Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Our ref: WGA/smb

Dear Eleanor

**CP 186 (Mortgage Regulation: Draft Conduct of Business Rules and Feedback on CP 146)**

This is the Consumer Panel's response to CP186. We have dealt with the issues raised in the paper, rather than with individual questions.

## Advising and Selling Standards

### *Sales Processes*

The Panel is pleased that the FSA is now proposing only two types of sales process – advised and non-advised sales - rather than the three originally proposed in CP146. This has removed a significant area of potential confusion amongst consumers. We strongly support the use of scripted questions in non-advised sales and the close supervision of staff selling on a non-advised basis.

### *Suitable Advice*

The Panel broadly agrees with the three-stage approach to giving suitable advice set out in CP186. Overall we have no objection to firms being permitted to adopt a criterion other than the 'better value' mortgage – such as better quality of service – provided that this is made absolutely clear to the consumer. Given this proposal, the Panel is disappointed that the FSA still believes that a suitability letter is unnecessary. This decision has been taken without the benefit of consumer research and is inconsistent with the FSA's approach in the investment business market, where a decision has been taken to retain them. According to the FSA's consultation paper CP170, research had shown that the suitability letter for investment products is "read and used effectively by consumers." We strongly urge the FSA to undertake research amongst consumers in the mortgage market to assess the usefulness of suitability letters and to retain them unless or until definitive research says otherwise.

### *Product Risk*

We welcome the removal of the 'lower risk' category of mortgage products, leaving just two categories: standard risk and high risk. This will give greater protection to vulnerable consumers, such as those who are often sold mortgages for a limited term or limited amount.

### *Independence*

The Panel strongly believes that use of the term 'independent' should be consistent across all financial services markets. The concept of "independence" is an important one and a different approach in different financial sectors would result in confusion amongst consumers. We support the FSA's proposals to restrict the use of the term to those firms providing a whole of market service where the consumer has the option of paying a fee.

### *Record Keeping*

It will be in consumers' interests for records relating to all mortgages to be retained for the life of the mortgage plus six years. This will give sufficient time for consumers to raise any concerns relating to their mortgage, including final settlement/redemption.

### *Training and Competence*

The Panel agrees with the FSA's approach that advisers should be required to comply with the full training and competence requirements and that the Commitments will apply to salespeople carrying out non-advised sales. For mortgages other than lifetime mortgages, we support the proposals for 'grandfathering' into the new regime those advisers who have met the Mortgage Code Compliance Board's fitness and competence requirements.

## Disclosure Requirements

### *Initial Disclosure*

The Panel believes that mortgage lenders and intermediaries should provide an Initial Disclosure Document ("IDD") at the time of initial contact with consumers. Unless the IDD is completed in the presence of the consumer – or by way of information or questions and answers over the telephone or the internet – its effectiveness will be significantly reduced and we do not believe the rules should allow firms to pre-print the IDD**.** Specific comments on the IDD are set out in appendix 1.

### *Pre Sale Disclosure*

The Panel supports the use of the Key Facts Illustration ("KFI", formerly the Pre Application Illustration). Overall we think that the changes that have been made to the documents since CP146 was issued are positive, although we have not reviewed all the documents in detail. We still believe, however, that question 10 ("what happens if you do not want this mortgage any more?") could be better expressed as "what if I want to repay this mortgage early?". We also think that the KFI should contain a section on what happens if negative equity arises.

Our particular concerns about the drafting of the KFI for lifetime mortgages are set out in Appendix 2.

The Panel agrees that the KFI should be provided as early as possible in the sales process and before the consumer submits an application. The Panel is pleased that the FSA has clarified that firms cannot issue mortgage illustration documents instead of the KFI, although they will be permitted to provide supplementary information or 'quotes'. We believe that a revised KFI should always be issued to the consumer if there is a change to the terms and conditions of the mortgage, whether material or not, before an application is accepted.

***Sustainable Home-Ownership Initiative***

We do not think that it would be appropriate for the KFI to include specific reference to the Sustainable Home-Ownership Initiative. It is important for both consumers and firms to consider the effect that accident, sickness and unemployment could have on an individual's financial position, but such insurance cover is not essential for everyone. To include reference to the Initiative in the KFI would perhaps add the FSA's 'endorsement' of these insurance products and this could be taken as a recommendation that cover should be taken out.

***Mortgages Without a Term and Without a Payment Plan***

The Panel believes that KFI's for these types of mortgage should include a prominent, clearly worded warning at the top of the form about the key differences between the product being purchased and conventional mortgages. The KFI should also set out the circumstances in which the consumer would be in default and what the penalties for that would be.

***Offer Stage Disclosure***

The Panel agrees that consumers should be informed about differences between the KFI and the Offer Document, although we think that this could most easily be achieved by highlighting the differences between the two, rather than placing responsibility on the consumer to compare the two documents.

***Variations to Contracts***

The Panel would like to see a requirement for firms to provide consumers with a KFI before they apply for any variation to their mortgage, including switching from repayment to interest-only or changing the term.

**Lifetime Mortgages**

***Overall Approach***

The proposals in this paper go some way towards meeting the Panel's concerns about lifetime mortgages. However we believe that the FSA should do more to protect consumers in this particular market.

Perimeter Issues: The MCOB sourcebook is largely disapplied for professional firms undertaking mortgage business which is incidental to their core business. We understand that many lifetime mortgages are arranged/advised on by solicitors and we would like the FSA to take steps to ensure that the relevant designated professional bodies enforce rigorous compliance standards in this area.

Suitability Requirements: The Panel supports the FSA's proposals for suitability requirements, in particular MCOB 8.5.7 which deals with consolidating loans into a lifetime mortgage. However, we have some concerns. The requirement to assess affordability seems to apply solely to interest-only mortgages. Affordability might also be an issue for mortgages where interest is rolled-up – for example if a requirement to pay interest is triggered when the debt exceeds a certain level. It could also be argued that this particular type of mortgage could never be suitable. In addition we believe that the option of trading down should be included in the suitability assessment.

Cooling off Period: It is disappointing that the FSA has decided against a cooling-off period, particularly when it proposes to do away with suitability letters. The built-in cooling off period associated with secured lending would not necessarily apply to lifetime mortgages. In addition the lifetime mortgage market currently has few expert advisers and the Panel would like the FSA to consider a strategy for making this market safer and more competitive – including the use of the comparative tables.

### *Training & Competence for Advised and Non-Advised Sales (Lifetime Mortgages)*

The Panel supports the proposals for new training and competence requirements, but we feel that they are undermined by the transitional requirements. It is intended that all existing qualified MCCB advisers will be grandfathered in to the new regime. This is not a concern for standard mortgages, but the current MCCB qualification does not cover lifetime mortgages in sufficient depth. The result is an incentive for advisers to sell lifetime mortgages now simply so that they can be grandfathered into the new regime, which poses a risk to consumers.

- As an appropriate exam is yet to be developed, we ask the FSA to consider: Requiring the top-up exam to be taken within, say, a year of being grandfathered as part of the 'maintaining competence' requirement;
- Encouraging SHIP, Age Concern or Help the Aged to fill the gap by running seminars and courses;
- Giving clear guidance to firms on how to assess competence; and
- Encouraging firms to comply with the FSA's mortgage regulation regime in the period between now and October 2004 on a voluntary basis.

Detailed comments on the proposed KFI for lifetime mortgages are contained in Appendix 2.

## Fair Treatment

### *Cooling-Off*

The Panel still believes that a cooling-off period should be imposed for debt consolidation loans as well as for lifetime mortgages. This will be a valuable safeguard for vulnerable consumers.

***Cold Calling***

The Panel supports the ban on cold calling.

***Non-Refund of Fees***

The Panel does not believe that the draft rules on initial disclosure will be enough to ensure that consumers appreciate where they stand on the refund of fees. We would like to see a capped non-refundable fee introduced.

***Excessive Charges/Disclosure of Commission/Responsible Lending***

The Panel supports these revised proposals, in particular the decision to apply the responsible lending rule to all sales, including non-advised. We are particularly pleased that arrears charges must be based on a reasonable pre-estimate additional administrative cost, as firms should not see arrears charges as a profit centre.

**Redress**

The Panel is pleased that the FSA has decided to extend the scope of the Financial Ombudsman Service compulsory jurisdiction to mortgage lending, administration, advising on mortgages and arranging mortgages. So far as the proposed compensation limits are concerned, the Panel can see no justification for the 90% cap. Our understanding from other FSA consultation papers is that the 90% limit in some way recognises an obligation on the consumer to buy products diligently. It seems unlikely that consumers could be aware that a firm is on the brink of insolvency, or that bad advice would have an impact on his/her financial position several years later. On this basis it does not seem appropriate to limit the amount of compensation consumers could claim.

**Safeguarding Client Money**

The Panel agrees that steps must be taken to protect consumers from the risk of financial loss as the result of client money abuse and failure of an intermediary. We do not think that option 1 in the paper (using existing regulatory tools) will provide sufficient safeguard and, in any event, we think the minimum capital requirement is too low. We favour option 2, the client money segregation rules. We do not have any data on the frequency or scale of client money losses in this area, but we are satisfied that the segregation of client money and the additional safeguards that entails, such as client bank account reconciliation, will provide the necessary security in a cost effective way.

**Cost Benefit Analysis**

The Panel is disappointed that the Cost Benefit Analysis at Annex 5 of the paper does not attempt to quantify the benefits to consumers (and to firms) of the new proposals.

**Shared appreciation mortgages**

One final point about a relatively recent market development. The Panel is concerned that the proposed rules as drafted would not capture mortgages such as shared appreciation mortgages. We urge the FSA to take pre-emptive action to ensure that consumers are fully aware of all the risks.

Yours sincerely,

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## Appendix 1: Comments on the Initial Disclosure Document

The Panel is supportive of the use of the KeyFacts logo on the IDD and overall we are reasonably satisfied with its contents. However we wish to make the following points:

1. We do not think it necessary to include sections 7 and 8 (complaints and compensation) except for lifetime mortgage customers.

2. Section 6 could be usefully included in section 1.

3. On section 2, we suggest that option 2 should be "we can select mortgages from X lenders" and any limitations on the type of mortgage covered should be stated. An explanation of the reasons for choosing the firms from which the range is selected and also the scale of the market from which the choice is made would be helpful. Option 3 should say "we can only select from all of the mortgages from X Limited. What we recommend may not be the best in the market."

4. On section 3, we suggest "we will advise you and make recommendations on what is suitable for your circumstances. You can take action against us if that is not the case". The second statement should read "you will not receive advice or recommendations on what is suitable for you. We may ask questions to narrow down the selection of products we offer you. You will then need to make your own choice about how to proceed. If a purchase you make turns out not to be suitable for your circumstances, you will not be able to take action against us."

5. Sections 4 and 5 should make clear that "fees" do not in this instance include valuation fees.

## Appendix 2: Key Facts Illustration – Lifetime Mortgages

1. Section 1 could usefully refer to the leaflet produced by Age Concern, which lists product providers.

2. Section 3 does not explain what a home reversion product is. Bullet point 2 could be clearer. We suggest amending "you may be able to transfer your lifetime mortgage to your new home" to "can you transfer? Some firms allow this."

3. Section 4 naturally refers to the consumer's age, but it might be less ambiguous to work on date of birth – being a year or two out can make a real difference to the income received.

4. Section 7 states "taking our this mortgage may affect your ability to claim benefits." This will mean little to consumers without a suitability letter. Bullet point 8 gives an unrealistic impression that further borrowing will be available.

5. Section 8. In this particular illustration the interest rate has been fixed for the duration of the loan at 7.5%, yet section 8 refers to the "current" interest rate.

6. Section 10 could usefully be combined with section 8, showing more clearly how the homeowner's equity in the property will be affected.