MS16/2.2: Annex 3

Market Study

Mortgages Market Study

Interim Report: Annex 3 - Finding a mortgage – supplementary analysis and research

May 2018

Annex 3: Finding a mortgage – supplementary analysis and research

Introduction

1. In this Annex we expand on our Chapter 4 commentary on the availability and effectiveness of tools to help consumers find, compare and access a mortgage. This includes advice and intermediation. In particular we provide further information on:

   - relevant findings from our Financial Lives Survey 2017[1] which supplements research previously carried out by ESRO[2]
   - our desk-based review of tools available online
   - our analysis of 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
     - 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 get advice
   - our analysis of tools for intermediaries to help them shop around for consumers
   - innovation in distribution and advice

2. The structure of the Annex largely reflects the structure of Chapter 4.

How consumers find a mortgage

3. Research indicates that many mortgage consumers of various types[3] (first-time buyers, home movers, and switchers) do a certain degree of pre-application research. See ESRO's 'Understanding consumer expectations of the sales process' paper for details. An important part of this is to gauge how much they may be able to borrow and the monthly cost to them.

4. Many consumers naturally turn to the internet as their first port of call when considering a mortgage. Online research is often wide-ranging, and can include use

[1] https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf

[2] https://www.fca.org.uk/publication/research/understanding-consumer-expectations-of-the-mortgage-sales-process-esro.pdf. 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.

[3] The ESRO Consumer Research did not consider Lifetime Mortgages

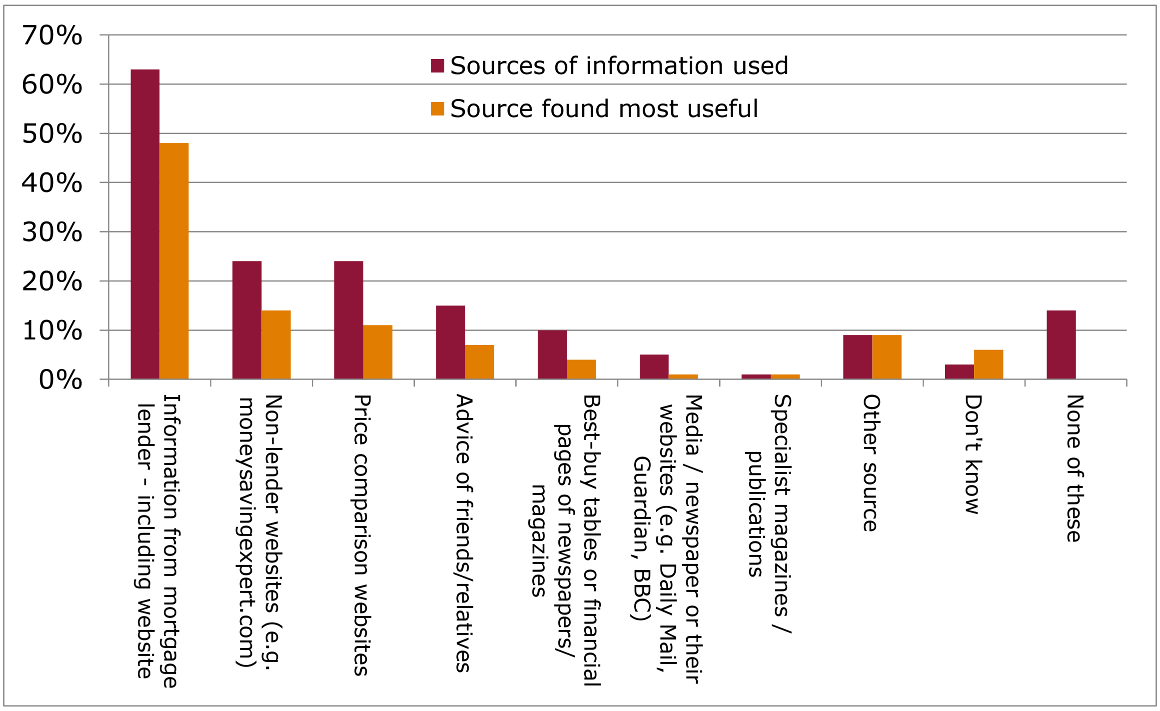
tools such as lender websites, aggregator or comparison sites, or advice websites and forums.[4]

Use of tools

5. Figure 3.1 outlines the percentage of consumers that use different information sources, and which they find most useful.[5] This is taken from the Financial Lives Survey 2017.[6]

Figure 3.1: Usage of key information sources (excludes lifetime mortgage holders)

Which, if any, of these sources of information did you use to help your decision-making? Which of these sources of information did you find most useful?



Source: Financial Lives Survey 2017 – UK adults who have taken out a residential mortgage (or switched product) in the last 3 years

6. Around 5 in 6 (83%) residential mortgage holders who had taken out a residential mortgage (or switched product) in the last three years had used 1 or more sources of key information to help their decision making:[7]

- Only 37% used more than 1 of these sources of information to help their decision making (45% consulted a single source of information, 14% used none and 3% didn't know)
- Information from mortgage lenders, including their website, was the most popular information source, used by 63%

[4] ESRO Consumer Research, 2015

[5] Not including consumers of lifetime mortgages

[6] Financial Lives Survey 2017 (Question M39a and M40Sum1)

[7] Financial Lives Survey 2017 (Question M39a)

- 48% thought the information from mortgage lenders, including their websites, was the most useful. Non-lender websites eg moneysavingexpert.com were most useful for 1 in 7 (14%), and price comparison websites for 1 in 9 (11%).

7. We did not look at the information tools offered by mortgage intermediaries in our survey. These may be reflected under the categories 'non-lender websites' or 'other sources'. Our own review of such tools indicated that online product and services information provided by intermediaries is often limited or difficult to find. Intermediary websites typically act as a marketing tool.

"Which products do I qualify for?"

8. Our Financial Lives Survey 2017 found that two-thirds (66%) of residential mortgage holders agree that they are confident they can find out who will lend to them. Some residential mortgage holders tend to feel differently – specifically those who are older (60% of those aged 55+), self-employed (54%), over-indebted (46% compared with 70% who are not over-indebted), or those who are surviving financially (60% compared with 71% of those who are financially resilient).[8]

9. The quality of the tools provided by lenders varies. The online information and tools about products and the amount consumers can borrow is more detailed than that provided by PCWs and intermediaries. This reflects the natural advantage that a lender has in this regard, given they are only supporting their own proposition. Information about eligibility and how much a consumer can borrow is often heavily caveated.

Using an intermediary to help establish who will lend

10. Intermediaries giving advice typically shop around among lenders. They gather information from the consumer on their personal details, circumstances (including income and expenditure), needs and preferences. They then review products from a range of lenders, using a mortgage sourcing system (MSS) to filter products. This helps narrow down products that fit the consumer's situation. They then use their knowledge and experience of different lenders to recommend a lender, based on eligibility criteria, speed and quality of service.

11. Lenders provide information tools to intermediaries about their products, eligibility criteria and their affordability assessments. Standard examples include lender websites for intermediaries, and telephone support. They also run events to present to intermediaries and offer access to underwriters for information on more difficult cases. This is valued by intermediaries and lenders have been competing on their ability to provide information in a convenient, effective way. Some intermediaries, networks and clubs also collect information across lenders themselves, for example on speed of service.

12. MSSs are also important tools for intermediaries to identify and compare a large number of products across a very wide range of lenders. However, these have limitations. A few specialist lenders indicated that they have found it hard to launch products through MSSs. Some MSSs are reluctant to make material changes to their systems.

[8] Financial Lives Survey 2017. For definitions of surviving and over-indebted please see the Glossary in the Financial Lives Survey report: https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf

13. We also conducted research using an MSS. This indicated that the strength of these tools is in comparing consistent factors across many lenders' products. For example, comparing initial rates, reversion rates, upfront fees and maximum LTV. However, softer, qualitative qualification conditions that may be more specific to a lender are more difficult to compare. These may include income verification required for self-employed, and limitations on properties that will be considered. These factors are also more likely to be important for consumers with more complex circumstances.

14. As a result, MSSs will tend to work better for consumers whose circumstances and needs are simpler and captured better by the quantitative, comparable features in the MSS. MSSs also do not provide enough information to allow an intermediary to assess with confidence the likelihood of a customer being accepted.

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

15. 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. The tools also look at a customer's mortgage preferences, household composition, changes in circumstances and attitude to risk.

16. The tools produce 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.

17. The implementation of the latest Payment Services Directive (PSD2) may speed up the recent developments in the mortgage market. From January 2018, payment service providers are obliged to share their customers' account data with third parties, provided the consumer gives consent. This data is shared using application programming interfaces (APIs) – a means of enabling 2 systems to talk to one another and share information securely.

18. Most of the tools being developed relied on the consumer filling in information on their income and expenditure. Intuitively, this is unlikely to be as reliable as data from current account providers. Implementation of PSD2 and other open banking initiatives could help an intermediary in the mortgage market to use APIs to source customers' financial data.

19. However, the success of these tools will still be heavily dependent on whether lenders offer other market participants (including intermediaries) access to information to assess product eligibility and borrowing amounts for consumers.

"How much do they cost?" and "Which mortgages are suitable and good value"

Some consumers find it difficult to calculate cost and compare mortgage products

20. Our Financial Lives Survey 2017 found that 1 in 3 (32%) of those who have taken out a residential mortgage (or switched product) in the last 3 years do not agree that mortgage products are simple to understand. This increases to between 40% and 55% for those who are self-employed, 'surviving' financially, over-indebted or who

are potentially vulnerable. Just 54% find it easy to understand total mortgage cost. A significant minority of 30% disagree. Only 56% find it easy to compare mortgages from different lenders (with 26% finding it hard).[9]

> “There is so much paper. Some of it is impenetrable. I can’t say the information wasn’t there; it just wasn’t in a particularly user-friendly format. They don’t put it out there. You have to go searching for it. They’ll give you the headline…much easier to speak to somebody”
>
> Financial Lives Survey 2017 respondent (First time buyer; Intermediated)

21. Residential mortgage holders cite attractive rates as an important reason for choosing their lender - 3 in 10 (32%) residential mortgage holders choose their lender because of attractive rates. Other reasons include being an existing customer (22%) and a recommendation by a mortgage intermediary or financial adviser (30%). These were quoted as more important considerations than convenience (14%), trusting the lender to treat them fairly (10%), trusting the lender to give them a good deal (10%) and the lender having a good reputation (13%).[10]

22. ESRO’s consumer research shows consumers focus on the headline rate and how this translates to their monthly payments. They look less at the total cost of credit. They noted the majority of consumers have a target monthly repayment amount in mind during their mortgage research.[11]

23. Information provided by lenders, PCWs and other third party sites tends to focus on headline rates. Information is often presented in an unsatisfactory way, for example where fees are not easily comparable or appear to be excluded.[12]

> “Not money comparison sites, I don’t really trust them – different sites give different answers
>
> Financial Lives Survey 2017 respondent (Switcher; Direct – advised; Retired)

24. Tools do not always allow consumers to personalise or tailor their search based on their personal needs or circumstances. This makes it difficult for them to establish which products suit their particular needs. How mortgages are presented in tools may also affect lenders’ design of products. For example, showing a low initial rate but with high fees which will rank highly. This may be a barrier to simplification of pricing structure as any firm presenting all costs together could appear more expensive than those whose rates and fees are fragmented.

Comparing mortgages from different lenders

25. Consumer research by ESRO indicates that house purchasers’ focus on finding the right property means that they do not appear to understand the full details of their mortgages.[13]

[9] Financial Lives Survey 2017 (Question M105). For definitions of surviving and over-indebted please see the Glossary in the Financial Lives Survey report: https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf

[10] Financial Lives Survey 2017 (Question M17)

[11] ESRO consumer research, 2015

[12] Which? and CML also identified this as an issue, and undertook an initiative to improve transparency and comparability of fees and charges. This includes a tariff of the most common fees and charges, published in November 2015. See www.cml.org.uk/policy/policy-updates/all/transparency-of-mortgage-fees-and-charges/

[13] ESRO Consumer Research, 2015

26. One-fifth (22%) of people who have taken out a residential mortgage (or switched product) in the past 3 years did not compare 2 or more lenders (figures taken from the Financial Lives survey 2017). Figure 3.2 sets out the reasons (cited by the 22%) for not comparing mortgages from different lenders[14].

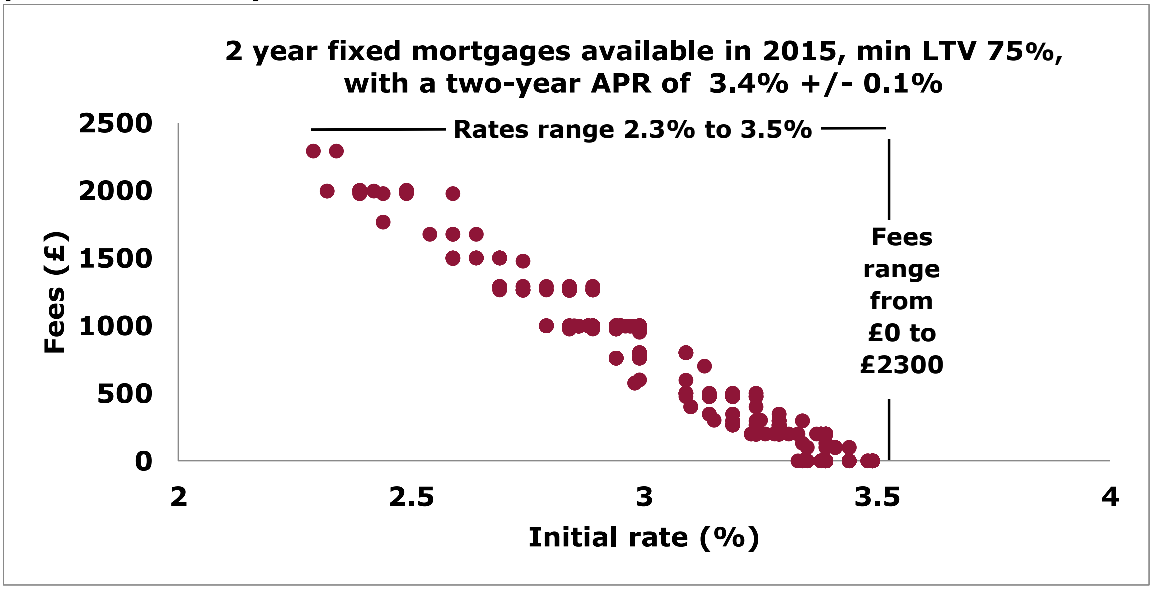
Figure 3.2: Reasons given for not comparing mortgages from different lenders

The mortgage lender I chose had a good choice of products	24%
The mortgage lender was recommended to me	22%
I have dealt with the mortgage lender I chose before	20%
The offer from the mortgage lender I chose was just what I wanted	19%
I feel loyalty toward the mortgage lender I chose	15%
It takes too much time	14%
I didn't think I could get a mortgage product elsewhere	10%
It's too difficult to compare	7%
I wouldn't know what to look for	5%
I didn't really think about getting a mortgage product elsewhere	5%
Don't know	5%
Shopping around or comparing mortgage lenders could damage my credit rating	3%
It's not worth it as there's no real difference between mortgage lenders	2%

Product comparisons can be difficult

27. There is a wide range of product features and pricing options available. This can make it hard for consumers to compare products. Figure 3.3 shows similar products with the same overall cost over a 2 year period, with widely varied headline rates and fees.

Figure 3.3: Scatter plot of mortgages with an equivalent overall cost for a loan of £100,000 over a 2-year period but different initial rate and fees (480 products in total)



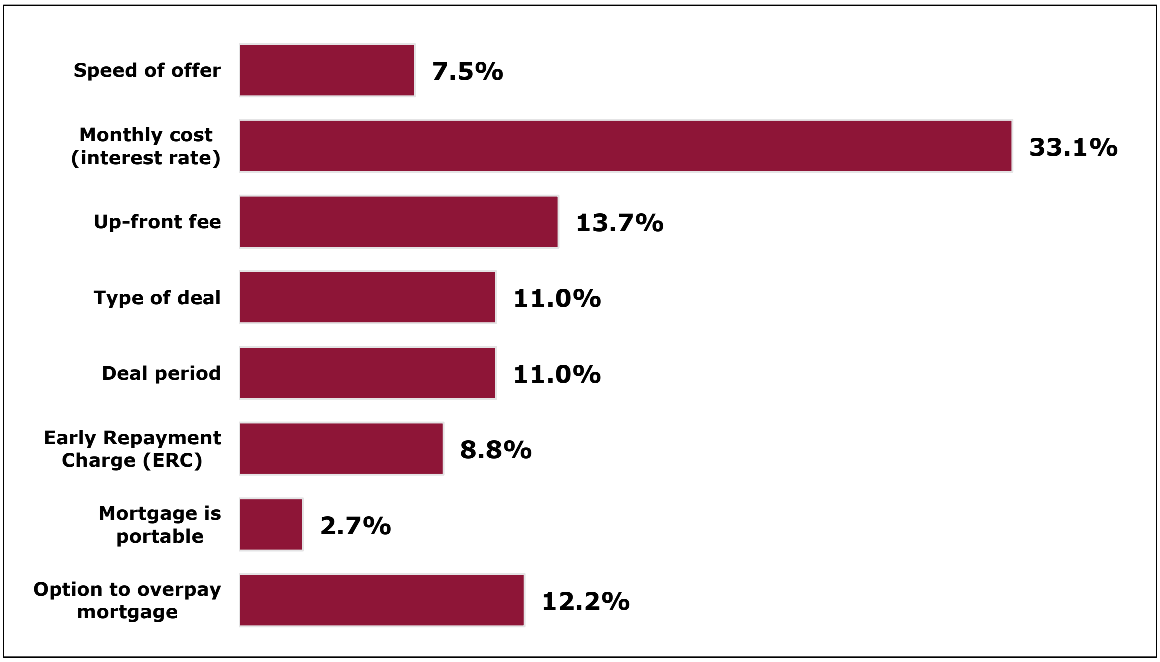
28. Consumers must be able to assess the value of features offered given the price of a mortgage. For example they must look at the period of any initial incentivised rate, portability, and the ability to make over- or underpayments.

[14] Financial Lives Survey 2017 (Question M79b)

29. It is not clear whether the complexity of product features and proliferation of products is driven by consumers' needs and preferences. The research consultancy BDRC[15] assessed the importance of product features to consumers when borrowing. They asked a sample of around 700 recent mortgage borrowers to choose (hypothetically) between mortgages with different features. Participants were asked to imagine themselves to be in the situation they were in when they got their current mortgage. Figure 3.4 presents the main findings. It shows that by far the most important feature to consumers is monthly cost. The ability to make overpayments, upfront fees, and the type of deal (fixed or variable), and the introductory period length were moderately important. Some features, such as portability, appear much less important in consumers' initial borrowing choices.

30. This may explain the popularity in the current market of 2-year fixed-rate deals. These tend to have lower headline rates or monthly cost compared to deals with longer incentivised periods. This shows that consumers are strongly price-focussed.[16] ESRO research also indicates that consumers have a limited understanding of the trade-offs associated with opting for a short term fixed deal.[17]

Figure 3.4 – Relative importance of product features to recent mortgage borrowers surveyed (when making hypothetical mortgage choices)



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

Why consumers choose advice

31. Buying a mortgage through an adviser (intermediated or direct) can help a consumer in many ways, beyond getting advice.[18] For example, advisers can explore a

[15] Conjoint analysis' is a survey-based, statistical technique that can help understand the value consumers place on different attributes of a product (eg price or particular features).

[16] In 2016 56% of mortgages sold were two-year fixed rate mortgages (residential first charge mortgages including internal switches).

[17] ESRO consumer research, 2015

[18] See MCOB 4, with regulated advice the adviser (intermediary or lender staff) gathers information and assesses that a recommended product is suitable for the consumer's needs and circumstances.

consumer's preferences, needs and circumstances and clarify what type of mortgage they may want. They can also provide reassurance and guide the customer through the mortgage selection and application process.

32. ESRO's consumer research indicated that consumers did not have a good understanding of the role of mortgage advice. They found it difficult to distinguish it from other aspects of the mortgage application process, in particular the lending decision. Some consumers thought discussions with advisers were mandatory to get a loan or to check the suitability of their chosen product. Some consumers believed the mortgage adviser was only responsible for giving support and guidance rather than advice.

33. Lender research also indicates that consumers are not aware of the execution-only route. This is unsurprising since, while lenders can describe their execution-only process, lenders are not allowed by our rules to steer consumers away from advice.

Innovation in advice

34. Responses to our request for information indicate little appetite among established intermediaries and lenders to develop online advice services. [19] Commercial incentives for doing this appear limited. Smaller intermediaries in particular may find it difficult to develop their own approach. Appointed representatives may be reliant on their principal instigating any change in approach.

35. 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 who are switching. This included established and new intermediaries.

36. 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.

37. We also heard a number of specific concerns in relation to online advice, including:

- it could be too much like order taking rather than a more nuanced consideration of consumers' needs or preferences that might be conflicting
- consumers would not understand product nuances or complexities if not explained and discussed
- consumers would place undue focus on headline rate at the expense of other product features
- consumers might be more inclined to misrepresent their circumstances in an online environment where an adviser doesn't have the opportunity to probe what the consumer is telling them

[19] Lifetime intermediaries in particular have little appetite for online advice. This may 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.

38. 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.

39. Whilst some of these risks may appear in this or other models, systematised online models could offer potential benefits – eg less prone to human error, or lower cost. There is also the chance to test, review and refine the model in a test environment. It could additionally provide more consistent records to support quality assurance, compliance and regulatory supervision. Online advice can advantage established intermediaries – for example, using the expertise of its own advisers when programming artificial intelligence and machine learning.

Reasons for choosing to buy directly from a lender

40. The lender's attractive rates was the most important factor for 30% of those who have taken out a residential mortgage (or switched product) in the last 3 years (data taken from Financial Lives study 2017). Around one-third (35%) said they chose the lender because they had an existing relationship, compared to 5% of those who used an intermediary.[20] Another third (37%) state that using the lender before influenced their choice. Over half (53%) reported that the ease of going into a branch to talk to someone influenced their choice to use an adviser at a lender.[21]

Reasons for choosing to use an intermediary

41. Our Financial Lives Survey 2017 found that mortgage holders who have taken out a residential mortgage (or switched product) in the last three years, and who used an intermediary to do this, are more satisfied than those using an adviser at a lender. They would also consider returning to the same intermediary firm for future mortgage transactions. Around 7 in 10 (68%) would use the same intermediary in the future.[22]

42. Lender research[23] points to consumers being more likely to use an intermediary when their circumstances are changing. For example, when moving home. They also find that home movers (including first-time buyers) prefer using an intermediary to going direct because they perceive their needs to be 'more complex and emotional'.

> “It was my first mortgage… I wanted some hand holding
> Financial Lives Survey 2017 respondent (First time buyer; Intermediated; Multiple income sources)

43. Consumers with more complex circumstances also believe that intermediaries increase their chances of acceptance. This partially reflects the limitations of information tools in conveying lenders' qualification criteria, presented above.

> “I think we sought advice [from an intermediary] because it is hard to get a mortgage when you are retired
> Financial Lives Survey 2017 respondent (External Switch; Intermediated; Retired; Interest-only)

[20] Financial Lives Survey 2017 (Question M17)
[21] Financial Lives Survey 2017 (Question M60)
[22] Financial Lives Survey 2017 (Question M56)
[23] Provided by a lender in response to our request for information.

44. Consumers who had made one or more previously unsuccessful applications, said that using a mortgage intermediary encouraged them to apply elsewhere.[24] This is based on a small sample size, as part of the Financial Lives survey 2017.

[24] Financial Lives Survey 2017 (Question M75)

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