MS16/2.2: Annex 7

Market Study

Mortgages Market Study

Interim Report: Annex 7 - Additional findings on commercial relationships

May 2018

Annex 7: Additional findings on commercial relationships

Introduction

1. In the main report we focused on different aspects of the relationships between lenders and intermediaries. We also set out a summary of the main findings on the relationships that lenders and intermediaries have with other market players. This Annex sets out some additional detail on those summary findings.

Additional findings

Intermediaries' panel review and strategy

2. 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 or ad-hoc basis.

3. Intermediaries have a range of approaches for choosing new additions to their panel. A common aim is for the panel to provide solutions for the majority of consumers, trying to cover as many consumer circumstances as possible. Most of the panels we observe have a range of lenders, from the big banks to challengers, to specialist lenders. Some of the larger intermediary firms have one or two lenders to serve certain segments of the market, for example underserved borrowers.[1]

4. Factors that intermediary firms consider as part of their strategy include lenders' service and proposition, brand, product types offered, and intermediary support. Recent examples are intermediary firms adding online lenders and lenders that target the self-employed, contractors, those with impaired credit history and consumers with more complex income.

5. In 2016, we found that 43 intermediary firms[2] added at least one lender to their panel. Of these,
   - 79% said they added between 1 and 5 lenders onto the panel
   - 16% added between 6 and 10 and
   - 5% added more than 11.

6. We found that a few lenders have unsuccessfully applied for, or expressed an interest in getting onto an intermediary firm's panel.[3] In these cases, lenders were told that the reason was, for example, that the intermediary firm already had a lender with a similar proposition on their panel. However lenders also told us that

[1] Underserved borrowers may include borrowers with non-standard credit history or who are self-employed.

[2] The other 7 intermediary firms said that they did not add any lender.

[3] 12% of lenders reported that they were not accepted onto an intermediary firm's panel in 2016.

tender processes can be lengthy and criteria may not always be communicated transparently.

7. We identified one example of a lender being removed from an intermediary firm's panel after a tender process. In this case, the intermediary firm told us they communicated the reason for removal to the lender, mainly that their lending proposition was similar to other lenders already on the panel.

8. A few medium and small lenders expressed concern that panels can be a barrier, for example stating that large networks are able to influence the market. Another lender mentioned that firms with closed panels may leverage procuration fees and require lenders to use survey/conveyancing services as part of their panel membership criteria. Finally, one lender told us that certain intermediaries that connected to national estate agency chains operate narrow lender panels.

Arrangements between estate agents and intermediaries

9. Responses to the Call for Inputs suggest that estate agents are influential in guiding consumers to a particular intermediary because many have structural links with intermediaries or because they encourage using particular intermediaries. A few intermediaries were critical of recommendations made by estate agents that consumers seek advice from certain intermediaries, particularly if they imply that doing so is necessary to view or secure a property. Financial Lives Survey 2017 indicates that of those who have taken out a residential mortgage (or switched product) in the last 3 years and arranged this through a mortgage broker around a quarter (23%) said they chose the broker because they were recommended by an estate agent. This indicates that this referral is influential for some consumers.

10. Market guidance for estate agents making referrals to mortgage intermediaries already exists. The National Trading Standards Estate Agency Team of Powys County Council is the UK's regulator for estate agents, and in September 2015 they re-issued OFT guidance on estate agents standards. In this, they outline some 'aggressive practices' which would breach the Consumer Practice Regulations, for example an estate agent '*pressurising a potential buyer to…take out a mortgage through the in-house mortgage advisor'.*[4]

Prevalence of agreements between estate agents and mortgage intermediaries

11. Around 32% of intermediary firms responding to our survey had arrangements in place to receive referrals from estate agents in 2016.[5] These firms have a market share of approximately 20% of the intermediated market (excluding direct relationships between some appointed representative firms). However, most intermediary firms obtain only a small percentage of their mortgage business from estate agents referrals.

12. Several networks do not have direct arrangements with estate agents but their ARs are free to enter into introducer agreements with them.

Referral process and remuneration

13. Estate agents often have internal guidance setting out the referral process to a mortgage adviser. In some cases they provide a disclosure leaflet to consumers.

[4] http://pstatic.powys.gov.uk/fileadmin/Docs/Estate_Agency/NTSEAT_guidance_on_property_sales_-_Sept_2015_en.pdf

[5] Network survey (Q36, 30 respondents), DA survey (Q40, 859 respondents)

14. We identified cases in 3 estate agency firms where it was not clear from both the internal guidance and consumer documentation whether it is mandatory for estate agency staff to make referrals to intermediaries or for consumers to speak to an adviser in order to secure a property sale. Anecdotal evidence suggests that consumers may feel pressured to speak to the estate agent's mortgage adviser and feel that it may impact the consumer's ability to buy the property.

15. Around 25% of intermediary firms remunerate the estate agents for referring consumers to them. The structure of this remuneration differs, ranging from a payment per referral or completion or a percentage of the intermediary fee, but most commonly the intermediaries pay the estate agent a percentage of the procuration fee (typically around 25-35%).

16. We did not find evidence of increases in referral fees based on volumes of referrals or exclusivity arrangements. We have identified one instance of trail commission, whereby the estate agent receives a percentage of the commission of future switching cases in addition to initial referral. We found a few instances where the estate agent receives a step increase of their fee as the size of the loan increases. We also identified one instance of pooled commission received by branch managers and individuals. While remuneration structures could create incentives for staff to encourage the referral to the consumer, we found that consumers do not pay a significantly higher price for mortgages arranged through estate agents as detailed below. From discussions with estate agencies we understand that typically revenues from referrals to mortgage intermediaries represent a small proportion of their total revenues.

17. In line with our rules, we expect estate agencies with in-house intermediaries to have appropriate conflict of interest policies in place to identify and to prevent or manage conflicts of interest.[6] We reviewed conflicts of interest policies from 3 estate agencies with in-house intermediaries to establish how firms identify, monitor and manage potential conflicts of interests arising from in-house referrals. The level of details in the policies varies, ranging from detailed examples of where potential conflicts of interest could arise to providing minimal detail and clarity.

Intermediary fees (to consumers)

18. Intermediary firms' strategies around setting fees charged to consumers vary significantly across the market. Fees may vary based on the complexity of the consumer characteristics or transaction type and on the size of the loan (such fees are typically capped at a few percentage points). Some firms charge lifetime fees, whereby consumers pay a one-off fee in return for repeated future advice. Responses showed some degree of flexibility in setting the fees and discounts. Reduced fees are common for returning customers or based on individual circumstances. Some firms do not charge consumers fees at all.[7]

19. Intermediary firms told us that their intermediary fee strategy is set to reflect administration and processing costs of intermediation. We did not find evidence to indicate that intermediary fee strategies are contractually affected by whether a referral is made by an estate agent or not.

20. We compared the fee charged by intermediaries associated with estate agents with the fee charged by intermediaries without commercial ties with estate agents. In

[6] SYSC 10.1.3 and PRIN 2.1

[7] A number of firms also told us that they do not charge fees when dealing with new build. See more details on this in where we discuss the new build sector.

2015 and 2016 intermediaries with and without ties charged similar fees to consumers.

Price of a mortgage

21. The price of the mortgage paid by consumers using an intermediary connected to an estate agency is not significantly different from the price paid using intermediaries without these arrangements. See Annex 8 for details on the methodology used.

Commercial relationships between lenders, intermediaries and developers

22. In response to the Call for Inputs a number of lenders and intermediaries expressed the view that property developers have close relationships with certain intermediaries and that these intermediaries tend to place business with a limited number of lenders (who they are confident can meet the tight timeframes imposed by developers).

23. Around 6% of mortgages are lent on new build properties. A greater proportion of sales are intermediated in the new build compared to the market overall. The share of intermediated sales in new build increased from 75% in 2014 to 82% in 2016.[8]

24. Several intermediaries in our sample said that customers have a narrower choice of lenders in the new-build space compared to the market overall. Indeed new build property lending market is more concentrated than the lending market overall. More restrictive lending criteria (eg lenders not accepting borrowers who use government schemes to help home buyers) or difficulties in meeting developers' timings among other things, may drive higher levels of concentration.

25. The mortgage intermediary market in the new build sector is slightly more concentrated than the overall intermediation market. This may reflect that some intermediaries specialise in new build mortgages. In 2016 the 10 largest intermediaries completed around 57% of the mortgages on new build properties, while the 10 largest intermediaries for existing properties account for around 46%.

26. Overall, only a small number of intermediaries had an arrangement with a developer in 2016, which has increased slightly since 2014. Around half of these intermediaries had arrangements with 1 or 2 developers and around 10% had more than 10 arrangements with developers.[9]

27. Developers told us that they do not have arrangements with lenders, although they do interact with them (eg in relation to lending strategies and products).

Contracts

28. We reviewed contracts between 4 intermediaries and developers and we also met with 2 large developers. Developers may operate panels of intermediaries but we did not find that the developers typically receive a fee for referring consumers to the intermediary (though this may be different in other parts of the market). Developers

[8] The data analysis is based on regulatory returns in PSD1, information from the Land Registry and information gathered through the survey to intermediaries. Where PSD1 data on whether a property is a new build is poor, we completed this field with information from the Land Registry. We provide more details of the methodology below.

[9] 5% of DAs and 6% of networks had an arrangement with a developer in 2016 (out of 870 DAs and 31 networks). This increased from 3% and 0% in 2014. Out of these, 56% of DAs had agreements with 1 or 2 developers and 10% with more than 10. The 2 networks had agreements with 1 or 2 developers.

told us that consumers are not required to use these intermediaries and that developers do not typically offer incentives to consumers to use their intermediaries.

29. Arrangements are typically in place because developers may benefit from being able to monitor consumer mortgage applications as well as from the reassurance when a potential customer use an intermediary they trust. Both the developer and broker want the customer to get a mortgage and to do so as quickly as possible; generating a sale for the developer and a procuration fee for the intermediary.

30. Developers often set contractual requirements for intermediaries about their proposition, for example the intermediary is required to be 'independent' or whole of market and to offer a fee-free service to the consumer. The contracts also typically have in place mechanisms and key performance indicators to ensure that the intermediaries process mortgage applications from developer referrals quickly.

31. Intermediaries in developers' panels may conceivably have a degree of market power over the consumers referred by developers and theoretically be able to charge fees to borrowers that are higher than the market rate. However, we received consistent evidence that intermediaries tend not to charge fees for mortgages on new build. In some cases this is a pre-requisite for working with the developer and getting on the developer's panel of recommended intermediaries.

32. We also considered whether the price of a mortgage product recommended by an intermediary with a relationship with a developer differ from the price recommended by an intermediary that has no such relationship. We find that there is no significant difference between the two. See Annex 8 for details on the methodology used.

Arrangements between lenders and price comparison websites

33. Price comparison websites (PCWs) are used by a significant number of consumers in the early stages of shopping around for a mortgage and the majority of lenders list their products on PCWs.[10] It is important that search results are ranked in an unbiased way and that commercial relationships do not channel volumes to certain intermediaries to the detriment of consumer choice.[11]

Relationships between lenders and PCWs

34. Most lenders' products appear on PCWs, but lenders and PCWs do not necessarily have separate agreements in place for this because PCWs can access data on lender products from other sources such as Moneyfacts.

35. Where lenders do have arrangements with PCWs, this typically happens at the lenders' initiative. Some lenders consider PCWs an additional distribution tool. The number of consumers attracted to the website, the volume referred and reputation of the PCW play an important role in lenders decision whether to have contractual agreements with a PCW.

36. The majority of lenders do not remunerate PCWs for simply appearing on the PCWs website. Where there is a commercial arrangement between a lender and a PCW, the lenders typically remunerate PCWs on a cost per action (CPA) or cost per click (CPC) basis. CPA can be based on, for example, a referral to the lenders online portal or telephone adviser.

[10] See Chapter 4 for a discussion on PCWs

[11] See for example the CMA CARE principles, included in the CMA's Final Report of its market study into Digital Comparison Tools. The Report can be accessed here https://assets.publishing.service.gov.uk/media/59c93546e5274a77468120d6/digital-comparison-tools-market-study-final-report.pdf

37. For most PCWs, agreements between PCWs and lenders do not affect the way products are displayed on the PCWs' comparison tools. We conducted desk-based research of 8 PCWs and find that 2 show sponsored products in their comparison tools as a result of commercial relationships with lenders.[12]

Product pricing on PCWs

38. Agreements between lenders and PCWs that affect the prices offered on the PCWs can reduce the benefits that PCWs provide in terms of improving choice and reducing prices for consumers, thereby restricting competition. This could be the case for example where lenders are unable to offer reduced prices or more favourable terms (for example better interest rates or cashback options) across PCWs due to contract clauses with some PCWs.

39. In our contracts review, we identified a small number of narrow most-favoured nation clauses (MFNs). Narrow MFNs restrict a supplier's ability to set cheaper prices through its own website compared to the prices set on the PCW.

40. We do not consider the narrow MFNs we have seen in the mortgage sector to currently restrict competition, in particular because they are not widespread and have the potential for efficiencies as explained above.

41. In contrast to narrow MFNs, wide MFNs stipulate that a supplier's products may not be sold at a cheaper price on the supplier's own website or on any other PCW. We found no evidence of wide MFNs in the mortgage sector.

42. The CMA has recently reached similar conclusions regarding narrow and wide MFNs in its market study on digital comparison tools (DCTs), which considered car insurance, home insurance, energy, broadband, flights, and credit cards.

43. We are also mindful that the CMA has recently reported its findings on digital comparison tools (DCTs). They have identified 4 high-level principles for how DCTs should behave, in order to support consumer trust and informed choice between DCTs and between suppliers. DCTs should treat people fairly, by being Clear, Accurate, Responsible and Easy to use (CARE).

Relationships between intermediaries and PCWs

44. Relationships between intermediary firms and PCWs are not very common across the market. Only a small number of intermediary firms who responded to our survey have arrangements in place to receive leads from PCWs. A number of intermediaries told us that they do not currently have an appetite to build relationships with PCWs.

45. Where intermediaries said they have relationships with PCWs, business arranged through PCWs accounts for around 11% of their total volume of business in 2016. The majority of these intermediaries pay a fee for each lead received from the PCW and around one-third pay a fee for each mortgage completion. Most of the relationships between PCWs and intermediaries seem to be historic arrangements, though one larger intermediary's business model is more targeted towards online leads.

[12] In addition to products being listed on a PCW's comparison tool, PCWs offer advertising banners to firms which may include lenders and intermediary firms. Firms may pay the PCWs for this but not in all cases. One PCW told us about advertising arrangements that result from agreements between a provider and search engines such as Google.

Ancillary services and mortgage sourcing systems

Valuation and conveyancing services

46. Some intermediary firms provide valuation and conveyancing services alongside intermediation services. This presents a potential conflict of interest, potentially leading them to favour lenders that use their conveyancing and valuation services.

47. Intermediary firms that offer or are connected to companies that offer ancillary services said that advisers are expected to recommend in-house services to borrowers. However, firms said that there is no obligation for consumers to take up these services and we do not find restrictive contract clauses between lenders and intermediary firms. For valuations in particular, the intermediary firms' strategies seem to be more focussed on relationships with lenders and ensuring a place on their valuations panel, while referral rates of consumers for surveys are low.

48. We considered whether the price paid for the mortgage product (calculated as initial interest rate and fees) is affected if the intermediary used by the borrower is linked with a company that provides ancillary services. We did not find evidence that these commercial agreements have any significant impact on price.

Mortgage sourcing systems

49. Mortgage sourcing systems (MSSs) are a class of software that intermediaries use widely to identify the products available for their consumers. We considered whether these relationships can affect the ranking of products, and hence the intermediary's advice. We also considered whether relationships between lenders and MSSs prevent more innovative products from entering the market.

50. Remuneration structures vary across the main MSSs. These range between charging lenders a fixed fee per month/year or a fee based on number of products or the number of registered advisers using the MSS.[13] We do not see evidence that payments made by lenders affect the lender's product visibility in the ranking on the MSS.

51. As part of our firm survey we asked lenders about their experiences in launching products through MSSs.

- 20% of lenders who responded to the survey said that they have had some difficulty in launching new products due to the requirements of the MSS or the way products are displayed. These difficulties had been overcome by utilising existing features of the systems (eg, manually inputting into the notes section)
- lenders do not typically require or request modifications to the system to accommodate new products
- MSSs themselves monitor developments in the market to identify and implement changes that would benefit products from several lenders[14]
- a few specialist lenders indicated that they have experienced difficulties in launching products through MSSs, for example MSSs being reluctant to make material changes to the system without the lender incurring significant costs.

[13] MSSs are often also remunerated by intermediary firms, either by fixed fee or by number of registered advisers.

[14] There have has also been occasional market-wide developments across MSSs, for example introducing a filter for HTB equity cases when other lenders were launching these products in 2013.

52. In the lifetime mortgages market MSSs differ in their approach. We have identified one MSS that specialises in lifetime mortgages but the appetite from the larger MSSs to support equity release products is varied. One equity release lender told us that having to bear the cost of modifications to an MSS can constrain product development and launch.

53. During the Call for Inputs phase some stakeholders expressed concerns about the fact that one of the large MSSs is owned by 6 lenders. We do not find any evidence that this affects the ranking of products on the system or leads to conflicts of interest. The MSS is run on an arms-length basis and some of the lenders have also shared with us the safeguards they have in place to ensure independence.

54. 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, we do not know the extent to which the earlier phases of product design and development are influenced by the way MSSs display products. We think MSS can also play a role in enabling intermediaries to assist consumers to find the right mortgages more easily, included in our proposals for potential remedies in Chapter 9.

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