents from the intermediaries sector.

2.7 The few respondents who disagreed with our conclusion did so because they thought that the higher costs imposed through capital requirements would represent a disincentive for lenders to offer high-risk loans. Others felt that more evidence was needed to support the theoretical analysis before any definite conclusions could be drawn on the likely effect of specific increased capital requirements for high-risk loans.

2.8 Consumer representatives agreed with the analysis, but encouraged us to focus on conduct of business regulation, as they believed this was a more crucial factor in improving outcomes for consumers.

Q3: Do you agree that more direct intervention through business model analysis; applying asset limits; or increased prudential requirements is required to deal with the consumer and systemic risks posed by non-deposit taking lenders?

2.9 We received feedback from a variety of stakeholders, including banks and building societies, non-banks, intermediaries and trade bodies. The views expressed were generally consistent within each type of respondent but varied significantly.

2.10 Banks and building societies were mainly in favour of increased prudential regulation of non-banks, in particular of bringing the requirements in line with theirs. In contrast, non-banks argued against a disproportionate response to the sector, mainly because they thought not all non-banks were higher-risk. Intermediaries had mixed views, although the majority were in favour of some action being taken. Some trade associations, in turn, agreed intervention was needed but argued we should focus on non-compliant lenders and outlier products.

2.11 There was general consensus that something needed to be done but, of the choices offered in the question, respondents favoured a greater focus on and closer supervision of business models, both at the application stage and thereafter. Respondents also expressed views that any action should focus on the product and the conduct of business rather than the type of firm, because higher-risk lending was not only undertaken by non-banks. The excessive use of automated underwriting systems was mentioned as one example of inappropriate conduct of business.

2.12 No specific suggestions were made concerning the type of prudential changes that we should consider, other than the need to bring the requirements in line with deposit takers and to consider specific liquidity standards. However, some respondents highlighted the view that non-banks should not be treated like banks as they are not funded by short-term deposits. One respondent commented that increased prudential requirements would be a justifiable way of mitigating the pro-cyclicality of the uncontrolled expansion of mortgage credit. Another respondent suggested that in order to reduce the ability of non-banks to withdraw quickly from the market they should have to hold their mortgages for a minimum period of 12 or 24 months before their mortgages could be sold on or securitised.

Q4: Are there any other considerations that are relevant to the issue of how prudential requirements influence mortgage market outcomes?

2.13 There were differing views as to what other considerations were relevant to how prudential requirements influence mortgage market outcomes. There was widespread concern – particularly among intermediaries – about the impact the current prudential reforms would have on the mortgage market and the need to properly assess this. Many respondents also stressed the potential negative effects of more regulation or controls, both in terms of increased costs for firms and reduced availability of mortgage products for consumers.

2.14 Several respondents argued that tightening the authorisation process for firms in the market would decrease the negative pro-cyclical effects of large numbers of firms entering the market during a boom and then exiting in a downturn. However, others stressed that we must ensure any reform measures will not reduce market competition, including raising barriers to entry.

2.15 Respondents answering for, or on behalf of, smaller firms consistently stressed the concern that tightened prudential requirements and the scale of regulatory reform would impact smaller firms disproportionately. They argued that this might lead to consolidation and reduced market competition.

2.16 Several respondents voiced their opinions on product-specific reforms they thought would benefit the mortgage market, such as mortgage insurance provision and capital levels for shared ownership mortgages. Consumer representatives suggested that we could investigate banning specific types of high-risk products and should consider applying similar prudential requirements to both non-bank lenders and deposit takers.

Q5: Do you agree with our analysis that, on the grounds of consumer protection, there is no case for prohibiting the sale of loans above certain LTV, LTI or DTI thresholds?

2.17 The overwhelming majority agreed that, on the grounds of consumer protection, there is no case for banning the sale of loans above certain LTV, LTI or DTI thresholds. This view was shared equally amongst all groups of respondents.

2.18 Most respondents said such measures were too blunt and did not take individual circumstances sufficiently into account. Banning these products would penalise consumers who are genuinely able to repay. Most respondents wanted a more sophisticated approach to determining affordability.

2.19 A few respondents supported banning high LTV/LTI/DTI loans for certain types of risky borrowers. Similarly, a few respondents said we should not rule out such tools as a macro-prudential lever.

> Q6: Do you consider that the FSA should prohibit the sale of mortgages to borrowers with multiple high-risk characteristics? If yes, what particular combinations of risk factors should the FSA consider prohibiting and why?

2.20 There was greater support for this proposal than for banning high LTV/LTI/DTI mortgages, this view being shared by various groups of respondents. However, most respondents were still against a ban on the sale of products with multiple high-risk characteristics, arguing that a ban would be a blunt and inflexible measure that could disadvantage those consumers who could repay. Many also commented that 'toxic' lending was only undertaken by a small minority of lenders, who have now left the market. So it would be disproportionate to penalise the whole industry.

2.21 Although most respondents did not support an outright ban, many still saw a need to address high-risk lending or 'toxic' products. Some suggested the issues would be addressed through the strengthened affordability assessments already proposed. Others suggested applying tighter supervisory controls to high-risk lenders, enhancing conduct of business requirements around these types of loans, or requiring compulsory Mortgage Payment Protection Insurance (MPPI) for these loans. Arguing that such alternatives would be less intrusive and better targeted than an outright ban.

2.22 Most respondents did not comment on the risk factors identified. Of those who did, several noted that people with significant debts were also high-risk borrowers. Many respondents stressed the importance of looking at the outcome of the analysis of the characteristics of arrears cases referred to in the Discussion Paper.

> Q7: Do you consider that requiring verification of income by the lender for all mortgage applications is a viable option, and one which is sufficient to ensure responsible and sustainable levels of mortgage lending?

2.23 Respondents had polarised views on the topic. Those in favour of the proposal argued that everyone should be able to verify income, even if the sources are diverse or the income streams irregular. Although support was strong from consumer representatives, intermediaries and some trade associations also supported it. This was mainly on the grounds of affordability and fraud prevention.

2.24 Smaller lenders and individual consumers were split on the question. Large lenders and large intermediary networks in particular disagreed. Respondents were concerned that the proposal would impact negatively on the self employed, trigger an increased use of fraudulent income documentation and increase lenders' administrative costs. Some respondents also believed the market has already adjusted by withdrawing self-certified products and, therefore, regulation is no longer required.

2.25 Some lenders and trade associations argued that mortgages without income verification should be retained if they are low risk. This could be measured, for example, by a low loan-to-value ratio and/or a good credit score.

2.26 Some respondents called for us not to be overly prescriptive when devising the rules, while others demanded detailed prescription as a prerequisite for a prevention of another 'race to the bottom' of underwriting criteria.

Q8: Do you agree with our proposal to require lenders to take ultimate responsibility for affordability?

2.27 The overwhelming majority of respondents agree with the proposal. This view was shared equally amongst all groups of respondents.

2.28 However, many respondents were concerned that making the lender ultimately responsible for the lending decision could be interpreted as implying that intermediaries, other professionals and crucially consumers, have no responsibility at all. Respondents suggested that this could have legal implications with regard to lenders' ability to enforce mortgage contracts where borrowers are in arrears. It may also lead to an increase in consumer litigation claims against lenders should a mortgage subsequently prove to be unaffordable.

2.29 As a way to avoid such consequences, some respondents suggested that we make the underwriting decision more transparent by ensuring the lender discloses the affordability assessment and requiring the consumer to take responsibility for the truthfulness of the information provided. This would ensure that the consumer takes responsibility for their financial decision, discloses the mortgage's affordability at the point of sale and avoids the lender taking responsibility for post-completion changes of the borrower's circumstances.

Q9: Do you agree with our proposal to require lenders to assess affordability based on
(i) the borrower's free disposable income;
(ii) a consumer's borrowing capacity;
(iii) the plausibility of the information obtained; and
(iv) a capital repayment basis?

2.30 A majority of respondents were in favour of the proposal and endorse the need for us to clarify what an affordability assessment should entail. Consumer representatives, in particular, agree with this as do most intermediaries. Individual consumers, too, are largely happy for their expenditure patterns to be assessed.

2.31 However, trade associations and some lenders raised concerns. Mainly because they consider affordability assessments to be a snapshot in time and are, therefore, unreliable as an indicator of an applicant's probability to default. Others were concerned about the degree of prescription that the rules will require, with some demanding greater prescription to ensure standardisation, while others called for flexibility.

2.32 Many respondents reserved judgement until we have provided further detail about the proposal. However, lenders expect the underwriting process to be lengthened, with a cost increase as a result. Others listed individuals with particular characteristics that would be unable to afford a mortgage if some of the measures proposed were to come into force.

2.33 A few respondents also called on us to go further than the proposals stated in the Discussion Paper. Demands included greater prescription about lending into retirement, affordability assessment at the end of a fixed-rate period and an insistence on individualised expenditure assessments due to the limited reliability of statistical estimates.

2.34 With regard to interest-only mortgages, most respondents agreed that there is a case for constraining this particular product type. However, several respondents met our proposal to address the issue by requiring the affordability assessment to be based on a capital repayment equivalent with scepticism. Some felt this would exclude individuals who could not afford a repayment mortgage. Others, in turn, argued we should go further, by regulating the repayment vehicle more tightly, imposing an LTV cap or only allowing interest-only mortgages as temporary forbearance measures.

2.35 Some other respondents criticised us for ignoring other undesirable developments in the market, including lenders' failure to assess affordability of re-mortgages, mortgage transfers and further advances, as well as the methodological flaws and pro-cyclical impact of lenders' credit scoring models.

Q10: Is the increased focus on affordability the right way to ensure sustainability of lending and consumer protection?

2.36 There was a general feeling from a wide range of stakeholders, particularly consumer representatives, that an increased focus on affordability would be helpful in improving consumer protection and ensuring the sustainability of mortgage lending. However, some noted that this was only one element of a holistic solution to the issues and other elements such as consumer awareness and effective regulatory supervision were also important. There was also acceptance that there are limitations to what regulation can achieve, as some consumer affordability issues resulted from unexpected changes to circumstances rather than poor lending decisions.

2.37 Stakeholders were keen to highlight that our approach to affordability should not be overly prescriptive and that the requirements should be flexible enough to account for the wide range of lenders and borrowers.

Q11: Are there any additional policy levers we should use to curtail income inflation and related mortgage fraud?

2.38 Respondents put forward a variety of ideas in response to this question. Many were concerned about the increased availability, mainly from the internet, of fake payslips, bank statements and other documentation. They suggested that the police and other authorities take a tougher stance against mortgage fraud and apply more resources to combating it.

2.39 Lenders in particular were of the view that they should not have to rely on paper evidence and suggested alternative methods of verifying income. The roll-out of an income verification pilot, run in 2009, between lenders and HM Revenue & Customs was mentioned as one option. Other measures proposed include introducing a standardised bank account reference from current account providers, standardised employer references and asking professionals such as solicitors, lawyers and accountants to certify income documentation.

2.40 A few respondents expanded on the idea of promoting greater sharing of information between lenders, intermediaries and other parties. Developing a standard definition of mortgage fraud was mentioned as a means to make identification and reporting easier. Income and occupational data could also be submitted and held by credit reference agencies, allowing lenders to check both creditworthiness and income in one place.

2.41 Most respondents also called for more severe consequences of inflating income and other fraudulent activity, including tougher supervision and enforcement through the FSA. The application process should include warnings to borrowers about the consequences of providing inaccurate information and a declaration that would need to be signed by the applicant. There were also some suggestions that we should work closely with other regulatory bodies, such as the Solicitors Regulatory Authority.

Q12: Do you think that the FSA should limit the amount of equity a consumer can withdraw from their home?

2.42 While many respondents acknowledged that there are risks to consumers related to equity withdrawal, most did not support our proposal of placing a direct limit on how much equity a consumer can withdraw from their home. This view was shared equally amongst all groups of respondents. Many considered that the best way to minimise any harm would be to ensure lending is affordable and consumers are aware of the implications of withdrawing equity.

2.43 Respondents also pointed to the benefits that equity withdrawal can offer to consumers, including increased flexibility for arranging their finances and access to a relatively cheap form of credit. They were keen that these benefits were not unnecessarily eroded.

Q13: Do you agree that we need to strengthen the selling standards for non-advised (information-only) sales to ensure consumers are only entering into contracts which are both affordable and appropriate?

2.44 The overwhelming majority of respondents supported our proposals to strengthen standards in non-advised sales but raised concerns that, in so doing, the regulatory line between advised and non-advised sales would be further blurred. This would not help consumer understanding of the regulatory distinction between types of sales, which for many respondents was an important objective.

2.45 Most intermediaries and consumers supported a fully advised market. Some consumer representatives were more cautious as such a move could limit consumer choice, but equally felt that the sales standards in the non-advised market should mirror those in the advised market.

2.46 Lenders were more cautious about a fully advised market, although some smaller lenders indicated that their sales process was fully advised already. Others argued that they already assessed affordability and appropriateness as part of their non-advised sales process and that their existing processes were, therefore, fit for purpose.

2.47 Some lenders supported a ban on non-advised sales for intermediaries and one supported execution-only sales as an alternative to non-advised. Several respondents, including lenders, supported advised sales as the default route for vulnerable consumer groups, such as first time buyers or those in financial difficulty. A small number of other respondents, including lenders, supported 'advised' as the default route for all consumers, with an opt-in facility for 'non-advised'.

2.48 Respondents were less supportive of our proposals to introduce an appropriateness test for non-advised sales. However, respondents were keen to understand the detail, including how the proposals would work in practice, before reaching a firm view.

Q14: What measures should the FSA take to ensure sales standards in advised sales meet the needs of the market and appropriately protect consumers?

2.49 The majority of respondents were not convinced of the need for additional measures. Large lenders in particular were not in favour. Many considered that existing standards are sufficient, provided we effectively supervise and enforce them.

2.50 However, a number of respondents voiced support for introducing suitability letters as a means of improving advised sales standards, because they act as a record of the advice itself and the reasons why it was given. There was also some support for all sales to be advised. Some respondents considered that further clarification of the responsibilities of lenders and intermediaries, for example in the assessment of affordability, would have a beneficial effect on standards of advice.

2.51 Risk warnings for lending into retirement received the strongest support of the potential enhancements to suitability requirements identified in the Discussion Paper. However, some questioned how effective further disclosure requirements would be.

Stress testing also received some support, although respondents' views varied on how it could be applied in practice. Some requested prescription to provide clarity and consistency across the market and others considered that the specifics of stress testing were a matter for firms to decide.

2.52 Few respondents commented on the proposal to refocus rules on explanation rather than fact-finding. Those that did mirrored responses to Question 22, with some raising concerns over the effectiveness of oral disclosure and others requesting less but more clearly focused disclosure. Few respondents commented on niche products being sold beyond their target audience. Those that did generally considered that it was not a matter for further regulation, as it is already covered by existing requirements, such as treating customers fairly.

Q15: To what extent should intermediaries retain responsibility for assessing a consumer's ability to repay? How could this work in practice?

2.53 The majority of respondents agreed that the lender is ultimately responsible for assessing and verifying affordability for every sale. Several lenders, intermediaries and trade bodies felt the proposal could result in a duplication of effort, with advisers and lenders carrying out the same checks. Intermediaries were also concerned that after carrying out the preliminary assessment, lenders may reject applications as the intermediary cannot sufficiently assess the borrower against the lender's criteria.

2.54 There was support from trade bodies and lenders for a collaborative approach, involving all relevant stakeholders, to develop the most appropriate solution. Suggestions were made about the best way in which to implement our proposals. Intermediaries favour an agreed industry-wide income and expenditure template. There was also a small amount of support from trade bodies, intermediaries and lenders for industry guidance to set out the respective parties' responsibilities.

2.55 A small proportion of respondents from across a range of stakeholders felt the current regulatory regime should be retained as it works well.

Q16: Do you agree that suitability letters should be introduced as a compulsory standard?

2.56 Most respondents were in favour of this proposal. Lenders, consumer representatives, and intermediaries were generally supportive, although there was less support from larger banks.

2.57 Respondents supported the proposal for a number of recurring reasons. These included suitability letters being widely considered best practice, the customer should have a record of the recommendation for future reference and should be put into a position to understand why a recommendation is being made and because it does not make sense to have a rule requiring a record of suitability to be kept by the firm but not to be passed on to the customer.

2.58 Amongst those in favour, there were mixed views on whether the format should be prescriptive or not, but the majority of respondents who expressed a view felt that the individual firm should be free to determine the format.

2.59 Respondents that disagreed with the proposal doubted whether there was any evidence of consumers being sold unsuitable mortgages and questioned whether consumers would benefit, given the significant amount of information they already receive. They also predicted that suitability letters would become generic, which would, therefore, not be of any value to the customer and argued that the proposal contradicted our discussion on the limitations of disclosure. Finally, respondents argued that enforcement action should be taken against firms failing to record the reasons for their recommendation.

2.60 Several respondents, regardless of whether they supported the proposal or not, commented that they did not believe a suitability letter would help consumers to shop around. In part, because of the stage of the buying process they would be at when given the letter.

2.61 There were mixed views on whether a similar requirement should apply to non-advised sales.

Q17: What are the implications of applying the 'Approved Persons' regime to all individual mortgage intermediaries?

2.62 Most respondents broadly supported our proposal to extend the approved persons regime to all mortgage intermediaries, including lenders' sales staff. They believed that applying the regime to this sector could have positive outcomes, including removing rogue individuals from the industry, greater accountability, raising the profile of mortgage advisers and fighting fraud. However, respondents warned that this would depend on adequate supervision and enforcement action against non-compliant individuals.

2.63 Respondents sought further clarity as to which roles we wish to capture within the regime's scope. Lenders were especially concerned as to whether our proposals would inadvertently capture administrative/back office functions, highlighting the risk that our proposals would potentially require a large number of roles to be 'approved' and therefore may be disproportionate.

2.64 Respondents were also concerned that the proposal would result in increased costs and an administrative burden on all parties. Some smaller lenders commented that the expected benefits would not justify the costs associated with the proposal and would inevitably result in less choice for, and costs being passed on to, consumers.

2.65 Respondents were also concerned that our current resources may be insufficient to allow appropriate policing of the intermediary community. They noted that many issues surrounding mortgage fraud resulted from solicitors' and valuers' actions that fall outside the proposal's remit. Others strongly recommended that we implemented the scheme rather than a third party such as a Professional Standards Board (PSB).

> Q18: Do you agree with our conclusion not to read across the adviser charging element of the RDR proposals into the mortgage market?

2.66 There was broad agreement, particularly among lenders and intermediaries, that we should not read-across adviser charging in the mortgage market. Many respondents cited a lack of evidence of consumer detriment arising from commission bias and the adverse impact of charging fees on consumer access to advice as key arguments against applying adviser charging.

2.67 Respondents frequently expressed the view that 'the current system works' and several stated that broad comparability among commission rates in product groups minimised the impact of commission bias. However, some did note that while there were problems created by commission bias, shifting the focus to robust affordability checks and suitability assessments was the appropriate way of dealing with them.

2.68 Those who did not agree, such as consumer representatives, cited concerns over churning and incentives to sell loans that were either unaffordable or brought borrowers to the limits of affordability.

> Q19: Are there any other considerations that are relevant to the assessment of the issues and risks posed by the current remuneration model within the mortgage market, which are not identified within the DP?

2.69 Several ideas were raised in answer to this question. These included the view that advice is presently focused on product selection, whereas it should be re-focused on suitability and affordability and this may be caused by commission structures. Other respondents argued that current commission structures may incentivise intermediaries to encourage sub-optimal re-mortgaging and unaffordable borrowing.

2.70 Others expressed the view that lender remuneration policies should contain a qualitative element, that commission should be capped, both between different products and within product categories and that it conflicts with consumer interests to offer the same product at different rates depending on the distribution channel.

> Q20: To what extent should the proposals for a PSB as outlined in the RDR be extended to the mortgage market?

2.71 Respondents did not provide a substantial amount of comment on raising professional standards in the mortgage market.

2.72 Most respondents supported our position in the Discussion Paper not to read across the Professional Standards Board (PSB). A small proportion of respondents did support a read-across but only as a means to register and track mortgage advisers. Many respondents noted that the proposals in our recent Consultation Paper on extending our approved persons regime[7] would be enough to ensure mortgage advisers are individually accountable.

7 CP10/2 Mortgage Market Review: Arrears & Approved Persons (http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_02.shtml)

2.73 A number of respondents commented positively about implementing a Code of Ethics and enhancing intermediaries' continuing professional development (CPD). However, firms called for more detailed information and clearer proposals in these areas before making firm judgments. On the whole, firms cautioned against moving forward until the effect of the Retail Distribution Review proposals could be fully assessed.

Q21: Do you agree that simplified scope of service labelling, limited to 'independent' or 'restricted advice' and also describing a non-advised service as 'information-only', will result in better consumer understanding of the services on offer?

2.74 An overwhelming majority of respondents were supportive of our proposals to simplify the labelling landscape. Respondents acknowledged high levels of consumer confusion, caused by the complexity of the existing distribution landscape, but were concerned about the impact of our proposals.

2.75 Respondents felt that the descriptions of the two types of advice were more important than the labels themselves. Descriptions should include short statements providing context and clarification of what the label means in terms of the service a particular adviser is offering. Many intermediary respondents commented on the limited nature of mortgage distribution, seeing it as the crucial differentiating characteristic between the mortgage and investment markets. They argued that any new landscape needed to ensure intermediaries only consider those products that are available to them. At best, these would only ever be a 'fair and representative' sample of the products and not all those available across the market.

2.76 Finally, a number of respondents were concerned that 'restricted' advice would be interpreted by consumers as restricted knowledge or understanding, rather than a restriction based on their range of products.

Q22: Do you agree with the proposals to;
(i) remove the requirement for the IDD and replace with disclosure of key messages;
(ii) retain use of the KFI; and
(iii) require elements of disclosure to be carried out on an oral basis?

2.77 Respondents generally agreed that consumers were not using information in the way we intended, but thought that both the Initial Disclosure Document (IDD) and the Key Facts Illustration (KFI) served a useful purpose as a record of the sale, for consumers and firms. Most respondents also saw benefits in refining the information given to consumers, to give clearer and more focused messages.

2.78 However, respondents were wary of change for change's sake and were keen to see clear evidence of benefits, with many interested in the results of our analysis of the impact of oral disclosure in the insurance market. Many respondents were conscious of the cost of change, including systems and training costs. Respondents were also keen that we consider European developments on disclosure before implementing any changes.

2.79 Additional comments were made on each of the three proposals specifically. Respondents were generally divided about our proposal to replace the IDD with disclosing key messages. Larger lenders and intermediaries favoured retaining existing requirements, while smaller intermediary firms were more supportive of change. Some felt unable to comment until more information was provided on what the key messages would be.

2.80 As to the second proposal, most respondents were in favour of retaining the KFI. Many supported simplifying of the KFI in some way, and increasing flexibility in its content and format. However they were also concerned about the high costs of making changes to the KFI.

2.81 Respondents were split over the final proposal on oral disclosure. Some thought that it would improve customer understanding, while others felt that consumers would be overloaded with information they would not understand or remember. Many were concerned that compliance with oral disclosure requirements would be difficult and costly to control and record. As a result, most felt that oral disclosure would need to be coupled with clear written disclosure – both for consumers to reflect on in their own time and as an audit trail for firms.

Q23: Do you agree that the limitations on the rationality of consumer behaviour in the mortgage market support the case for greater regulatory intrusion?

2.82 This question drew a polarised response, much like the views expressed in response to our earlier Discussion Paper on consumer responsibility.[8] Lenders and intermediaries generally argued against further intervention on the grounds of cost and the impact on consumer access and choice. Respondents commented that changes would undermine the principle of *buyer beware* and would absolve consumers from taking responsibility for their decisions. On the other hand, consumers and some other respondents argued for further action to address knowledge imbalances and behavioural biases.

2.83 Many respondents recognised that recent years have seen a number of consumers making poor purchasing decisions. Views were more mixed as to the number of consumers involved and the extent of their 'irrationality', given low interest rates and a long period of year-on-year house price growth.

2.84 A further theme common with many responses was the potential for further consumer education initiatives to better prepare consumers for making responsible purchasing decisions. However, respondents also recognised that any consumer education objectives must be long-term.

8 DP09/2 Consumer Responsibility: Feedback on DP08/5 (http://www.fsa.gov.uk/pages/Library/Policy/DP/2009/fs09_02.shtml).

Q24: Do you agree that the FSA has a role in preventing the extension of credit to individuals who are unable to afford such high levels of debt?

2.85 Very few respondents argued against our legitimate interest in preventing the over-extension of credit. Many saw this as a natural consequence of our consumer protection objective. There was also broad agreement that *Mortgage Market Review* proposals on strengthening the verification of income and lender assessment of affordability, would be an important contribution alongside closer supervisory scrutiny of business models.

2.86 Equally though, many respondents highlighted limitations in our ability to intervene, or potentially adverse consequences from further regulation. One key constraint was the ready availability of unsecured credit. The chief adverse impact identified was a narrowing in consumer's access and choice, many of whom are able to meet their credit commitments.

Q25: Do you have any comments on the financial capability initiatives designed to support the overall mortgage market reform?

2.87 There was considerable support for the initiatives we outlined in the Discussion Paper and more generally for ongoing financial capability work. Respondents acknowledged that this work was likely to deliver significant benefit over the longer term. Consumer representatives were particularly supportive although at the same time they considered that education was not a substitute for adequate consumer protection. Industry respondents supported the targeted new initiatives, both to make best use of resources and to better reflect the different needs of borrowers.

2.88 A further common theme was that greater benefit was likely to arise from a preventative approach, with views on this extending from more formalised financial education in schools through to exploring the scope for pre-purchase counselling to groups of consumers considered higher risk.

Q26: Do you have any comments on our proposals to strengthen our approach to firms' arrears management practices?

2.89 Most respondents supported our high-level proposals. However, some firms indicated they would rather respond to the detailed proposals in our current consutation on strengthening our arrears rules.[9]

2.90 Those that disagreed with the proposal, which included most building societies, believed that the poor arrears practices we have seen were not indicative of the market as a whole and that we should take enforcement action against individual firms, rather than introducing further regulation across the market.

9 CP10/2 Mortgage Market Review: Arrears & Approved Persons (http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_02.shtml).

2.91 With regard to banning early repayment charges on arrears fees and charges, lenders did not disagree with the proposal itself but were concerned that systems changes would be costly and disproportionate compared to customers' benefit.

2.92 With regard to lenders' requirements to consider government forbearance schemes, some lenders were concerned that participating in such schemes may be seen as mandatory. However, our intentions in this area have subsequently been clarified in our current consultation[10] and should allay these fears.

2.93 Finally, our proposal to review our regulatory approach to Third Party Administrators (TPAs) received strong support from trade associations and TPAs alike, who suggested that lenders should take full regulatory responsibility for all activities undertaken by the TPA. Of the few lenders that responded in respect of TPAs, the majority were in favour of reviewing TPAs and our more interventionist approach.

> Q27: Do you consider that the mortgage market fees and charges reflect the underlying costs or are consumers paying excessive charges?

2.94 Respondents were split on this question. Half believed that excessive charges were not an issue. A quarter felt that consumers were paying excessive charges and the remainder were undecided.

2.95 Views were particularly polarised between lenders and consumers. Most lenders felt there was no need for us to become more intrusive on charges, as arrangement fees were part of product pricing and do not need to reflect costs. Others argued that it is common for higher arrangement fees to offset lower interest rates, this is also said to be a practice that promotes competition and consumer choice.

2.96 By contrast, consumers and consumer representatives believed that charges were excessive and disclosure had proved an inadequate constraint. Those least able to repay often suffered the heaviest burden.

2.97 A significant number of respondents suggested that issues could be addressed through the combination of disclosure, appropriate supervision under the existing rules and/or standardising fees terminology.

> Q28: What would be the impact of consumers not being allowed to roll up intermediary fees and product charges into the mortgage loan?

2.98 The majority of respondents did not see a strong case for banning the rolling up of intermediary fees and product charges into mortgage loans. They considered that this might have unintended consequences, such as limiting consumer choice, restricting access to the market (particularly for first-time buyers), preventing people from switching to a more affordable mortgage, reducing access to intermediary advice or leading people to borrow their fees and charges from unsecured lenders.

10 CP10/2 Mortgage Market Review: Arrears & Approved Persons (http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_02.shtml)

2.99 Some pointed out that this approach would be particularly difficult for the equity release, short-term funding and second charge markets. This as a result of the fact that a large proportion of the consumers accessing these products do so because they do not have large amounts of cash available.

2.100 There was the strong feeling from many respondents that consumers should be made fully aware of the consequences and costs of rolling up fees and charges into their mortgage. Consumer representatives raised alternative options such as banning the automatic roll-up of fees or regulating the level of fees.

> Q29: Do you agree that the FSA should collect data to enable us to track arrears and repossessions cases back to the original product transaction on a permanent basis? What would be the costs imposed on the market?

2.101 Most respondents were not opposed to the proposal that we should collect data to enable us to track the performance of individual lending transactions with regard to arrears and repossessions. Some respondents stated that having such data would enable us to analyse risks taken by the lenders and to ensure that the firms comply with the principles of responsible lending. However, a few respondents expressed concerns that linking arrears back to product characteristics would have limited value as payment difficulties are often caused by life events, such as unemployment or illness.

2.102 Some respondents noted that the arrears and repossessions data is already available to lenders and should not be difficult or costly to report. However, others expressed concerns that the additional data collection requirement may necessitate changes to IT systems and that the cost of this could be significant. We have not received any responses that quantified these costs.

> Q30: Do you agree the FSA should standardise some existing industry definitions such as sub-prime? And if yes, are there any existing definition issues other than sub-prime?

2.103 Respondents' views were divided on the question. Many agreed that it would be helpful to standardise the definition of sub-prime as this would improve consumers' understanding, remove ambiguity and assist comparability of the data. Some proposed their own versions of the definition of sub-prime, while others suggested that, rather than redefining a term that is already widely in use, a new term should be introduced.

2.104 Those respondents who were opposed to the proposal stated that there was no need for change, as the industry and consumers understood the existing definitions. Some expressed concern that having a standard definition might stigmatise consumers.

2.105 There were also calls to standardise the entire product terminology, while others urged us not to do so. In addition to sub-prime, respondents listed a number of other mortgage-related terms that they thought would benefit from greater standardisation.

Q31: What are the potential compliance costs if the FSA collected better data on fees and charges directly from lenders on an ongoing basis as part of regulatory reporting?

2.106 Respondents thought the potential compliance costs would depend on the level of detail we would require. Some thought that the compliance costs would not be material, while others noted that costs may be significant and would outweigh the benefits. According to respondents, additional costs would arise from systems development and staff costs.

2.107 Some respondents noted that as this data is already collected by third parties there is no need for us to duplicate effort in this area. A few respondents suggested that data should be gathered from existing information sources, such as tariffs of charges and lenders' web-sites and we should raise any subsequent concerns we have with individual lenders.

2.108 Lenders also stated that intermediaries' fees data should be reported directly to us by intermediaries.

Q32: Are there any additional measures that you feel the FSA could take to reduce the risk of financial crime?

2.109 Many of the suggestions in response to Question 11 were raised again here, including very strong support for finding ways to share information between HM Revenue & Customs, counter-fraud agencies, credit agencies and lenders.

2.110 Several respondents demanded stronger deterrence, by identifying and enforcing against those responsible for financial crime. This included increasing the resources of the police and other bodies devoted to combating mortgage fraud, introducing better training and reporting systems for lenders and introducing stricter controls on the mortgage industry overall through measures such as the proposed extension to the approved persons regime.

2.111 Our recent supervisory and enforcement focus on 'rogue' intermediaries was recognised and several respondents asked that this level of supervision be extended to solicitors, surveyors and other mortgage related professionals. Criminal collusion between professionals was clearly a concern and respondents felt that we should have closer contact and greater influence with bodies such as the Royal Institution of Chartered Surveyors, the Association of Chartered Certified Accountants, the Council for Licensed Conveyancers, the Solicitors Regulation Authority and the Law Society.

Q33: Do you agree that the cumulative effect of the policy levers as outlined within our DP will have a positive effect on:
(i) the equity release market; and/or
(ii) the right-to-buy market?

2.112 Responses to this question were mixed, with a roughly even split between those agreeing, those disagreeing and those who felt there would be no effect on these markets. Our approved persons proposal, however, was widely welcomed as adding protection for vulnerable consumers in both market segments.

2.113 For equity release, most respondents felt that the measures would not have any effect. Several respondents raised concerns that some of our proposals, such as affordability testing or restricting equity withdrawal, would not be appropriate and could unintentionally restrict providers in this market. A few respondents would like to see a separate analysis of equity release, rather than including it in the wider mortgage market.

2.114 For right-to-buy, most respondents felt that our suitability and affordability proposals would help protect the more vulnerable consumers. Several respondents called for additional protection measures, including improvements to disclosure and the sales process. Some suggested that right-to-buy should only be sold on an advised basis.

List of non-confidential respondents

AJ Gray
AXA Life
Adam Samuel
Age Concern and Help the Aged
Anne Braid Mortgages
Anthony Pepper
Ashley Law Wimbledon
Association of Arrears Mediators
Association of Mortgage Intermediaries
Association of Short Term Lenders
Aviva plc
Bank of Ireland Personal Lending (UK)
Bath Building Society
Beverley Building Society
Bradford & Bingley plc
British Bankers' Association
British Property Federation
Brunel Mortgages & Loans
Building Societies Association
C Hoare & Co
CIFAS
Callcredit Limited
Charles Goodhart
Chartered Institute of Bankers in Scotland
Checkmate Mortgages Limited
Citizens Advice Bureau
Co-operative Financial Services
Consumer Focus
Council of Mortgage Lenders
Countrywide Principal Services
Darlington Building Society
Department of Communities and Local Government
Derek Lovell

Dodd Murray Limited
ea Consulting Group
Elite Financial Services
Experian plc
Express Finance Corp
Ferret Information Systems Limited
Finance and Leasing Association
Financial Fusion
Financial Services Consumer Panel
Formula Limited
Foster Denovo
Furness Building Society
G Macfarlane
GE Money Home Lending
Gardner Finance
Gareth Butler
Genworth Financial
Glasgow City Council
Graham Swindon
Guy Kingston
HCL Financial Services
HM Revenue & Customs
Highclere Financial Services
Holmesdale Building Society
Home Builders Federation
Home Counties Mortgage Services
Homeloan Management Limited
Homes and Communities Agency
Homes for Scotland
Housing Rights Service
IM Andrews
Ian Brotzman
Ian Butters
Ian Michell
Ian Ruddick
Intermediary Mortgage Lenders Association
Ipswich Building Society
Jack Bateman
Jane Davies
John Wheatcroft
Joseph & Hepple-Wilson
Just Retirement
KA Leason
Keith Butler FCIB
Knight Frank Finance LLP
L&C plc
Leeds Building Society

Liverpool Victoria Friendly Society Limited
Lloyds Banking Group plc
Lorna Mackay
MIAC Acdametrics Limited
Mansfield Building Society
Martin Joyce
Martin O'Hearne
Money Advice Trust/National Debtline
moneysupermarket.com Financial Group
Mortgage Business
Mortgage Intelligence Limited and Mortgage Next Network Limited
Mortgages Made Easy
National Association of Commercial Finance Brokers
National Association of Estate Agents & Association of Residential Letting Agents
National Australia Group UK
National Counties Building Society
National Federation of Property Professionals
National Fraud Authority
National Housing Federation
National Housing and Planning Advice Unit
National Landlords Association
National Outsourcing Association
New York University
Newbury Building Society
Nicholas Roach
Northern Rock plc
Norwest Consultants
Nottingham Building Society
Office of Fair Trading
Openwork Limited
PK Richardson
Paragon Group of Companies plc
Paul Adleman
Paymex Group Limited
Philip Jenks Consultancy
Philip Staintton
Positive Solutions (Financial Services) Limited
Prestige Finance
Prudential
RS Mortgage Consultancy
Residential Landlords Association
Richard Sollis
Roland Baker
Royal Bank of Scotland
Royal Institution of Chartered Surveyors
SA Compliance Ltd
Safe Home Income Plans

Santander UK and Alliance & Leicester
SesameBankhall Group
Shelter
Sila Accountancy Services
Simon Shinerock
Simon Webster
Skipton Building Society Group
Society of Equity Release Advisers
Society of Professional Mortgage Arrears Counsellors Limited
Start Financial Services
Stroud & Swindon Building Society
Taylor Engley Mortgage Services
Teachers Building Society
The Chartered Insurance Institute
The Mortgage Practitioner
The On-Line Partnership Limited
The Right Mortgage Company
Tieto UK Limited
Tipton & Coseley Building Society
Tiuta plc
UBS Wealth Management
West Bromwich Building Society
Which?
William Docherty
Yes Financial Services Limited
Yorkshire Building Society

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