Mortgages Market Study
Final Report

Market Study
MS16/2.3

March 2019

How to respond

In this report we set out our final findings of the Mortgages Market Study.

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1 Executive summary

Introduction

1.1 Every year, hundreds of thousands of consumers finance the purchase of their homes with a mortgage or re-finance existing mortgages. Mortgage debt accounts for over 80% of total UK household liabilities, so choosing a mortgage is an important financial decision. But it can be difficult to get right.

1.2 The mortgage market works well in many respects. It is very different to how it was before the financial crisis. This reflects both the immediate market reaction to the crisis and the regulatory response. Importantly, engagement is high and consumers are getting mortgages that are suitable and affordable.

1.3 But there are limitations to the effectiveness of the information and tools available. Many consumers miss out on cheaper deals that are just as suitable. There is also a small number of consumers on a relatively high reversion rate (the interest rate payable once an introductory rate ends), who are up-to-date with their payments, but unable to switch. For many this is due to changes in affordability requirements following the financial crisis, though there are also others who are unable to switch for different reasons. These customers are often called 'mortgage prisoners'.

1.4 We want to enable greater innovation in mortgage distribution and help consumers' to identify, at an earlier stage, the mortgages for which they qualify. We also want to reduce barriers to switching for those consumers' who are up-to-date with payments and not seeking to borrow more. These interventions are part of a package of measures that will help consumers' get the best value, suitable mortgage.

Our objective

1.5 This market study focuses on first-charge residential mortgages, in particular

i. consumers' ability to make effective choices given the tools available
ii. commercial arrangements between firms leading to possible conflicts of interest

1.6 We were keen to understand the impact of our advice rules and guidance, and how technology can improve how the market works, particularly by helping consumers make effective choices. We also sought to assess the extent to which mortgage prisoners were suffering harm, and what can be done to help them.

1.7 Our vision for the market is one in which:

- borrowers who can afford a mortgage can choose suitable and good value products and services
- firms have a culture of treating all consumers fairly

- competition and proportionate regulation empower consumers to make effective choices before taking out, and throughout the life of, a mortgage

1.8 In this final report, we describe how well we believe the market is working currently and how we would like to see it develop. This takes account of feedback on the interim report we published in May 2018 and the work we have done since.

Our findings and remedies

1.9 Overall, we found a mortgages market that works well in many respects but that fell short of our vision in some specific ways, leading to harm for some consumers. There is no single factor behind this; the picture is complex.

What works well in the mortgages market

1.10 Much of what we found was reassuring, including:

- consumers largely take out suitable mortgages that they can afford
- high levels of consumer engagement; currently over three quarters of consumers switch to a new mortgage deal within 6 months of moving onto a reversion rate
- a wide range of products on offer and apparent competition on headline rates
- many consumers value the experience and expertise of intermediaries
- current commercial arrangements between firms, such as commission lenders pay to intermediaries or referral agreements between intermediaries and estate agents or developers, do not appear to result in consumers paying significantly more for their mortgage

How the market could work better

1.11 We found that there are limitations to the effectiveness of the tools available to help consumers choose a cheaper mortgage. Also, there are some longstanding borrowers on a relatively high reversion rate who do not or cannot switch.

1.12 We believe the market could work better in a number of ways. To help achieve our vision, we would like:

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

1.13 Where possible, we sought to address some of the issues we found through collaboration with industry in the first instance, rather than through rule changes. We do not believe that the mortgages market requires an intervention on pricing.

Making it easier for consumers to choose the right mortgage

1.14 A market that is working well should provide products or services that meet consumers' needs and offer value for money. While we have found that consumers typically get a mortgage that is suitable and affordable, many miss out on savings they could have made from a cheaper but just as suitable mortgage.

1.15 There is no easy way for consumers to identify, at an early stage, those products for which they qualify. This hampers their ability to find the best deal. It also inhibits (to a lesser extent) intermediaries' ability to do likewise.

1.16 We estimate that around 30% of consumers (in 2015-2016) could have found a cheaper mortgage with the same key features (eg the duration of a fixed introductory rate) as the product they chose. On average, these consumers paid around £550 per year more over the introductory period compared to the cheaper product.

1.17 To tackle this, we set up a working group of representatives from intermediary and lender trade bodies. We explored whether and how lenders could make more information available or engage with new tools that would allow intermediaries to more easily identify the products a consumer is likely to qualify for, earlier in the sales process.

1.18 Lender and intermediary trade bodies are opposed to FCA intervention in this area. They argue that innovation is already happening and that regulatory intervention can lead to unintended consequences.

1.19 We welcome the tools that are emerging to help consumers identify the mortgages for which they qualify. But these tools are still nascent; whether they can provide a comprehensive solution is untested. They will require active engagement from a range of lenders to succeed. But this has not yet happened. We are mindful of the risk of unintended consequences of intervention, but we want to see real progress in, for example, lender participation.

1.20 Our preference remains a market-led solution. As well as continuing to monitor the traction that the new and innovative tools gain with lenders, intermediaries and consumers, we will continue to seek working group input to help identify barriers to lender participation, and agree how we will measure progress. We will also look at other sectors for potential approaches, such as the progress made by using APIs in Open Banking. And we will consider whether any FCA action (eg making rules or our ability to convene) would be beneficial.

1.21 We will update stakeholders once sufficient progress has been made.

Giving consumers more choice about the support (including advice) that they need

1.22 Almost all new mortgage sales are advised, while about half of internal switches are advised. Our advice rules and guidance are effective in helping consumers get suitable mortgages. But they do not result in consumers getting the cheapest suitable deal.

1.23 We believe that some consumers are being channelled unnecessarily into advice. But perhaps more importantly, there has been little significant consumer-facing innovation in mortgage distribution. For example, unlike other markets, for purchases of new products it is usually not possible to complete a mortgage transaction online (from initial search to acceptance of offer). Some lenders and intermediaries have told us that this is in part due to our advice rules and guidance. They have provided feedback on areas where it may limit innovation.

1.24 We are committed to identifying changes to our advice rules and guidance that would reduce barriers to innovation in mortgage distribution. At the same time, we recognise the important role our rules play in providing a degree of consumer protection for many borrowers and we do not want to restrict access to advice for those consumers who can benefit from it. We have carefully considered the feedback on our interim report and we will consult on specific changes to our advice rules and guidance in the next quarter of this year.

More help for consumers choosing an intermediary

1.25 Many consumers use an intermediary to help them choose a mortgage. We found that a consumer's choice of intermediary can have a significant effect on the cost of borrowing: up to £400 a year during the introductory period of a mortgage. But it is difficult for consumers to find the right intermediary.

1.26 More informed consumers will be better able to choose an intermediary most likely to meet their needs. This will help drive more effective competition between intermediaries.

1.27 To progress this, we set up a working group of consumer organisations and both lender and intermediary trade bodies. Listening to the views of the group, our preferred approach is for the Single Financial Guidance Body (SFGB)[1] to extend and develop its existing retirement adviser directory (currently under the Money Advice Service (MAS) brand). At the same time, we will seek to ensure that any existing commercial providers of such tools are not unduly disadvantaged.

1.28 SFGB has confirmed it has a high number of consumers seeking mortgage information and guidance through its contact centre and website, and that extending the existing directory to cover mortgage intermediaries is a logical addition to its service which helps consumers find a retirement adviser. As well as building on the existing MAS adviser directory it could include certain additional content, such as information on the number of lenders with whom intermediaries typically place business.

Switching: fair treatment for long-standing consumers

1.29 Currently, most mortgage products sold in the UK have a short-term introductory deal (often at a fixed interest rate) after which the rate changes to another (reversion) rate. Moving to a reversion rate often increases mortgage payments. At this point it is usually in a consumer's interest to switch to a new introductory deal.

1.30 Switching in mortgages is relatively high. But we estimate that about 800,000 consumers are paying a relatively high reversion rate and do not switch when they could. The financial impact on those who do not switch is around £1,000 a year on average during the introductory rate period.

1.31 In our interim report, we proposed intervening to make it easier for less active consumers to switch. We received helpful suggestions from stakeholders.

1.32 We are undertaking further research to better understand the characteristics of those consumers who do not switch. Once the research is complete, we will consider how best to target potential remedies on those customers that would benefit most, taking account of ongoing work on the fairness of pricing in financial services. We will report back later this year.

1 The new Single Financial Guidance Body (SFGB) creates one organisation from the three existing providers of government-sponsored financial guidance: The Money Advice Service, The Pensions Advisory Service, and Pension Wise.

Switching: fair treatment for consumers who are unable to switch

1.33 The mortgages market changed significantly after the financial crisis. There was an immediate market reaction. There was also a regulatory response. This included our Mortgage Market Review (MMR) which sought to prevent a return to previous poor practices.

1.34 Changes in lending practices following the financial crisis, including those reflecting changes to regulatory requirements around affordability assessments, have left some consumers on a relatively high reversion rate unable to switch to a cheaper mortgage. This is despite them being up-to-date with their existing mortgage payments. These consumers are sometimes called 'mortgage prisoners'.

1.35 We estimate that, in 2016, there were around 10,000 mortgage prisoners with active lenders and around 20,000 with firms authorised to lend but which are inactive.

1.36 There are also some consumers who have mortgages with unauthorised firms. We have little data on these consumers but understand that many share characteristics with the mortgage prisoners we have identified. We estimate that around 120,000 consumers who have mortgages with unauthorised firms may benefit from switching.

1.37 We are also aware that there are consumers who are up-to-date with mortgage payments but cannot switch due to a change in circumstances meaning they no longer pass lenders' affordability tests. A similar situation could arise in future for different reasons. For example, a fall in house prices pushing up a borrower's loan-to-value (LTV) to a level that lenders are unwilling to accept.

1.38 We want to make switching easier for consumers who are up to date with payments and not seeking to borrow more. This has received widespread support.

1.39 Lender trade bodies[2] have facilitated a voluntary agreement among over 65 active lenders (covering around 95% of the market). The agreement allows these lenders' customers, who are up-to-date with payments, to switch internally without any affordability assessment, subject to meeting certain criteria. We welcome this positive development which should help many of the 10,000 consumers mentioned above. This agreement is not limited to pre-crisis borrowers. It should also help those who continue to maintain their mortgage payments but cannot switch due to a change in circumstances. We will monitor future switching data to ensure that it is delivering the anticipated benefits.

1.40 Helping consumers who have mortgages with inactive firms is more complex but equally important. Active lenders have told us that they may wish to lend to some of these consumers, but that there are regulatory barriers that may prevent them from doing so. Therefore, alongside this final report, we have published a consultation paper which sets out proposed changes to our responsible lending rules and guidance. This should help some of the 20,000 consumers with authorised but inactive firms, as well as some of the 120,000 consumers with unauthorised firms. It could also help those who are unable to switch due to a change in circumstances.

Next steps

1.41 We will continue to progress the remedies as described above and provide updates on progress.

2 UK Finance, the Building Societies Association and the Intermediary Mortgage Lenders Association

2 Background and approach

2.1 This is our final report following the mortgages market study. It sets out our final findings after considering feedback on our interim report, confirms our proposed remedies, describes the progress made on each remedy, and sets out the next steps.

Why we decided to look into the mortgage market

2.2 The mortgage market plays a crucial role in the UK economy. Mortgage debt accounts for over 80% of total UK household liabilities. Choosing a mortgage is one of the most important financial decisions for a consumer but it can be difficult to get right.

2.3 This market changed significantly after the financial crisis. There was an immediate market reaction. There was also a regulatory response. This included our Mortgage Market Review (MMR) which sought to prevent a return to previous poor practices and improve the affordability of mortgages.

2.4 We were keen to understand how well certain important aspects of the market are now working, in part to help assess the impact of the MMR on advice and intermediation. So, in December 2016 we launched this Mortgages Market Study (MMS).

Scope of the study

2.5 The focus of the MMS is first-charge, residential mortgages. Lifetime mortgages and further advances are within scope.[3] We considered 2 main questions:

i. At each stage of the consumer journey, do the available tools[4] help mortgage consumers make effective decisions?
ii. Do commercial arrangements between lenders, intermediaries and other players lead to conflicts of interest or misaligned incentives that could harm consumers?

2.6 We also considered:

- the role of our Handbook rules and guidance
- opportunities for (or barriers to) better technological solutions
- whether some consumers on a (relatively high) reversion rate don't or can't switch

2.7 The MMS did not focus on buy-to-let, second-charge or commercial mortgages, or home reversion plans. However, we have considered how any insights gained are relevant to those markets we regulate. Prudential issues were out of scope.

3 We propose to include lifetime and second charge mortgages in further work aimed at (i) giving consumers greater certainty, earlier in the sales process, on the products for which they qualify, (ii) helping consumers make a more informed choice of broker and (iii) switching.

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

Sources of evidence gathered to support our analysis

2.8 We have used information from a wide range of sources. This includes regulatory returns data, additional data from firms, insights from the FCA's new biennial consumer survey (Financial Lives), additional surveys of lenders and intermediaries and credit reference bureau data. We have also taken account of feedback on our interim report, and input to our remedies working groups. For more detail on our sources of evidence see Annex 2 of the interim report.

2.9 We also undertook 4 specific pieces of in-depth data analysis:

- Dominance analysis which assessed whether consumers (who were not switching internally) could have obtained a mortgage with equivalent features but at a lower cost (ie having one or more rates or fees that are lower with none that are higher).
- Matching analysis which assessed impacts of intermediation (as opposed to going direct to lenders) on first-time buyers and home-movers. It also assessed impacts of extending regulatory advice under the MMR to those who now get advice but would not without the MMR.
- Broker choice analysis which compared the average cost of 2-year fixed mortgages across specific intermediary firms, taking into account variations due to differences in consumer characteristics.
- Procuration fee analysis which sought to identify if there was a correlation between intermediaries recommending higher cost mortgages and receiving more commission (sometimes called 'commission bias').

Recent market developments

2.10 A summary of the market information we have considered is in Annex 1. There have been few significant changes in the market that are specifically relevant to the scope of our study since the period of our original analysis (2015-16).

2.11 We have seen some innovative tools emerging that could help consumers understand which products they qualify for. However, these tools are nascent and have achieved only limited traction with consumers and intermediaries (understandably, given the relatively short period of time for some since launch). Moreover, they will require active participation from lenders to succeed. This has not yet happened. See Chapter 3 for more on this.

2.12 Since the period we analysed during the study (2015-16), we have seen a further increase in the number of lenders offering procuration fees to intermediaries for retention business. These are fees paid by lenders to intermediaries if the intermediary's client chooses to move to a new mortgage deal with the same lender (ie an internal switch). Wider use of retention procuration fees should strengthen the incentives on intermediaries to target such business which could encourage switching. However, it will take time for any impact of these changes to materialise. We continue to believe that further action is required on switching. See Chapter 6 for more on this.

Main feedback on our interim report

2.13 We received 51 formal written responses to the interim report from lenders, intermediaries, consumer organisations, trade associations, other professional bodies, and individuals. Detailed feedback is summarised in Annex 2.

2.14 Stakeholders mostly focused their feedback on our early thinking on remedies. These views are reflected in the relevant chapters on remedies (Chapters 3-7). There was a small number of more general (but still significant) challenges to our findings and approach. Two points were raised in particular: (i) that we focused too much on price, and (ii) the timeliness of data used. We received little feedback on our findings on commercial relationships.

Focus on price

2.15 Much of the harm we have identified relates to consumers missing out on cheaper mortgages that are just as suitable. Some respondents argued that we have been too focused on price at the expense of other important aspects, in particular that:

- we took price as the primary, or even only, factor in a consumer's choice of mortgage and failed to recognise the importance of suitability
- we failed to take certain 'soft factors' (eg speed of service) into account and have therefore overstated the harm to consumers from not finding a cheaper mortgage

2.16 We agree that price, while typically an important factor in a consumer's choice of mortgage, is by no means the only one. Mortgages sold to consumers should be affordable, suitable and offer value for money.

2.17 Thematic reviews we have previously carried out on mortgage advice and distribution and on responsible lending found that most mortgage recommendations post-MMR are suitable and that firms have largely implemented our responsible lending rules. See TR15/9: Embedding the Mortgage Market Review: Advice and Distribution and TR16/4: Embedding the Mortgage Market Review: Responsible Lending Review.

2.18 To complement this previous work, much of our analysis in the MMS did focus on price as little was known about it. Our findings are based on price comparisons within groups of products with the same features, holding suitability constant. Since the interim report, we have also extended our analysis of the impact on customers who did not use mortgage advice before MMR to take account of more outcomes related to suitability (see paragraphs 2.22 to 2.24 below).

2.19 We also recognise the existence of other 'soft' factors that could explain why a consumer might in some cases deliberately choose what may appear at face value to be a more expensive mortgage. A consumer may rationally trade off a number of factors against a higher price, such as a desire for speed, specific property characteristics that require certain eligibility criteria, or a preference for a particular lender based on previous experience or geographic location.

2.20 We are aware of the limitations of what the data can tell us, and that some of these 'soft' factors cannot (strictly) be identified. However, we do not believe that the harms from consumers' choice of mortgages that we set out in the interim report are significantly overstated.

2.21 We took a number of steps to check that the limitations of the data did not bias our results. For example, one would ordinarily expect speed (from application to offer) to be more important to a consumer who is buying a property than one who is remortgaging. However, our analysis indicated no significant difference in the proportion of missed savings between these two groups of consumers - in other words, there was no indication that remortgage consumers were able to make a significantly better choice of mortgage in terms of price, despite being less constrained than a consumer taking out a mortgage to buy a property.

2.22 Since publishing the interim report, we have done further analysis of whether factors relating to lenders' service could explain why some consumers appear to be overlooking cheaper mortgages that are just as suitable. This additional analysis is set out in more detail in a research note published alongside this report.

2.23 We found that the existence of cheaper (but just as suitable) mortgages is not driven by niche lenders. The better-value alternatives that consumers appear to overlook come from a variety of lenders. In fact, over a third of these alternatives were supplied by the largest 5 UK lenders. And for a significant majority of those consumers that missed out on a cheaper mortgage, there was more than one better value alternative available.

2.24 We also checked whether consumers might have chosen their mortgage for reasons such as branch proximity or reputation for high customer satisfaction. But we found that the chosen products are not systematically better than the cheaper alternatives with respect to these other factors.

2.25 Perhaps most significantly, while it is our findings on missed savings that drive our package of remedies, the remedies themselves are not solely focused on price. While we have found in the past that most mortgages sold are suitable, being suitable does not necessarily mean a mortgage best meets a consumer's needs. So, our remedies are designed to help consumers choose a mortgage that better meets their needs overall rather than just to find a cheaper one. Feedback indicates that the industry supports this ambition.

Timeliness of data

2.26 Respondents argued that the data we used for our analysis, from 2015 and 2016, are now out of date, and that the market is more competitive now than it was then.

2.27 There have been some changes in the market since 2016. But our analysis focuses on consumers' ability to find a mortgage. While there has been some development in the tools and information available, it appears to have had insufficient traction (so far) to impact on consumers' ability to find a mortgage since the period we considered.

2.28 We therefore believe that our analysis and our findings remain relevant, and that any changes in the market has little or no effect on them.

Commercial relationships

2.29 In our interim report, we said that there was little evidence of commercial arrangements between lenders, intermediaries and other participants in the mortgage market currently leading to poor consumer outcomes. We described our findings in more detail on procuration fees, panels, relationships between brokers and estate agents/developers and the new build market.

2.30 Most respondents did not mention commercial relationships. Comments typically made a simple reference to the analysis or welcomed our findings.

Structure of this final report

2.31 The rest of this final report is structured by issue, as follows:

- Chapter 3: Making it easier for consumers to choose the right mortgage
- Chapter 4: Giving consumers more choice about the support (including advice) that they need
- Chapter 5: More help for consumers choosing an intermediary
- Chapter 6: Switching: fair treatment for long-standing consumers
- Chapter 7: Switching: fair treatment for consumers who are unable to switch (often called 'mortgage prisoners')

2.32 Each chapter presents our final findings and our current position on remedies. More detail on the feedback on our interim report can be found in Annex 2.

Next steps

2.33 Alongside this final report is a consultation paper on the changes to our rules that we propose to make to help certain borrowers switch – those who are up-to-date with payments and not seeking to borrow more. See CP19/14.

2.34 Also published alongside this report is a research note setting out some additional analysis we have done on why some consumers appear to be overlooking cheaper mortgages that are just as suitable.

2.35 In the next quarter of this year, we will publish a consultation paper setting out our proposed changes to our advice rules and guidance.

2.36 Our strong preference is to deliver the remaining remedies through voluntary agreement with industry. On giving consumers a clearer idea of the products for which they qualify, over the coming months we would like to see tangible outputs from the effort firms have put into giving and/or getting access to qualification information. We will continue to monitor the traction that any new tools gain with lenders, intermediaries and consumers and work with industry to agree how we will measure progress. We will provide an update on this once we have made sufficient progress.

2.37 On helping consumers find a mortgage adviser, SFGB will undertake discovery work during quarter 2 and 3 to scope the project and establish exactly what information will be presented on the directory and in what format. It will do this by consultation with the FCA and industry and consumer representatives.

3 Making it easier for consumers to choose the right mortgage

Summary of findings

- **It is difficult for consumers to identify and choose the best value product** - There are many mortgage products available, but no easy way for a consumer to identify (at an early stage) the products for which they qualify.
- **The lack of information hampers shopping around for consumers and, to a lesser extent, intermediaries** - Most mortgage recommendations are suitable, but we estimate that about 30% of consumers miss out on cheaper mortgages that are just as suitable.
- **Incentives on intermediaries** - There are strong financial incentives on an intermediary to quickly find a client a mortgage. But, the incentives to search extensively and find the cheapest (suitable) mortgage are weaker*.*
- **Innovation is limited** - There is evidence of innovation in mortgage distribution but it is still developing. Widespread lender participation will be critical to its success.

Final findings

3.1 A market that is working well should provide products or services that meet consumers needs and offer value for money.

Most mortgage recommendations are suitable and affordable

3.2 Thematic reviews we have previously carried out on mortgage advice and distribution and on responsible lending found that most mortgage recommendations are suitable and that firms have largely implemented our responsible lending rules. See TR15/9: Embedding the Mortgage Market Review: Advice and Distribution and TR16/4: Embedding the Mortgage Market Review: Responsible Lending Review.

It is difficult for consumers to find the best value product

3.3 Choosing a mortgage can be challenging. There is a large number of products for which a consumer may qualify, but the tools and information currently available to consumers to navigate the choices available are limited. Chapter 4 of the interim report provides further details.

3.4 According to research by ESRO, most consumers undertake a degree of pre-application research, with a particular focus on how much they can borrow and monthly cost. Shopping around by consumers is limited though. Our Financial Lives Survey 2017 found that only a minority used more than one information source. It also found mixed views about how easily consumers can identify products for which they qualify. Some were confident about choosing a lender who will accept them. Others were motivated to seek support and advice, particularly if their circumstances were more unusual.

3.5 Intermediaries also face barriers to assessing whether a client will be accepted for a product, making it harder for them to find the best mortgage. Most intermediaries use Mortgage Sourcing Systems (MSS) and tools provided by specific lenders to help understand likelihood of acceptance. But these tools are limited and intermediaries must still rely extensively on their experience. Given the number of lenders and products available, each with different qualification criteria, this is challenging.

3.6 There are strong incentives on an intermediary to find a customer a mortgage, and to do so as quickly as possible, to generate a procuration fee. And this is in line with a typical consumer's needs. However, the incentives on an intermediary to search extensively for the best value mortgage are weaker. This is reflected in intermediaries' panel strategies. These typically seek to cover a broad range of consumer circumstances (eg self-employed, poor credit history, etc) rather than a range of lenders for a specific customer, which could result in finding a cheaper mortgage.

The lack of information hampers shopping around and leads to some consumers getting poor value-for-money

About 30% of consumers missed out on savings of around £550 per year on average

3.7 Following extensive analysis of thousands of mortgage transactions made in 2015-2016 (the 'dominance analysis' referred to in Chapter 2 and explained in detail in OP 33) we found that about 30% of borrowers could have qualified for a cheaper, almost identical mortgage. On average, these consumers missed out on savings of around £550 per year over the introductory period. This takes account of both the cost of interest on the mortgage during the introductory period as well as any up-front fees.

3.8 The pattern of missed savings was similar for consumers who used an intermediary and those who went direct to a lender[5]. It was also similar for first-time buyers, home movers, and those remortgaging to a different lender. But, consumers with lower credit scores, lower income and/or aged over 60 typically fared worse than the average.

Lack of transparency of eligibility criteria and range of lenders used

3.9 Our evidence indicated that one of the main reasons consumers choose a more expensive mortgage was lack of clarity on whether they meet certain eligibility criteria.

3.10 Lenders typically charge higher prices to riskier consumers to cover the higher expected costs of lending to them. So mortgages with less demanding eligibility criteria tend to be more expensive. To keep borrowing costs down, a consumer should buy a mortgage for which they just meet the eligibility criteria. Otherwise, they are likely to pay a premium for unused 'buffers' they have in one or more of the eligibility criteria.

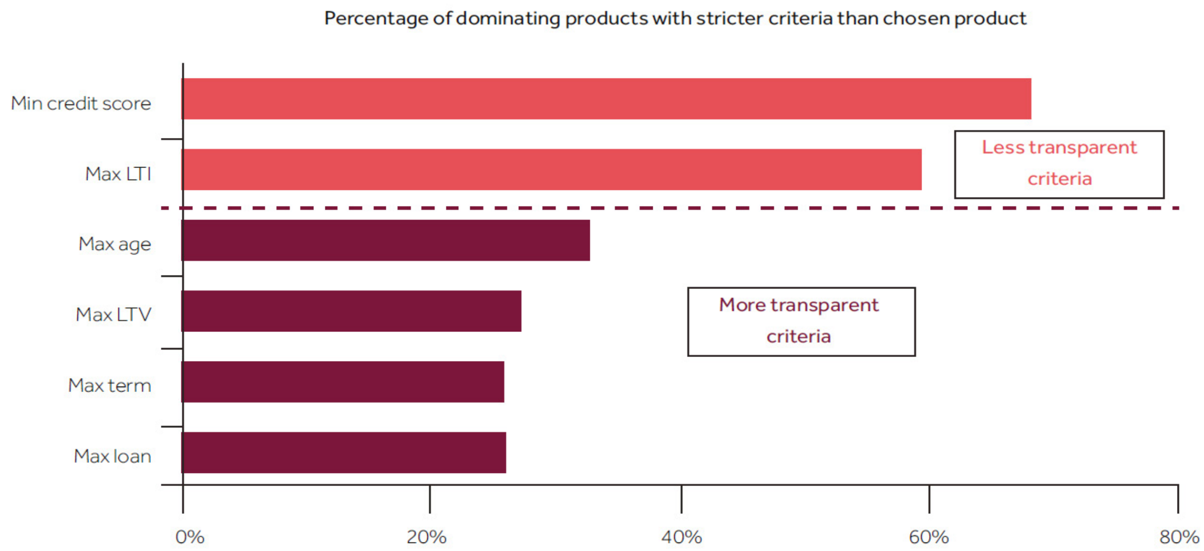
3.11 We found that consumers who missed out on a cheaper (but virtually identical) mortgage tended to pay for certain types of unneeded buffers more than for other types. For example, 25% to 30% of consumers paid for mortgages with a higher age limit or maximum LTV than they needed, while a larger proportion of borrowers left buffers for other criteria, such as maximum loan-to-income (LTI) and credit score.

3.12 This difference can be explained by transparency. Some eligibility criteria are not very transparent and a consumer (or intermediary) will be less confident they will meet it

5 See paragraphs 3.16 to 3.18 for more on the findings when taking account of lenders distribution decisions.

and be accepted. In this case it makes sense to be cautious and choose a product for which they can be more confident they are eligible, especially if speed is key. Maximum loan amounts, LTV and age are clear from the outset (or at least before the mortgage application is made). So, consumers did not tend to overpay for them. Where criteria are less transparent, such as LTI and minimum credit score, consumers tend to leave larger buffers and pay more as a result.

Figure 3.1 – Eligibility criteria of cheaper (but just as suitable) mortgages compared to chosen option



3.13 We also found a correlation between intermediaries that typically placed business with a larger number of lenders and those finding better value for money mortgages for consumers. Missed savings were more significant when an intermediary appeared to search across fewer lenders.

3.14 Together these findings strongly indicate that improving the ability of consumers and intermediaries to shop around on products – in particular by making it clearer for which products a consumer is likely to qualify – should help consumers find a better deal.

3.15 Stakeholders have told us that the missed savings are now likely to be lower than we estimated, because the market has become more competitive since 2015-2016 (the period of the analysis). We recognise that the market has changed in some ways, for example retention procuration fees paid by lenders to intermediaries are more prevalent. While this may have a positive effect on switching levels, we do not believe it likely to be any easier for consumers to identify the best value mortgage. We believe it likely that consumers continue to miss potential savings.

Lenders' choice of distribution channel

3.16 Some intermediaries say they are hampered because not all lenders distribute mortgages through all intermediaries. This narrows the range of products available through intermediaries and might cause poorer outcomes for consumers who use an intermediary (but may be unaware of this).

3.17 When considering only products available through an intermediary (ie excluding any that are only available direct from the lender) we found that fewer consumers missed out on significant savings – only around 20%. This may be a better measure of the effectiveness of intermediaries in finding a consumer the best mortgage among those available to them. But it is not necessarily a better measure of how the current market delivers the best outcomes for consumers.

3.18 Unless a firm has a degree of market power, or a dispute has arisen between a lender and intermediary, there should be little incentive for lenders with unmet capacity to lend to restrict the availability of their mortgages. All lenders have distribution strategies comprising some or all of: sales in branch, by telephone, via intermediaries. Indeed, for new lenders, distributing mortgages through an intermediary network can be the most cost-effective way of reaching the widest customer base. Seeking to push all lenders to sell through all intermediaries risks significant unintended consequences. And, if effective, our package of remedies ought to make it easier for consumers to find the best deal available. So, we do not propose to intervene.

Remedies

What we want to happen

3.19 We believe there are considerable opportunities to improve the mortgage buying process, enabling consumers to access, assess and act upon qualification criteria earlier. And we want to foster an environment where innovation that meets consumers' needs can flourish, encouraging the development of new, convenient tools.

3.20 New tools could be consumer-facing or could support more traditional methods of sale. We know that some consumers value telephone or face-to-face advice and a tool for use by an intermediary could complement that. The tools also have the potential to provide tailored feedback on why a particular consumer is not eligible and suggest ways to improve their chances of being approved. New tools should also incentivise lenders selling direct to improve the information they make available. At present, consumers who go direct to a lender are often reliant on limited eligibility and affordability information provided online.

3.21 Innovative new tools that have the potential to achieve this have begun to emerge. But they are still developing. To succeed, they require far greater traction with lenders, which has not yet happened. We want to work with lenders to enable this.

What we have done

3.22 In July 2018, we set up a working group of lender, intermediary and fintech trade bodies. We asked the group to consider how to make it easier for intermediaries to identify, at an earlier stage, the products for which a client is likely to qualify.

3.23 Analysis by the working group has identified a range of information that is already shared through existing tools such as mortgage and criteria sourcing systems. This includes product information and, increasingly, some eligibility criteria. However, information about a lender's approach to affordability and risk appetite, and its approach to credit scoring, is not widely shared.

3.24 While a few lenders have been willing to share this information with specific commercial partners, most are uncomfortable with sharing it widely. Lenders tell us the information is proprietary and/or that sharing it might increase the risks of fraud and gaming.

3.25 We believe there are models that would potentially mitigate these concerns while still helping consumers to understand, at an early stage, for which mortgages they are likely to qualify. This includes intermediaries providing consumers with indicative decisions in principle from multiple lenders via an application programming interface (API). This approach works well in other sectors. For example, in general insurance there are intermediary websites that will search for quotes from insurance providers, based on information from the consumer, and return a quote in a matter of seconds. For this to work in the mortgages market, widespread lender participation is needed.

3.26 We recognise the complexities involved for firms in either providing or acquiring qualification information. We are also aware that evolving market solutions could inadvertently exclude some consumers. For example, those with less standard circumstances or smaller lenders without the capacity to invest in new systems.

3.27 The working group agrees that the mortgages market could work better if intermediaries can more easily identify the products for which consumers are likely to qualify. And that, for this to happen, lenders need to be able to support the early provision of qualification criteria in the form of an indicative decision. These indications would not be a binding offer but would need to be based on a reasonably certain level of acceptance (ie still subject to usual lender due diligence). However, lender and intermediary trade bodies are opposed to FCA intervention in this area. They consider that FCA intervention in this area and even the prospect of it might create uncertainty and dampen innovation.

What's next

3.28 We welcome the innovation that is happening and are mindful of the risk of unintended consequences from FCA intervention. Our preference here remains a market-led solution. However, the innovation has not yet delivered the results required to remedy the harm identified. And we have not yet seen sufficient evidence that this will happen without further collective effort by the industry, which we stand ready to support.

3.29 We are not seeking a specific solution, rather looking to the market to enable the development of such tools. We have already seen how lenders can develop solutions to effectively manage the risks of compromising confidential or business sensitive information, as other financial services sectors have managed to do this.

3.30 Over the coming months we want to see tangible outputs from the effort firms have put into potential means of giving and getting access to qualification information.

3.31 We will continue to monitor the traction that new innovative tools gain with lenders, intermediaries and consumers. We will continue to seek working group input to help identify barriers to lender participation, to explore the scope for industry and FCA action to address those barriers, and to agree how we will measure progress. We will also look at other sectors for potential approaches, such as the progress made by using APIs in Open Banking, and will keep under review whether there may be any benefit from more direct intervention, for example through FCA rules or our ability to convene. We will update stakeholders once sufficient progress has been made.

4 Giving consumers more choice about the support (including advice) that they need

Summary of findings

- **New mortgage sales are almost all advised, while many internal switches are completed on an execution-only basis.**
- **Our advice rules and guidance appear to lead to sales of suitable mortgages. But they do not result in consumers getting the cheapest suitable deal.**
- **Our advice rules and guidance appear to be one factor explaining why innovation in mortgage distribution has been limited.**

Final findings

4.1 In 2014 the MMR significantly changed the regulatory regime for mortgages. It did this through the introduction of stronger responsible lending and arrears handling rules and a new approach to mortgage advice and selling.

New mortgage sales are almost all advised, while half of internal switches are on an execution-only basis

4.2 The changes to our advice rules and guidance introduced by the MMR included the introduction of the 'interaction trigger' for advice. This required firms interacting with a consumer in a new mortgage sale to provide advice.[6] As a result, almost all new mortgage sales are advised (pre-MMR 70% of new sales were advised, post-MMR this has risen to 97%). Intermediaries almost universally do not sell execution-only. See the market overview in Annex 1.

4.3 For some internal switches, the situation is different. The interaction trigger does not apply when consumers choose a different mortgage with their current mortgage provider and do not borrow more. Lenders typically contact consumers ahead of a rate change, such as the end of an introductory deal, and many have developed easy options for consumers to switch to another product. Around half of internal switches (51%) are sold on an execution-only basis.

Impacts of advice on suitability and price

4.4 Our advice rules and guidance appear to lead to sales of suitable mortgages. As well as confirming our own expectations of firms, they can usefully inform others (such as the Financial Ombudsmen Service or the courts) about what we consider relevant to the provision of suitable advice.

6 Pre-MMR, many firms (lenders typically, but also some intermediaries) had a non-advised sales channel where staff would use scripted questions to guide consumers. Research found that many consumers who bought mortgages this way thought they were receiving advice but were not. We also found that some consumers in non-advised sales were buying unsuitable products. We found that some of the poorest practices and highest fees were from intermediaries that did not give advice.

4.5 Evidence from a sample of (post-MMR) sales reviewed in a thematic review (TR15/9) carried out in 2015 indicates that most involved the purchase of a suitable mortgage. This is an important benefit, although the fact that a mortgage is suitable does not necessarily mean that it best meets a consumer's needs.

4.6 Our current advice rules and guidance focus predominantly on suitability and no longer refer explicitly to price. As almost all new customers are channelled by firms to an advised route, it is likely that some consumers are being channelled unnecessarily into advice. However, further analysis we have carried out since the interim report suggests the harm from this does not appear to be large.

Innovation in mortgage distribution is limited

4.7 Lenders and intermediaries have told us that our advice rules and guidance are a barrier to innovation. To avoid inadvertently breaching our rules they do not develop tools to sell via execution-only. In particular, they mentioned:

- our Perimeter Guidance which states that where a firm gives generic information that leads to the identification of particular or several particular mortgage contracts they may be considered as giving regulated advice
- the 'interaction trigger' for advice which requires firms interacting with a consumer in a new mortgage sale to provide advice

4.8 These perceived barriers appear to restrict lenders' and (new and existing) intermediaries' ability to innovate to meet consumer demands for information and guidance in a non-advised, digital environment.

4.9 There has been limited appetite among established intermediaries and lenders to develop online advice propositions. We do not think that any specific provisions present barriers to online advice but firms appear to think that the FCA does not see a role for online mortgage advice.

4.10 Ultimately, it is for firms to consider whether and how to develop innovative tools (including online advice models). The FCA's Innovate Department can play an important role here. Innovate helps firms which are using innovation to improve consumer outcomes. We would encourage both new and established firms looking to bring innovative propositions to market to contact the respective Innovate teams:

- Advice Unit; provides regulatory feedback to both established and new entrant firms developing automated models to deliver lower cost advice and other services that help consumers make their own mortgage choices.
- Direct Support; a dedicated contact for innovator businesses that are considering applying for authorisation or a variation of permission and need support when doing so, or do not need to be authorised but could benefit from the FCA's support.
- Regulatory Sandbox; provides a live market environment that allows firms to test innovative products, services and business models, while ensuring that appropriate safeguards are in place.

Further analysis of our advice rules and guidance on suitability

4.11 Since the interim report, we have expanded the analysis of the effects of advice on the consumers who chose not to get mortgage advice before the MMR (See Occasional Paper 34). Using the same approach as in the interim report we looked at impacts of advice on certain measurable outcomes related to suitability and mortgage performance, such as the likelihoods of the consumer falling into arrears, needing forbearance or triggering an early repayment charge.

4.12 The findings show that, on average, consumers who bought a mortgage without advice (before the new rules resulting from MMR) experienced no significant change in any of these outcomes due to receiving advice, since the introduction of new rules following the MMR. This suggests that, many (but not all) consumers who opted out of getting mortgage advice before the MMR had sufficient financial capability to make suitable product decisions on their own.

4.13 There are some important caveats to these findings[7] but they do not dissuade us from the proposals we described in the interim report.

Remedies

What we want to happen

4.14 We are committed to identifying what changes we can make to our advice rules and guidance to reduce barriers to innovation in mortgage distribution.

4.15 At the same time, we recognise the important role our rules play in providing a degree of consumer protection for many borrowers, and we do not want to restrict access to advice for those consumers who can benefit from it.

What we have done and what's next

4.16 We have carefully considered the feedback on our interim report and we will consult on specific changes to our advice rules and guidance in the next quarter of this year.

7 Data constraints at present only allow mortgage performance outcomes to be measured for the first two years of the mortgage contract. The very low rates of arrears and forbearance in the overall population of the mortgage borrowers in these years currently make any effects more difficult to detect. And as with our estimates of the impact of advice in the interim report this analysis does not apply to any effects advice has on groups of consumers who chose to receive advice both before and after MMR.

5 More help for consumers choosing an intermediary

Summary of findings

- **A consumer's choice of intermediary matters** - We found that for consumers in very similar circumstances the choice of intermediary can affect the cost of borrowing by up to £400 per year during the introductory period of a mortgage.
- **It is difficult for consumers to compare intermediaries** - Current tools to help consumers choose an intermediary are few and limited in scope and coverage. They do not cover all intermediaries in the market, and do not have certain critical information that is pertinent to a consumer's assessment of the relative strengths of different intermediaries.
- **Any tool designed to help consumers choose an intermediary should be accurate and impartial, and gain traction with consumers** - It should be simple to use and include appropriately contextualised information.

Final findings

5.1 It is important that consumers' initial contact with any market takes place on an informed basis. This drives up quality among providers and improves competition between them, rewarding those firms that best meet customers' needs.

A consumer's choice of intermediary matters

5.2 There are strong financial incentives on an intermediary to find their customer a mortgage and to do so quickly, and this is in line with consumers' needs. However, the incentives on an intermediary to find a customer the cheapest (suitable) mortgage are weaker. This reflects what intermediaries with panels have told us about their panel strategies. They typically seek to cover a broad range of consumer circumstances (eg self-employed, poor credit history) to help ensure they can find a mortgage for a customer, rather than multiple lenders for a specific customer circumstance that would be more likely to lead to a better value mortgage.

5.3 Irrespective of whether they operate a panel, intermediary firms vary widely in the number of lenders they use. Some intermediaries use few lenders, while others place their business with more than 60 lenders. Even when the same number of lenders is used, intermediaries vary in how evenly they spread applications across lenders.

5.4 Choosing the right mortgage intermediary can have a significant impact on the cost of a mortgage. We found that intermediary firms that use a small number of lenders recommend more expensive products on average compared to intermediary firms who use a greater number. The price difference could be around £400 for the first year of the incentivised period (calculation based on the median loan amount). See Occasional Paper 35 for more details on the methodology.

It is difficult for consumers to compare different intermediaries

5.5 Consumers value intermediaries' services for a range of reasons. Our Financial Lives consumer research tells us, for example, that they believe intermediaries provide access to a wide range of products to help them to get a good deal, and they value intermediaries experience and expertise. There are a number of reasons why consumers choose a particular intermediary firm. The most common reasons given by consumers[8] as influencing their choice of mortgage intermediary include recommendations from a friend or relative (29%) and having used the intermediary before and being happy with the service (26%).[9] Around a quarter (23%) said they chose the intermediary because it was recommended to them by an estate agent. Our Financial Lives Survey 2017 also indicates that, of those who used an intermediary recommended by an estate agent, around 1 in 4 felt they had to do so.[10]

5.6 There are few tools currently available to help consumers choose an intermediary. One lender launched a tool in 2016 to help consumers find intermediaries in their local area. A small number of other independent websites also aim to help consumers identify, compare and choose an intermediary.

5.7 Current tools are limited in both scope and coverage. Participation is voluntary, so the tools do not cover all intermediaries in the market. And a lack of availability of certain useful information in existing tools means that they cannot provide consumers with all the information they need to compare the relative strengths of different intermediaries. For example, consumers cannot see the extent to which an intermediary uses lenders from across the whole market to find the best deal.

Any tool needs to be accurate and impartial and gain traction with consumers

5.8 We said in our interim report that any tool designed to help consumers needs to contain information that is relevant to a consumer's decision and needs to gain traction with consumers. Stakeholders have agreed with this, and provided helpful suggestions on the 'design principles' of such a tool and the information that should be included. We provide further details on this in the remedies section below.

Remedies

What we want to happen

5.9 We want consumers' initial contact with the mortgages market, when considering a new mortgage or remortgage, to be on an informed basis. We want consumers to have a means to access, assess and act on relevant and impartial information on the strengths of different intermediaries when seeking mortgage advice. In particular, information about intermediaries' services should clearly show the extent to which an intermediary *uses* a broad or narrow range of lenders and products, distinct from the range of products they *offer*[11].

8 Consumers who have taken out a residential mortgage (or switched product) in the last 3 years, and arranged this through an intermediary.

9 Financial Lives Survey 2017 (Question M48)

10 Financial Lives Survey 2017 (Questions M48 & M42). While sample sizes here are small, the findings fits with earlier research by ESRO where consumers report estate agents encouraging them to receive in-house advice to improve their chances of getting viewings and making offers on properties (ESRO consumer research 2015).

11 MCOB 4.4A

5.10 We believe this will incentivise intermediaries to use more lenders. This should drive up quality among intermediaries and improve competition between them (as well as competition between lenders). This might also help consumers referred to an intermediary by estate agents and/or developers. Consumers would be better placed to identify whether that intermediary offers the level and quality of service that they want.

5.11 Most feedback to our interim report supported our proposals for the development of a tool to help consumers to choose an intermediary. Many also commented on the challenges faced in designing a tool that is fair and workable.

What we have done

5.12 We gave the intermediary sector an opportunity to develop a way of enabling a consumer to more easily identify an intermediary that meets their specific needs. In July 2018, we set up a working group (WG) to support this, made up of consumer organisations and lender and intermediary trade bodies.

5.13 The group has agreed a range of success measures, which take account of feedback from stakeholders, to facilitate a solution that delivers against our objective while taking account of the challenges and the risks of unintended consequences. Design principles of the tool include:

- Traction with intermediaries (accurate, regularly updated, subject to verification and monitoring).
- Traction with consumers (accessible, user-friendly, credible, impartial, consistent and not easily gamed).
- Proportionate costs (development and maintenance).
- Commercial impact (not unduly disadvantaging existing commercial intermediary tool providers, not unduly benefitting larger intermediaries over smaller or specialist intermediaries).

5.14 Other feedback supports the inclusion of information on fees, the number of lenders intermediaries place business with, and areas of particular expertise such as lifetime mortgages, channels for communicating advice, and adviser certifications and qualifications. It also encouraged close links with our Financial Services Register and our proposed Directory.[12] The case for including information on complaints is weaker. This is due to the low number of complaints per intermediary and the difficulty in identifying complaints relevant to the intermediary's service (ie rather than the mortgage application process).

5.15 The consensus among participants on the working group was that the SFGB should host a tool (building on the existing MAS Retirement Adviser Directory). SFGB has confirmed it has a high number of consumers seeking mortgage information and guidance through its contact centre and website. And that extending the existing directory to cover mortgage intermediaries is a logical addition to its service which helps consumers find a retirement adviser.

12 The Financial Services Register is a public record that shows details of firms, individuals and other bodies that are, or have been, regulated by the PRA and/or the FCA. The Directory, which we consulted on and set out rules for, is a new public register for checking the details of key individuals working in financial services. The Directory will include information available through the FS Register, as well as information about a wider group of individuals. PS19/7 sets out the final rules on the Directory.

5.16 The proposed approach, subject to further discussion, refinement and agreement with stakeholders, is described in more detail in Figure 5.1. We believe that this approach is fair and workable, and will deliver an effective tool for comparing different intermediaries.

5.17 The approach is described in more detail in Figure 5.1. We believe that this approach is fair and workable, and will deliver an effective tool for comparing different intermediaries.

Figure 5.1 Summary proposals for an intermediary choice tool

Host	SFGB to develop and host a broker choice tool aligned with its existing Retirement Adviser Directory (currently under the MAS brand). Commercial entities should not be disadvantaged. To support this, any baseline data about firms provided by the FCA (eg from the FCA Register and proposed Directory) will need to be made available to commercial providers on equal terms. The success of the initiative, including the ongoing need for the SFGB to support a tool, will be reviewed.
Funding	Activities under the SFGB are funded from the existing financial services levy. The expectation is that this will be sufficient to fund the development and maintenance of a broker choice tool.
Key content, source, context, link to the Directory	See Annex 3 for proposed content. Some data can be sourced from the FCA's Register and proposed Directory (once the Directory is launched for mortgage advisers). The SFGB will design the means for collecting supplementary information in a way that minimises the burden and costs of participation on individual firms. Firms will be encouraged to provide the information voluntarily. The SFGB will lead work to design the tool. This includes agreeing how information will be presented and contextualised, how this will be captured from participating firms, and how the relationships between advisers, firms and networks will be presented. The SFGB will consult with working group members on this and options for verifying and enforcing data accuracy.
Incentives on brokers to participate	Participation to be incentivised through trade body advocacy, the positive support of lenders, and articles in the trade press. The uptake and success of the tool can be reviewed against agreed success measures (including the ability of consumers to make more informed choices) and consider whether a different approach is needed (eg further incentives or mandating participation).
Traction with consumers	The SFGB (currently under the MAS brand) has existing traction, through its website and call centre, with consumers who are considering a mortgage. It ranks highly in search engines, often receives referrals from other bodies, and many consumers already seek information about how to get mortgage advice and use its mortgage calculator and stamp duty tools. These, and other guidance material, can be linked to the Broker Directory. Trade bodies and lenders could also advocate a SFGB tool to consumers.
FCA rules	While the FCA could consult on rules to mandate participation or data disclosure, the preferred approach is to incentivise firms to participate because it is in their own commercial interest.

What's next

5.18 SFGB will undertake discovery work during quarter 2 and 3 to scope the project and establish exactly what information will be presented on the directory and in what format. It will do this by consultation with the FCA and industry and consumer representatives.

5.19 At the same time, we will engage with existing commercial providers of tools designed to help consumers choose an intermediary to seek to ensure that this approach does not unduly disadvantage them.

6 Switching: fair treatment for long-standing consumers

Summary of findings

- **Consumer engagement in the mortgage market is high** – over three quarters of borrowers switch within 6 months of the end of an introductory deal.
- **Inactivity is harming some consumers** – we estimate that about 800,000 consumers do not switch when they would benefit from doing so.
- **The harm is significant** – consumers who do not switch when they would benefit from doing so miss out on an average saving of £1,000 per year during the introductory rate period.[13]
- **Lenders' retention strategies and intermediaries' contact strategies continue to develop** – many firms already engage with consumers and make it easy for them to switch to another deal. Commission paid by lenders to intermediaries for retention business has become more prevalent.

Final findings

6.1 Currently, most mortgage products sold in the UK have a short-term introductory deal (often at a fixed interest rate). After this, the rate changes to another (reversion) rate such as a standard variable rate (SVR). Moving to a reversion rate often increases the interest rate and mortgage payments. At this point it is usually in a consumer's interest to switch to a new mortgage product to get a new introductory deal. Switching also drives competition between lenders to offer attractive rates to the benefit of other consumers.

Consumer engagement is high

6.2 Overall, we find that levels of switching at the end of the introductory period are high. Over three quarters of consumers switch within 6 months of moving on to a reversion rate. This indicates that the market works well for many, and that consumers are generally active and engaged.

6.3 Lenders tell us that this high level of engagement results from lenders and intermediaries proactively informing consumers about their options, and facilitating hassle free switching. The scale of the potential savings from switching are also relevant. Some stakeholders suggested that switching levels are even higher than they were at the end of 2016 (the period of our analysis). This is mainly due to an increase in brokered internal switches, reflecting the increase in the number of lenders paying an intermediary a commission for an internal switch.

13 Assuming an internal switch to a 2-year fixed rate with the customer's existing lender.

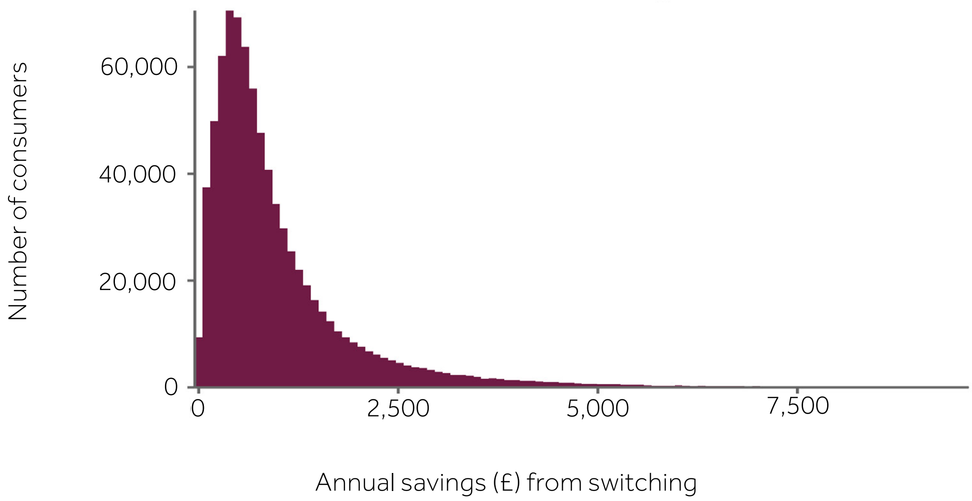
Some consumers are inactive and suffer harm from not switching

6.4 Although consumer switching is relatively high, there remain some consumers who can switch and would benefit from doing so but do not. We estimate that about 800,000 consumers (around 10% of mortgage holders) may be suffering harm as a consequence. This excludes consumers with small balances and short remaining mortgage terms and those on low legacy reversion rates who all have less to gain from switching. The figures also exclude consumers in arrears who may be ineligible for a new mortgage.

6.5 The costs of inactivity are significant. Our analysis indicates that these 800,000 consumers who do not switch when they would benefit from doing so could save significant amounts. On average, they could save £1,000 per year in the first 2 years (on a new 2-year introductory deal) and around £100 per year for the rest of the term of their mortgage.[14]

6.6 We also looked at the median savings for this group, and found that it is about £700 per year in the incentivised period (with median savings of about £60 per year after that). This means that 50% of consumers (400,000) would save at least £700 a year in the first two years with some consumers saving many thousands. Our analysis further shows that fewer than 100,000 consumers would save less than £20 a month (after any fees). Figure 6.1 sets out the distribution of estimated savings.

Figure 6.1 Distribution of annual savings for inactive consumers in 2-year period of an incentivised rate[15]



6.7 Some respondents have told us that consumers may choose to stay on an SVR for different reasons, primarily to gain flexibility, and not necessarily because they are inactive. We agree that flexibility is a feature that some consumers may consider worth paying for. For example, if they plan to move soon or where the savings from switching are considered relatively small. But, many inactive consumers have been paying a relatively high reversion rate for more than 5 years (around 70% of consumers on a reversion rate in 2016) making it unlikely that many are doing so to gain flexibility. We

14 Product fees and any monetary costs of switching are accounted for, with any fees added to the mortgage balance and repaid over the remaining term of the mortgage.

15 Our analysis assumes that a consumer takes the 'minimum effort' switching option, by switching with their existing lender. Taking account of fees, we assume each potentially inactive consumer switches, on 1st June 2016, to the most popular 2-year fixed rate product (for which they were eligible) offered by their existing lender in H2 2016.

believe there are other reasons that cause them not to switch when they would benefit from doing so.

Retention and contact strategies vary widely and continue to evolve

6.8 In responding to our proposals, many lenders told us that they proactively and effectively engage their customers in switching. Others have told us that they have recently begun to do so. The strategies existing lenders and intermediaries use have supported a market where most customers are engaged and switch when it is in their best interests to do so. Respondents to the interim report stressed this point.

6.9 However, past supervisory work into the retention strategies of some of the large banks found that not all firms engage with all customers. For example, one large lender appears to segment their customers and focus retention efforts based on an assessment of a customer's likelihood of switching to a different lender. Another large lender has historically not sought to proactively engage with customers remaining on a reversion rate for longer periods, but offers comparably generous retention procuration fees to intermediaries.

6.10 The greater prevalence of commission paid by lenders to intermediaries for retention business and the growth in non-advised internal switches appears to have incentivised intermediaries to contact customers more proactively. This could encourage switching.

Citizens Advice super-complaint

6.11 Since we published our interim report Citizens Advice made a super-complaint to the Competition and Markets Authority (CMA). They raised concerns about long term customers paying more than existing customers in a number of markets, including mortgages. Citizens Advice refers to this as 'the loyalty penalty'. Citizens Advice says that vulnerable and low-income consumers in the mortgage market are more likely to pay more.

6.12 Protecting more vulnerable consumers is a high priority for the FCA. Our initial analysis did not suggest that consumers who do not switch are more vulnerable than those who do switch. There are some differences between the two groups of customers, but they do not obviously explain why consumers appear to be inactive. For example, we found the median LTV for inactive consumers (49%) is slightly higher than for other residential mortgage holders (41%) and inactive consumers have slightly higher average income (median income of £43k compared to £37k).

6.13 In its response, the CMA has agreed that some consumers' inactivity can be exploited by firms. The CMA supported the FCA's findings and proposed remedies for inactive customers and those that cannot switch (ie 'mortgage prisoners'). It has also proposed a range of measures, across the various markets included in the scope of the Citizens Advice super-complaint.

6.14 For mortgages, the CMA recommends that the FCA conducts further analysis to better understand the characteristics of those customers that do not switch.

The structure of mortgage pricing

6.15 Most stakeholders supported our proposals to consider solutions to engage inactive consumers. Some respondents provided suggestions on how to proactively encourage more consumers to switch. Many of the suggestions are set out in Annex 2.

6.16 Some stakeholders questioned whether the real concern relates to what has become the standard pricing model for mortgages – a short-term introductory deal (often at a fixed interest rate) followed by a (typically higher) reversion rate. They questioned the focus on switching, suggesting that instead we should focus on lenders' use of introductory and reversion rates. For example, some suggested that addressing the differential between the two would better address the root cause of the issue and mitigate the harm to those customers that do not (or cannot) switch.

6.17 Some respondents (both firms and consumer groups) were sceptical that further demand-led remedies can have much impact on the 10% of consumers that are less active. They argued that the lenders were already making considerable efforts to engage their customers, and that it was unlikely that consumers who do not respond to these efforts will respond to other measures.

6.18 We do not believe that there is currently a strong case for changing the pricing model for mortgages. The rates of switching in mortgages are high compared to other financial markets, suggesting that this model works well for most consumers. We believe it is better to focus on helping the minority of consumers who do not switch when it would be beneficial for them to do so.

Remedies

What we want to happen

6.19 When a customer moves from an introductory rate to a reversion rate it is usually in their interest to switch to a new mortgage product (ie to a new introductory deal) offered either by their existing lender or a different lender. Switching also drives competition between lenders to offer attractive rates to the benefit of other consumers.

6.20 Switching in mortgages is high compared to other markets. But around 800,000 customers do not switch when it is in their interests to do so. We would like to see more switching where it is beneficial for consumers.

What we have done

6.21 We have taken steps to ensure we have sufficient data on switching. In December 2018, we published our consultation on possible changes to mortgage reporting requirements. These include requiring firms to provide sales data about internal product transfers. These data will allow us to monitor internal transfers and understand possible conduct and competition harms in the market. The consultation recently closed and we will publish the feedback and any final rules in summer 2019.

6.22 Relevant to this issue is our recently-published discussion paper on fairness of pricing in financial services. Fairness in pricing is a complex issue. Our paper covers 2 issues:

firms charging different prices to different consumers based solely on differences in consumers' price sensitivity (also known as 'price discrimination') and firms charging existing customers higher prices than new customers (sometimes called 'loyalty pricing' or 'inertia pricing'). These pricing practices, the latter of which is common in the mortgages market, can disadvantage some consumers significantly. But the judgement of when price discrimination is fair is not always straightforward.

6.23 We have committed to exploring with lenders how they can make it easier for consumers to switch. Since we published our interim report, we have set up a working group of lender trade bodies to explore how to make switching easier for those that would benefit from doing so.

6.24 So far, the group has focused only on consumers who cannot switch (see Chapter 7). However, the group will also consider what more can be done to encourage the inactive consumers to switch when it would benefit them.

What's next

6.25 We have begun further research to better understand the characteristics of those customers that do not switch (when they would benefit from doing so). This includes considering whether these consumers have particular needs or common characteristics, or whether the numbers are concentrated in specific lenders such as those who do not proactively offer internal switches.

6.26 Once the research is complete, we will consider how best to target any potential remedies on those customers that would benefit most, reflecting progress the working group makes. Also taking account of ongoing work on the fairness of pricing in financial services, we will report back later this year.

7 Switching: fair treatment for consumers who are unable to switch

Summary of findings

- **Some consumers may benefit from switching but are unable to do so despite being up-to-date with their mortgage payments** - These consumers are sometimes called 'mortgage prisoners'.
- **We estimate that there are a relatively small number of mortgage prisoners who have mortgages with active lenders** - This number is relatively small because switching internally is usually easier than moving to a new provider.
- **Most mortgage prisoners appear to be with inactive firms** - For example mortgage books in run off or those sold to firms that are (legitimately) outside our regulatory perimeter.
- **It appears that most (but not all) mortgage prisoners took out their mortgage or last switched before the impact of the financial crisis** - But a similar situation could occur in the future for different reasons.
- **There is widespread support across the mortgages market for helping mortgage prisoners** - In July 2018, UK Finance announced a voluntary agreement among some of its members to allow existing customers to switch to a new rate without any new credit or affordability checks.
- **We have committed to removing potential barriers in our rules to customers switching to a more affordable mortgage** - We are consulting on proposed changes to our responsible lending rules to deliver a more proportionate, modified affordability assessment for consumers who are up-to-date with payments on their existing mortgage and who are looking to switch to a more affordable mortgage without borrowing more.

Final findings

Characteristics of consumers who may be unable to switch

7.1 The mortgage market has evolved into one where customers take out a series of short term deals. As described in Chapter 6, most consumers in the mortgage market appear well engaged, with switching rates higher than in many financial services markets.

7.2 A number of consumers are unable to switch despite being up-to-date with their mortgage payments and not seeking to borrow more. These consumers are sometimes called 'mortgage prisoners'. Many of them are unable to switch as a result of changes in lending practices during and after the 2008 financial crisis, and the regulatory response that tightened lending standards. But a similar situation could occur in the future for different reasons.

7.3 We consider that consumers are incurring harm if, now or in the future, they are unable to switch to a more affordable mortgage despite being up-to-date with their mortgage payments. This is because the consumer is paying higher than necessary mortgage payments.

7.4 The existence of mortgage prisoners is not a case of rule breaches by lenders, nor is it necessarily a judgement about the use of reversion rates in the mortgage market. And it is to be expected that credit risk appetites fluctuate to a degree over time so that some lenders may choose not to lend to a consumer who was previously able to get a loan.

7.5 The total number of affected consumers is relatively small but the harm for each, from paying relatively high reversion rates over an extended period, is significant. A small number of these consumers have a mortgage with an active lender that applies (now more restrictive) affordability checks for existing customers wanting to switch to a new deal, or does not offer new products to existing customers. Most have a mortgage with inactive firms that do not offer new mortgages. For example, firms that are authorised to lend but have stopped doing so, or firms that are not authorised to lend. The chart in Annex 4 also sets this out.

A small number of mortgage prisoners have mortgages with active lenders

7.6 Using detailed product sales data from 2016, we estimate that around 30,000 consumers on a reversion rate with firms authorised to lend would benefit from switching but cannot. This is despite them being up to date with payments on a relatively high reversion rate.

- Around 10,000 of these consumers hold mortgages with 'active' lenders that continue to lend to new and/or existing customers. This figure is relatively small because many lenders tell us they do not carry out any new credit or affordability checks on existing customers applying to switch to a new introductory deal.
- The remaining 20,000 are with firms that, although authorised to lend, are no longer active.

Most mortgage prisoners are with firms that are inactive and/or not authorised to lend

7.7 In addition to the 20,000 consumers (referred to above) with firms that although authorised to lend are no longer actively lending, there are potential mortgage prisoners with firms that are not authorised to lend.

7.8 Under the current legal framework, mortgage accounts can legitimately be sold on to firms that are not authorised to lend.

7.9 We hold insufficient detailed data on these mortgage books to estimate the overall number of borrowers on a reversion rate that are unable to switch. However, using aggregated data collected we estimated that around 120,000 customers of firms not authorised to lend could potentially benefit from switching. And, given what we know about these mortgage books from other FCA work, it is possible that many of these customers will also face barriers to getting a new deal despite being up to date with payments.

7.10 The limited information we have does give some insight into the characteristics of these consumers. They appear more likely to have an interest-only mortgage and have a relatively high loan to value mortgage. Moreover, some of these customers had poor credit history when they originally took out the mortgage.

7.11 This aligns with the hypothesis that these consumers have characteristics that are now considered too high risk by lenders and cannot switch because of (i) major changes to lending practices during or immediately after the crisis, and (ii) the subsequent regulatory responses aimed at preventing a return to past poor practices. It also supports our assertion that most consumers who would benefit from switching, and are up to date with payments, but may not be able to do so took out their mortgage or last switched before 2009 (before the impact of the financial crisis).

Other consumers who are up-to-date with payments and not borrowing more but unable to switch

7.12 We are aware that there are others who may not be able to switch despite being up to date with their payments. For example, because their circumstances have changed since they took out their mortgage or last switched. A similar situation could occur for certain consumers in the future but for different reasons, such as a fall in house prices.

Consumers in arrears

7.13 In addition to the 150,000 accounts mentioned above, around 100,000 accounts on a reversion rate for the duration of 2016 H2 were in arrears by one monthly payment or more. There are also some consumers with unauthorised lenders who are in arrears. The consumers are not up to date with payments and therefore not demonstrating they are able to afford their existing mortgage. We do not define them as mortgage prisoners, but we expect lenders to treat these customers fairly.

7.14 In MCOB 13, we set out how we expect firms to treat customers in payment shortfall. This includes making reasonable efforts to agree with the consumer how that shortfall can be cleared and considering forbearance options given the customer's individual circumstances.

7.15 We recently completed a thematic review on management of long-term mortgage arrears and forbearance (TR18/5). Our review found that firms generally treated customers in long-term financial difficulty appropriately. But we also found some inconsistencies in firms' arrears management practices that may result in a poor customer experience and have the potential to cause harm.

Are reversion rates the driver of harm?

7.16 Some stakeholders questioned the focus on switching. They suggested that instead we should focus on lenders' pricing structure. They felt that addressing the differential between introductory and reversion rates would better address the root cause of the harm and mitigate against the risk of future prisoners. We considered the arguments for focusing on SVRs rather than switching in Chapter 6.

There is widespread support for helping mortgage prisoners

7.17 There is widespread support for tackling this issue. There are more potential solutions for customers of active lenders, but some stakeholders also support seeking solutions for the more challenging issue of customers of inactive lenders.

7.18 More cautious respondents suggested more work was needed to understand why consumers who have paid their mortgage for over 10 years were still unable to evidence affordability. Others pointed out that the ability to meet payments in the current low interest rate environment did not mean they would be able to maintain payments in a stressed scenario or repay their interest-only mortgage at maturity. Some lenders were concerned they were being asked to take on more risky lending.

Remedies

What we want to happen

7.19 The fair treatment of existing customers is one of the FCA's cross-sector priorities. We want to make switching easier for customers who are up to date with payments and not borrowing more.

What we have done

Mortgage prisoners with active lenders

7.20 In July 2018, we convened a round-table meeting with lenders and lender trade bodies and challenged them to help us tackle this issue. We also set up a working group of lender trade bodies to consider the issues in more detail.

7.21 Lender trade bodies responded to our interim report by facilitating a voluntary agreement which covers large and small (active) lenders (reflecting around 95% of the market). They have agreed to commit to help their existing customers who previously didn't qualify for a switch to find a better deal, providing they meet the minimum criteria set out in Figure 7.1.

Figure 7.1: Minimum qualification criteria agreed by industry for the lender voluntary agreement

To qualify, customers of participants to the agreement need to be:

- first-charge owner-occupiers
- an existing borrower of an active lender
- on a reversion rate
- looking for a like-for-like mortgage
- up to date with payments

They must also have a minimum remaining term of 2 years and a minimum outstanding balance of £10,000.

7.22 We understand that lenders have already contacted qualifying customers (those who had not previously been offered an internal switch) to offer a switch to a better interest rate. We welcome this agreement – it is good news.

7.23 This agreement is not limited to pre-crisis borrowers and so should also help a small number of consumers in addition to those primarily affected by the financial crisis. For example, those who continue to maintain their mortgage payments but cannot switch due to a change in circumstances. However, there are lenders accounting for 5% of the market that have not yet signed up and we will monitor what proportion of mortgage prisoners have mortgages with these lenders.

Mortgage prisoners with inactive firms

7.24 Lenders are not required to offer new products to existing consumers, and some do not. Where a customer of an inactive firm is unable to switch to a new lender the situation is more complex.

7.25 We are committed to tackling the more complex issue of helping consumers who have mortgages with inactive firms and cannot switch despite being up-to-date with payments and not seeking to borrow more. Lenders have told us that they may have appetite to lend to some of these customers, but that there are regulatory barriers preventing them from doing so. Lenders have said that barriers include our rules that require firms to demonstrate, based on an assessment of income and expenditure, that the consumer will be able to afford the mortgage including under a stressed interest rate scenario.

7.26 We have sought to (i) better understand the characteristics of those consumers who are unable to switch, and (ii) explore the extent to which lenders could place greater reliance on consumers' past track record of making mortgage payments when demonstrating affordability.

7.27 We are consulting on changes to our responsible lending rules to deliver a more proportionate, modified affordability assessment for consumers who are up-to-date with payments on their existing mortgage and who are looking to switch to a more affordable mortgage without borrowing more. See our detailed proposals in CP19/14.

7.28 We also want to be better informed about consumers whose mortgages are with firms that are not authorised to lend and are outside our perimeter. So, we have also consulted on changes to the mortgage reporting requirements on mortgage books that have been sold to unregulated entities. For more information, please see CP18/41.

What's next

7.29 We are working closely with the lender trade bodies to monitor the impact of the lender voluntary agreement through our industry working group. We will assess the effectiveness of the agreement and consider whether further action is needed.

7.30 We will consider feedback to CP19/14.

Glossary of terms and abbreviations used in this document

CMA	Competition and Markets Authority
External switch	A change of mortgage from one lender to another
FCA	Financial Conduct Authority
Financial Lives	FCA's biennial consumer survey
FOS	Financial Ombudsman Service
HHI	Herfindahl-Hirschman Index
Internal switch	A change of mortgage deal with the same lender
LTI	Loan-to-income
LTV	Loan-to-value
MAS	Money Advice Service
MCD	Mortgage Credit Directive
MCOB	Mortgages Conduct of Business sourcebook (a module of the FCA Handbook)
Mortgage prisoner	A consumer who would benefit from switching but is unable to switch despite being up to date with payments
MMR	Mortgage Market Review
MMS	Mortgages Market Study
OP	Occasional Paper
PRA	Prudential Regulation Authority
Procuration fee	Fee paid by a lender to an intermediary for new business
PSD	Product Sales Data
Remortgage	An external switch (see above)
Retention procuration fee	Fee paid by a lender to an intermediary for an existing borrower switching to new mortgage with the same lender.
SFGB	Single Financial Guidance Body

Soft factors	Non-price factors (such as speed of service) that are not strictly observable in PSD
SVR	Standard variable rate

Annex 1:
Market overview

Introduction

1. A mortgage is a secondary product many consumers need to buy and retain a home (the primary product). For existing homeowners it can also be a means of releasing money by borrowing against the value of their home.

2. In the UK, consumers typically take out a long-term contract (eg a mortgage with a term of 30 years) but switch regularly to get the best deal (eg every 2-5 years).

3. For many consumers, the value and term of a mortgage can make it a significant financial commitment. In 2016 for first-time buyers the median loan size was around £135,000 with a median initial term of around 30 years.

4. We provide a brief overview of the main features of the UK mortgage sector below. A more detailed description of the market can be found in Chapter 3 of the interim report.

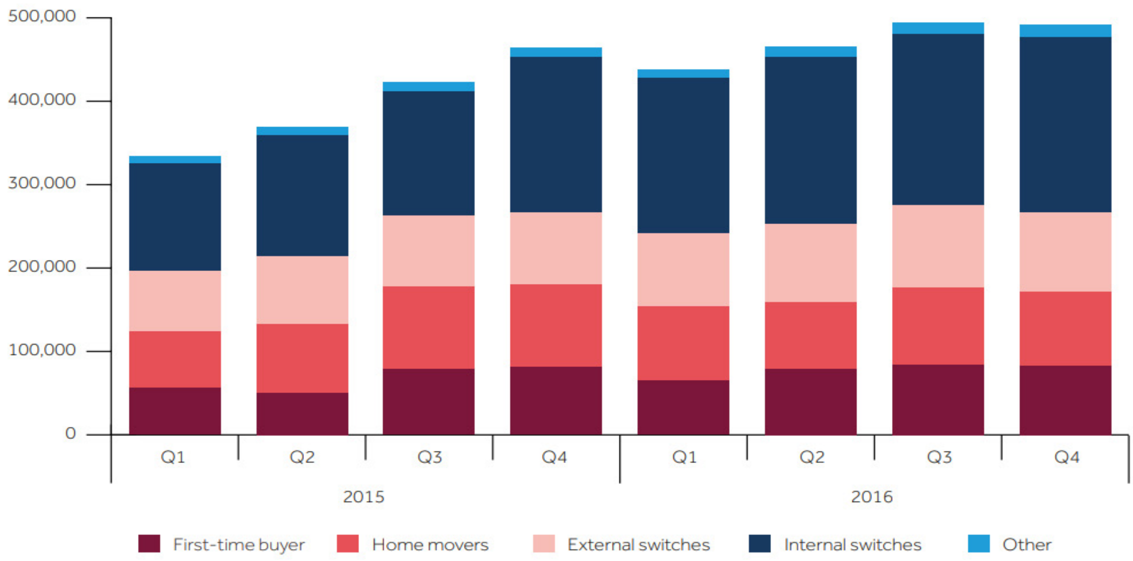
The size of the mortgage sector

5. The mortgage sector is significant in the UK economy. The regulated residential mortgage sector is currently worth at least £1 trillion, with roughly 8 million outstanding mortgage accounts in 2016.[16]

6. In 2016, there were around 1.9 million mortgage transactions. Figure 1.1 shows that internal switches accounted for around 42% of mortgages arranged in 2016 while consumers moving their mortgage to a different lender (external switches) accounted for around 20%. The remainder comprises mortgages for house purchases (first-time buyers and home movers) and others (including lifetime mortgages).

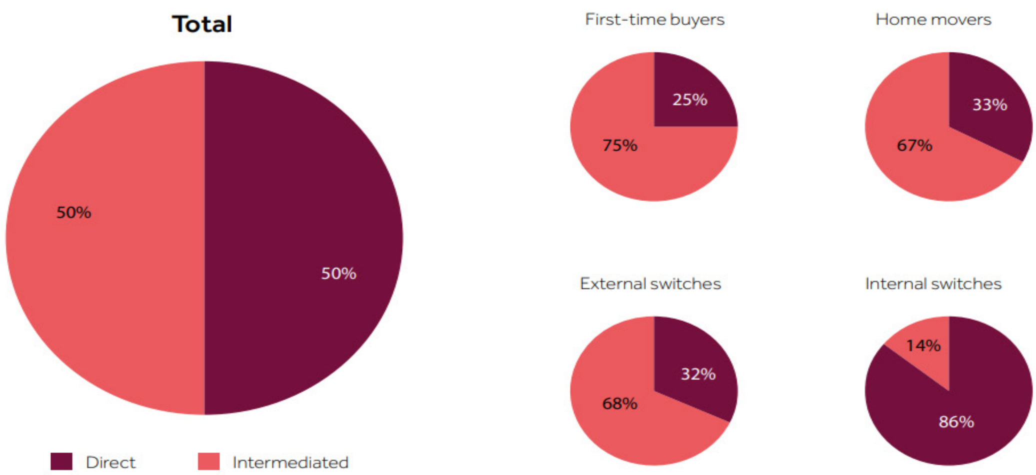
16 MLAR; PSD. Does not include mortgages entered into before 31 October 2004 or mortgages administered by a regulated firm on behalf of a beneficial owner which is not regulated.

Figure 1.1: Number of transactions between 2015 Q1 and 2016 Q4



7. Figure 1.2 below shows what proportion of these transactions were arranged by the lender (direct) or by a third party brokering the deal (intermediated).

Figure 1.2: Breakdown of mortgage transactions by direct and intermediated in 2016

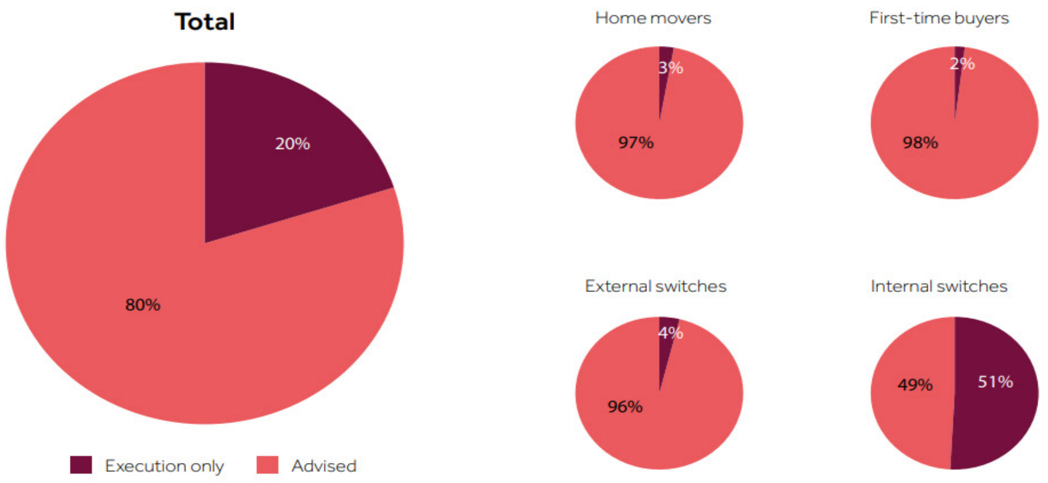


8. Around 50% of all transactions in 2016 were direct[17] in large part driven by the high proportion (around 86%) of internal switches that are arranged directly.

9. Around 80% of all transactions in 2016 were advised. Of the 20% execution-only mortgages shown in Figure 1.3, the majority is made up of internal switches of which around half are carried out on an execution-only basis.

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

Figure 1.3: Breakdown of mortgage transactions by advised and non-advised in 2016



Firms in the market

10. There were around 100 active lenders in 2016.[18] The 6 largest lenders[19] account for around three-quarters of the outstanding balances and market concentration has remained broadly stable in recent years.[20] The lifetime mortgage market is much smaller and more concentrated - 10 lenders were responsible for almost all lifetime mortgage sales in 2016.

11. Intermediaries range from larger firms with thousands of mortgage advisers, to firms consisting of a single adviser. With around 4,000[21] directly authorised intermediaries currently active in the market, the sector is not particularly concentrated.[22] The lifetime mortgage market is largely intermediated although only a small number of intermediaries arrange lifetime mortgages - 10 intermediaries were responsible for approximately 80% of sales in 2016.

12. Intermediaries are remunerated for these services by fees paid by the consumer or commission payments paid by the lender, or both. Many intermediaries also earn revenues from sales of protection and other services.

Products

13. The personal and financial circumstances of consumers, the property, and lenders' risk appetite will determine how much consumers can borrow, from whom, and at what

18 Some 180 lenders sold one or more mortgage in 2016, while 94 of these sold more than 100 mortgages.
19 Lloyds, Nationwide, RBS, Santander, Barclays and HSBC are the top 6 lending groups in the mortgage market.
20 Estimates of market concentration based on the Herfindahl-Hirschman Index (HHI) show that the market for mortgage lending is not particularly concentrated, fluctuating between 1,000 and 1,200 since 2012. See the Competition and Market Authority's Merger Assessment Guidelines (September 2010, CC2/OFT1254) for more.
21 We estimate that some 4,000 directly authorised intermediaries sold one or more mortgages in 2016 H1, while around 240 of these sold more than 100 mortgages.
22 The intermediary market is not concentrated – the HHI is around 250. In 2015 the top 10 intermediary firms accounted for around 45% of intermediated sales.

price. There are also regulatory factors here such as our responsible lending rules, prudential requirements, and the FPC's macroprudential levers.

14. In the current market, most mortgage products sold in the UK include some form of rate management feature, such as a short-term introductory deal at a fixed interest rate, after which the rate changes to a reversion rate (such as the lender's standard variable rate (SVR) or a rate linked to a benchmark rate).[23] At the expiry of the introductory deal consumers often transfer to a new mortgage product, either with their existing lender (an internal switch) or a new lender (an external switch). Over three-quarters of consumers switch to a new deal within 6 months of moving onto a reversion rate.

15. There is a large number of products available with a range of different features available such as the ability to make over and/or underpayments, the portability of the mortgage when moving property, and offset mortgages where interest payments are reduced to take into account savings held with the mortgage lender.

Consumers

16. In order to take out a mortgage, consumers need to meet certain criteria set by a lender, for example they need to demonstrate their ability to afford to service the mortgage. As such, mortgage holders are not entirely representative of the overall population. For example, residential mortgage holders are more likely to be working, and have higher household incomes compared with all UK adults. Residential mortgage holders are also more likely to consider themselves to be confident and savvy consumers and have higher levels of confidence in managing their money.

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

- **Loan-to-Value** - a consumer seeking to borrow more money relative to the value of their home presents a higher risk
- **Affordability** - whether the consumer can afford to service the mortgage, accounting for income and expenditure
- **Employment status** - Nature of employment (or trading history of a self-employed consumer). The more secure the employment the lower the risk
- **Credit profile** - a consumer with an impaired credit history is likely to be higher risk
- **Nature of the security** - most lenders restrict the type or location of the property they will lend on

18. As a result of this, different consumers have a different range of mortgages to choose from and some may face higher prices for those that are available to them.

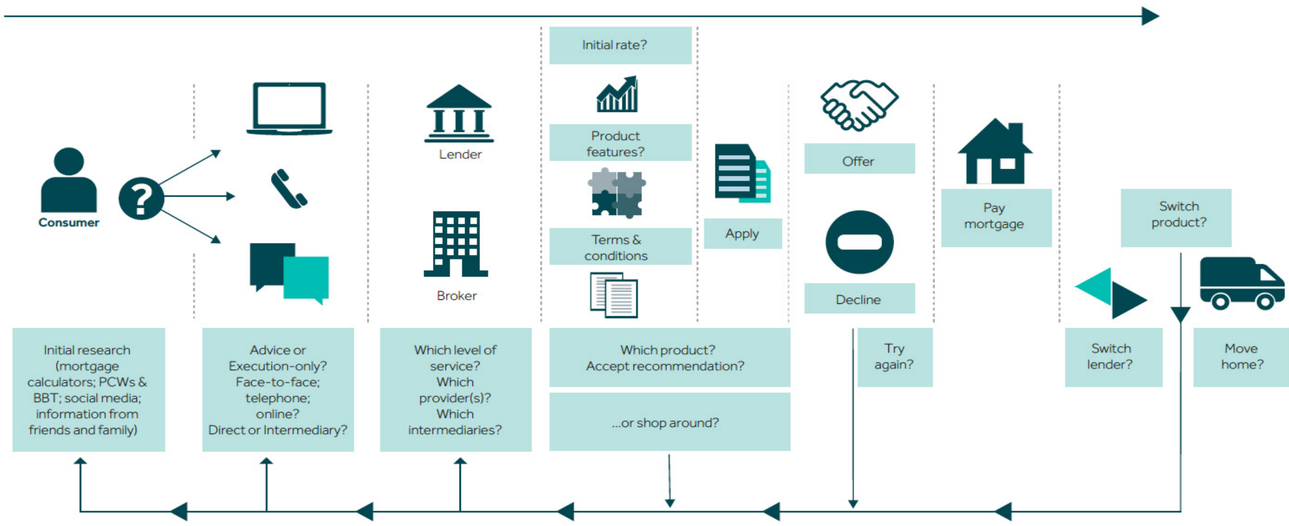
23 For example the Bank of England base rate or the London Interbank Offered Rate (LIBOR).

The consumer journey

19. There are some elements of a mortgage sale that are always present, such as an application, lender offer, and acceptance by a consumer. Some elements are present for some consumers but not all, such as the receipt of advice or use of an intermediary.

20. Consumers therefore have the option of taking a number of possible routes through the stages of buying a mortgage. Figure 1.4 below illustrates one version of the journey, covering some of the main decision points.

Figure 1.4: Consumer mortgage buying journey



Annex 2: Detailed feedback on our interim report and our response

Making it easier for consumers to choose the right mortgage

Feedback on findings

Feedback	Response
Our analysis overstates the potential benefits of shopping around. Some respondents argued that our modelling focused too heavily on price and that we failed to take into account other factors, for example speed of service. They argued that this resulted in overstatement of harm from not taking out a cheaper mortgage. They argued that we over-estimated the missed savings.	See paragraphs 2.15 to 2.25 in the main report.

Feedback on remedies

Feedback	Response
Creating an eligibility tool is too complex. Some respondents argued that creating tools that make it easier to identify the products for which consumers will qualify is too complex and impractical. They argued that lenders will need to share their full qualification criteria, which lenders would be unwilling to do.	We are not seeking to develop a tool (to help consumers understand whether or not they qualify for a mortgage) ourselves. We are seeking to create the circumstances in which the market could develop such tools. Similar tools already exist in other financial markets (eg in general insurance) and some tools are already being developed for the mortgages market. This gives us confidence that similar tools can be developed for the mortgages market. Participation and collaboration across the whole of the market is key for such tools to deliver the benefits we want to see. The working group we established aims to support that, and we are considering whether additional measures are needed.

Reliance on new eligibility tools could lead to poor consumer outcomes if advice is not received, especially for vulnerable consumers. Some respondents argued that eligibility tools might lead to an increase in consumers buying unsuitable products. They consider that the existence of eligibility tools might lead more consumers not to take advice, which in turn might lead them to choose unsuitable or poorer value products. They argued that consumers will be at risk of focusing on finding the cheapest product, while there are other factors that determine the suitability and overall value of a mortgage.	We acknowledge this risk. But we believe that the risk is manageable and that the benefits from having such tools significantly outweigh the risk. • The risk is manageable – There are existing rules around affordability that continue to apply in execution-only sales. There are also rules aimed at protecting vulnerable consumers which mandate that advice is given to certain vulnerable consumers groups (eg those consolidating debt). We will also monitor the market to look for signs of emerging risks, including to vulnerable consumers. • The benefits of having tools outweigh the risks – Eligibility tools will help consumers who don't want or need advice to choose a suitable mortgage. They are not necessarily a substitute for advice and will also help intermediaries to find the best products for their clients.
Eligibility tools might reduce the number of options available to some consumers. Some respondents argued that eligibility tools might make it harder for lenders to exercise judgement on certain eligibility criteria in grey areas or niche circumstances (eg where a consumer may be borderline on certain criteria). This would lead to less choice for consumers, particularly those in more complex situations. They argue that the tools might provide a simple yes or no answer on qualification, whereas the reality is sometimes more nuanced.	We acknowledge that any eligibility tools developed by the market may focus, at least initially, on consumers with more straightforward needs, not those with the most complex circumstances. Lenders' approach to niche or grey areas will remain within their gift to determine. We also consider that, in time, the data can be used in ways that will allow for greater granularity, so that the tools can also help consumers in niche circumstances.

Giving consumers more choice about the support (including advice) that they need

Feedback on findings

Feedback	Response
Our modelling of advice is too focused on price and ignores other factors and benefits from suitability.	See paragraphs 2.15 to 2.25 in the main report.
The FCA's analysis of advice is based on data from 2015/16 which have limited relevance today. Some respondents argued that the period of 2015/16, on which the analysis is based, is not representative of current market conditions. Therefore, they argue, the conclusions we drew from this analysis, are not applicable to the market today.	See paragraphs 2.26 to 2.28 in the main report.

Feedback on remedies

Feedback on the proposed remedy and our response will be included in our forthcoming consultation paper.

More help for consumers choosing an intermediary

Feedback on findings

Feedback	Response
An intermediary choice tool is not needed and the cost of creating one outweighs the potential benefits. Some respondents argued that there is limited evidence that consumers need, or will benefit from, enhanced intermediary choice tools. They considered that most consumers will not have the capability to assess the necessary trade-offs, to benefit from such a tool. They further argued that the costs of delivering new intermediary choice tools will outweigh benefits. Other respondents agreed that making it easier to choose an intermediary could be beneficial for both consumers and the industry. A number of stakeholders provided helpful suggestions on the 'design principles' for creating an intermediary choice tool and the information that should be included.	Our analysis identified that a choice of intermediary significantly affects the cost of borrowing (up to £400pa during the introductory period of a mortgage). We found in particular that intermediary firms that use a small number of lenders recommend more expensive products on average compared to intermediary firms who use a greater number. We also found that the current available tools are few in number and limited in scope and coverage, making it difficult to compare the relative strengths of different intermediaries. We therefore believe that an effective intermediary choice tool, that helps consumers choose the best intermediary for their needs, is both needed and can make a significant impact. Furthermore, we believe that providing consumers with information about intermediaries' services, including the range of lenders and products an intermediary uses, could incentivise intermediaries to use more lenders, which will in turn improve competition between lenders. We acknowledge the feedback on the challenges of creating an effective tool, including the need for it to be clear and simple, so that it creates traction with consumers. The working group designing the tools has been considering this feedback and embedding it in the design principles.

Feedback on remedies

Feedback	Response
It is unclear how the proposals fit with existing rules, tools and initiatives in other markets. Some respondents argued that in considering the design of the intermediary choice tool, existing initiatives in other intermediated markets should be considered. They considered that there are benefits to providing consumers with holistic, cross-market solutions. • existing commercial adviser choice platforms • the strategy and objectives of the Single Finance Guidance Body (SFGB) including options to extend the Money Advice Service's (MAS) Retirement Adviser Directory • the FCA's proposals for a new Directory which will list all Certified staff under the Senior Managers and Certification Regime (SM&CR)	We recognise that there are other tools and disclosures that deliver information on intermediaries. However, these tools do not contain all the information consumers need to make an informed choice. Importantly, they do not contain information on the number of lenders a mortgage intermediary uses, which has the greatest impact on the price of the mortgage. The working group is collaborating with the SFGB, working with providers of existing tools, and building on links to the FCA register and proposed Directory.
Information contained in the tools needs to be contextualised, accurate, impartial, and not open to 'gaming'. Any tool must: • be user-friendly, credible, accurate, relevant, impartial and consistent • not unduly benefit larger intermediaries • be cost-effective, regularly updated and subject to verification and monitoring	We agree with these important points on how to make the intermediary choice tool as effective as possible and fair to consumers, intermediaries and lenders alike. The working group has considered them in its work, and its terms of reference include them as success measures.
It is not the FCA's role to push for a commercial solution. Indeed, commercial firms already offer a directory.	The working group has had regard to the legitimate commercial interests of intermediaries, as well as existing 'find an intermediary' tool providers.
Respondents supported the inclusion of intermediaries in the Lifetime and Second charge market in the scope of the tool.	The working group has considered inclusion of such intermediaries.

Switching: fair treatment for long-standing consumers

Feedback on findings

Feedback	Response
We overstate the size of the issue. • Most consumers are engaged and switch. This is better than in other financial markets. The percentages of consumers switching continue to increase, with the recent move to pay procuration fees to intermediaries for internal switches supporting more switches. • Although the average saving might be £1,000pa the saving for some consumers might be very small. • Many of the relatively small number of consumers on SVR may choose to do so because of the lack of a significant benefit from switching and the flexibility remaining on SVR gives them.	While proportions of consumers not switching may be relatively low, for many who stand to save by switching, savings are material. We have reviewed the distribution of estimated savings and find that the median saving for the 800,000 consumers is £700pa (so half would save at least £700pa). A significant proportion of consumers not switching remain on a reversion rate for 5 years or more (eg 69% for more than 5 years) for whom the benefits of flexibility are much less apparent.

Feedback on remedies

Feedback	Response
Potential unintended consequences from increasing switching by consumers who pay a higher rate and are inactive. • Proposals to increase switching could have an impact on pricing of new mortgages. Firms will have to offset the loss of income by raising prices. This will result in a zero-sum game, and no real benefit to consumers overall. • The financial and prudential positions of some building societies might be at risk from this loss of income. These proposals conflict with the PRA's expectations that building societies manage assets on administered rates.	While an increase in switching might lead to increased prices for new customers, it is likely to have only a modest impact on most firms. This is because most mortgage consumers already switch. We will consider the price and prudential implications (liaising with the Prudential Regulatory Authority (PRA)), when developing the demand side switching remedy with the working group.
There is an **inappropriate focus on price** - lender communications should encourage consumers 'to engage their mortgage intermediary so that a full discussion on needs and circumstances can take place'.	The working group will be considering demand side interventions that are the most effective in engaging long term inactive consumers with switching.
The FCA should undertake further work to establish why consumers do not switch; **a behavioural approach is needed**. Switching communications should be more proactive, consistent, better tailored to consumer circumstances with comparisons.	We agree there are benefits to behavioural approaches and tailored communications. We consider these as part of our work and interventions on an on-going basis.

Suggested demand-side solutions included: • Adopting a consistent and standardised approach across firms, including, where relevant those who do not currently offer internal product switches. For example: • requiring all lenders to prompt customers 12 months, 6 months and 3 months before their introductory rate expires - with the benefits of switching clearly explained • an annual reminder setting out the specific costs and benefits of switching providing comparable illustrations including the total cost of credit • prompts that encourage consumers to use intermediaries to check for a better suitable deal • Obtaining a better understanding of why some consumers do not switch and using behavioural economics and nudge techniques to design solutions tailored to those consumers and their communication preferences • Labelling mortgage costs and rates differently such as renaming standard variable rates as an 'expired rate' • Use of outbound calls or encouraging 'regular reviews' • Product innovation tailored to those on low incomes or with a short remaining mortgage term	We are grateful for these suggestions and will consider them in the working group.

Switching: fair treatment for consumers who are unable to switch (often referred to as 'mortgage prisoners')

Feedback on findings

We received no specific feedback in relation to the findings on mortgage prisoners.

Feedback on remedies

Feedback	Response
Almost all respondents agree with the proposals to help those borrowers who are unable to switch as a result of market-wide changes in lending criteria.	
The proposal that active lenders voluntarily offer products switches to their own customers **should be a compulsory requirement** (consumer representative)	We do not think this is necessary. Around 95% of the active mortgage market has signed up to the industry agreement.
There was general support for work to identify solutions for consumers with inactive lenders who are unable to switch. These included: • the **removal of regulatory barriers (eg MCD, PRA/FPC, MCOB) to facilitate an external switch for some borrowers.** • options to **widen the perimeter**; and • **requiring inactive firms to offer new product switches**.	We have published a consultation paper which sets out proposed changes to our responsible lending rules and guidance. These aim to remove any unnecessary regulatory barriers for consumers looking to switch and who are up-to-date with payments and not seeking to borrow more – see CP19/14. We considered the option of requiring inactive (unregulated) firms to offer new product switches. But this would necessitate a widening of the perimeter to bring these firms into our remit. The regulatory perimeter is a question for Parliament and will require changes in legislation. Better reporting of data from these firms will help FCA/Government consider ongoing fair treatment of these consumers. We have consulted on this in FCA – CP18/41.
The FCA should **work with the government on a potential scheme** to address this specific issue.	We have kept Government updated on our consultation paper proposals. Our preferred approach is to facilitate a more market based solution.
The problem is a failure to enforce existing rules, with lenders segmenting their existing customers and unnecessarily denying borrowers access to mortgage products or lower rates; and a rigid interpretation of the MMR affordability requirements.	Firms have largely implemented our responsible lending rules. We believe that the primary cause is changes in market risk appetite reinforced by regulatory intervention post-crisis. The voluntary agreement will help address any potential segmentation issue by participating lenders.

Annex 3: Proposed content for an intermediary choice tool

The table below sets out the consensus amongst the working group on the criteria that should be used in an intermediary choice tool, and the additional information that the tool should allow intermediaries to provide. The working group's approach to developing an intermediary choice tool is detailed in Chapter 5.

Recommended criteria
Clear summary of the degree of lender market coverage / lenders used for each market • Metrics and context to be agreed
Remuneration (Fees / Commissions) • Options and context to be agreed
Relevant products and markets supported including substitutable products (eg Equity Release, Second Charge, Additional finance (refinance), Help to Buy, B2L) • Areas of expertise/specialisms (eg Self Employed, Credit-impaired, High Net Worth etc)
Channels for communicating advice (Telephone, Face to Face, Email; Online; omni-channel) (can tick more than one) • For face to face; geographical coverage is required
Relationship of adviser to Firm; Group etc
FCA Authorisation / Permissions (Firm)
Adviser Certifications / Qualifications
Minimum (and maximum) loan amount considered
Minimum and maximum (estimated) purchase price / value of security supported
The tool should also offer brokers the option to provide information on:
Website; Social Media
Free Initial Consultation; ongoing review
Services provided in languages other than English (languages offered)
Hours of service
Other services offered (eg protection propositions, pension, retirement income, financial planning, investments, debt management, holistic financial advice)
Consumer Reviews; feedback; or links to review sites

Annex 4: Summary of customers who cannot or do not switch

In June 2016 there were
8.04 million
mortgage borrowers with authorised lenders

2.04 million
were on a reversion rate for 6 months or more

6 million
were on an introductory rate, or on a reversion rate for less than 6 months

Borrowers who were unable to switch

30,000 could not switch and would benefit

20,000 could not switch but would not benefit

Borrowers who could switch

800,000 could switch and would benefit

160,000 could switch but unclear if they would benefit

790,000 could switch but would not benefit

Other borrowers

100,000 were in arrears

140,000 were near the end of their mortgage

A further
260,000 had mortgages with firms that are not authorised for mortgage lending

120,000 were likely to benefit from switching

120,000 were unlikely to benefit from switching

20,000 were in arrears

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