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Loud and Clear

Brokers have welcomed moves in the FSA's latest MMR paper to ban non-advised sales and demand greater clarity over lenders' provision of advice to consumers

It took its time but the final consultation paper for the Mortgage Market Review came as an early Christmas present for the industry.

The Financial Services Authority worked flat out to ensure mortgage brokers didn't have to eat their turkey and sprouts without the mammoth paper beside them.

Speaking at the Mortgage Business Expo in November, Sheila Nicoll, director of conduct policy at the FSA, warned brokers to expect a huge doorstop of a document to arrive - and in this respect it did not disappoint.

But compared to the backlash over the last MMR consultation paper, published in the summer of 2010, it was a positively festive document with glad tidings for the industry.

The FSA had toned down some of its more contentious proposals to effectively ban interest-only and fast-track while retaining core principles of stricter affordability checks and income verification.

But the real surprise was the ban on non-advised mortgage sales, which the broker market hailed as a victory for the role of advice.

"There is no doubt this is good for brokers," says Ray Boulger, senior technical manager of John Charcol. "If a higher proportion of sales are advised, brokers' share of the market must increase."

It is high praise indeed for a regulator that has often been accused of unfairly attacking the broker market.

There were other causes for optimism as the plan to scrap the Key Facts Illustration was abandoned and the Initial Disclosure Document consigned to the dustbin.

There is also now no need for a separate KFI for direct-only deals but brokers will have to provide a KFI for each different product they offer, if a KFI is specifically requested or for execution-only deals.

The regulator officially binned the idea of all mortgages being assessed on 25-year terms, having revealed the plan earlier last year.

Furthermore, it has introduced more flexible transitional arrangements to help mortgage prisoners in negative equity and has clamped down on the bridging market.

Known Unknowns

Despite the new detail in the 700-page report there remain, to paraphrase former US defence secretary Donald Rumsfeld, many known unknowns, particularly over the costs to the industry and the role of European regulation.

The FSA estimates that overall the changes could cost the industry up to £170m a year on top of an initial one-off bill of £65m.
But those estimates are subject to huge variations, with ongoing annual costs ranging from £47m to £170m while one-off costs vary from £40m to £65m.

The primary reason is the difficulty in assessing capital compliance costs for lenders, which could be anything from £16m a year to a whopping £126.8m. One area where the FSA is clearer is the cost to itself, which it estimates to be negligible with no range.

It’s not just mortgage firms who will feel the impact of this huge piece of regulation but prospective homeowners too.

The FSA is predicting the new rules would have prevented 17% of all mortgages in the boom. The fact that the regulator considers almost one in five loans dished out in the boom to be unsafe lending aptly illustrates the scale of the problem it believes must be tackled.

Easy credit was also a major factor behind booming house prices in the last decade so the FSA estimates that by 2022, homes will be 11% cheaper than they would have been without the MMR rules.

The economy too may be affected, with GDP as much as 0.2% lower over the decade.

The consequences are huge for mortgages, housing and the economy, which will naturally affect the broker market.

Further on the negative side is a worrying - and apparently contradictory - prediction by the regulator that the number of brokers will continue to fall as more borrowers go direct.

In its cost benefit analysis the FSA predicts the MMR will accelerate the trend of consumers moving away from brokers. It also claims some lenders would be more likely to use direct channels as they are forced to take more control of affordability assessments.

This is bleak reading for the sector, so why have all mortgage trade bodies and the industry been so welcoming of the latest paper?

No advice, no mortgage

One theory put forward by industry insiders is that the impact assessment for direct deals was undertaken before the FSA finalised its rules on non-advised sales.

It claims that this assessment is now outdated and the proposed rules would benefit brokers. This is backed up by the Association of Mortgage Intermediaries, which praised the move as positive.

The Council of Mortgage Lenders says it is too early to make a full assessment but warns that any moves must not create barriers to lenders offering mortgages.

“One of the potential benefits of having all advised sales is that consumers may have greater clarity over what service they are being given,” says a CML spokesman. “But clearly we need to see how the rules are drafted and how they would be applied.

“We are at the early stages of what will be a long consultation process and we will be looking carefully at the proposals and how they affect our members,” he adds. “We will be pressing for rules that provide clarity for the consumer without creating any unnecessary barriers for the industry.”

Boulger agrees that the latest MMR is good news for brokers.

“Some lenders offer a choice between information-only and advice, some offer all advised and others simply offer information-only,” he says.

“Clearly those that offer information-only will be most affected but those who offer the choice of advice may also have cost implications if they have a high proportion of non-advised sales.

“The FSA is doing this because of concerns that a large majority of customers who go direct believe they have received advice when they haven’t,” he adds.

“It is a problem that the FSA has struggled to resolve because mortgage sellers must ask questions to offer an appropriate product but that leaves customers believing they have had advice.”

This gets to the heart of why many believe we won’t see a trend of lenders choosing to go direct rather than via brokers. Boulger believes the moves could also see a change in lender attitudes towards brokers as they become more valued.

“It may make lenders value brokers more highly,” he says. “Lenders that rely on direct channels may have to sharpen their rates and criteria if they want to attract brokers.

“Lenders will have to consider the costs of getting their branches up to scratch. Some may decide it is too difficult or expensive and choose to outsource more business to brokers.”

But lenders are cautious over how the plans will affect their sales processes, claiming it is too soon to make predictions.

Andrew Baddeley-Chappell, head of mortgage strategy and policy at Nationwide, says it undertakes both advised and non-advised sales through its branches but the difference between the two can be relatively small.

“Given that the MMR will be making wider changes to the whole sales process, it is still too early to assess the overall impact of the changes that are proposed,” he says.

“Mortgage customers and their requirements vary greatly and it is still to be tested whether the proposed regime will adequately and efficiently accommodate the full range of mortgage transactions - including those looking for the best deal for existing borrowings.”

Halifax offers both advised and non-advised sales in its branch network and customers decide which to use at the start of their mortgage appointment. A Halifax spokeswoman says most branch sales are advised but it sees a proportion of non-advised sales too.

“However, given that the significant majority of our advisers are qualified to provide both, we do not expect to make any significant changes to our sales process,” she adds.

While these lenders claim there is little extra cost, the ban on non-advised sales is one of the most significant areas for lenders. One lender source describes the ban as the most contentious area of the latest MMR, though he adds it is too early to formulate positions.

Considering the backlash to a European proposal to make advice compulsory and force mortgage sellers to offer a range of products, one would expect lenders to lobby against theses changes.

Fast-track is dead - long live fast-track

Another seemingly positive move for brokers is the survival of fast-track - albeit under a radically different guise.

Income verification will be required for all mortgages so it will be a different beast post-MMR. Brokers will still be allowed to verify income but they will need to pass information to lenders, leaving them with ultimate responsibility.

The MMR states that systems are already in place to deal with evidence passed from brokers from non fast-track business.

“It does not appear to be overly onerous to propose that this happens for all applications, given the benefits that would be achieved,” it says.

Applicants will be able to pass pay slips and bank statements through their brokers, and lenders will be able to use existing customer data, such as current accounts, to verify income.

Aaron Strutt, broker at Trinity Financial, says lenders have been clamping down on fast-track practices for years now.

“Brokers already have to keep original copies of any documents in their office and the lender can come and check them,” he says.

He adds that Abbey for Intermediaries, for example, has a two strikes policy, which means that if it finds brokers don’t have the documents twice then they are struck off.

“So I don’t think simply handing over the verified income documents to the lender will have much impact,” says Strutt.

The FSA is still demanding human intervention in income verification, however, which means self-cert is dead and buried.

Lender responsibility has been a key feature of the entire MMR, particularly their affordability assessments.

But Charles Haresnape, managing director of residential mortgages at Aldermore, believes brokers should still have a role in checking affordability.

“MMR outcomes are fairly predictable,” he says. “They make sense in the main but I do wonder why intermediaries are no longer required to assess affordability in order to give advice.

“And some of the changes, including those to interest-only calculations, will require significant and costly system changes for lenders. I hope the cost benefit analysis has factored this in.”

Interest-only lives

Interest-only borrowing ballooned during the boom and at one point accounted for 30% of all mortgages, according to FSA data in the MMR paper on responsible lending in 2010.

FSA data in the MMR shows that around half of all interest-only deals had no repayment vehicle in place. Clearly the FSA would be concerned that a niche product had obtained such a prominent role.

Initially the FSA appeared to ban interest-only altogether in its responsible lending reform but now it is allowing it to continue so long as a repayment vehicle is in place.

Jane Manning, head of compliance at Crown Mortgage Management, says it is a return to the lending practices of a decade ago.

“Crown is witnessing first-hand the impact on borrowers who took out interest-only loans without a suitable repayment vehicle or strategy in place,” she says.

“Some of these are reaching the end of their mortgage term and for many, there is no alternative to the loss of their home.”

Nigel Stockton, financial services director at Countrywide, says the MMR had to review interest-only. “Frankly, interest-only mortgages were used far too widely as a way to bend lenders’ affordability calculations before the credit crunch,” he says.

“I was pleased to see the recommendations for interest-only mortgages. By not completely bolting the door on interest-only mortgages, the FSA is allowing buyers with clear and credible repayment plans in place to access these types of loans. This is entirely right for people who have interesting tax positions and some high net worth clients.”

A bridge too far?

Other niche areas affected include bridging, which saw wide-ranging changes to the industry.

Bridging has been under the spotlight for the last six months and it is little wonder that the FSA has sought to take action.

In her speech at the Mortgage Business Expo in November last year, Nicoll issued a warning over the misuse of bridging loans and admitted the area was becoming a growing concern for the regulator.

Days after Nicoll’s speech the FSA fined non-advised mortgage seller Fastmoney £28,000 for failing to ensure that customers who took out bridging loans were treated fairly.

It also banned its owner and director, Simon Latham, and former chief executive, Stuart Mason, from performing significant influence functions in future, while Latham was also fined £17,500.

AMI has also warned brokers that they may be risking regulatory reproach by using unregulated bridging lenders, so attention to bridging in the MMR is not surprising.

The FSA proposes to define a bridging loan as lasting no more than 12 months and being secured against a property.

It also plans to ban speculative repayment methods for bridging such as its ability to repair borrowers' credit. And it wants interest-only strategies from short-term lenders and credible exit plans for borrowers put in place.

Despite the seeming clampdown, a senior member of the bridging industry, who asked not to be named, said it was a relief that the FSA did not go further. In particular, they were happy that a distinction between short and long-term lending remains.

But Rob Jupp, managing director at Brightstar Financial, says he is disappointed the regulator has not gone further to tackle bridging while the MMR highlights remaining areas of concern to the regulator, including inaccurate reporting of unregulated loans, bridging being used by vulnerable borrowers and the quality of underwriting. It adds that brokers must justify why a bridging loan is required and a mainstream mortgage is unsuitable.

The European mortgage directive also pledged to regulate all bridging loans when it was published last March.

Buying an exemption

Another niche area given special treatment is high net worth clients who received a series of exemptions from the MMR.

Notably, high net worth clients will be exempt from mortgage rules and are set to be defined as those earning £1m or holding assets of no less than £3m. They will also be able to take out interest-only deals with looser repayment vehicles based on future earnings and speculative investments.

It seems that high net worth clients will be treated more like commercial mortgages without the added protection of consumer deals.

Boulger says much of the MMR debate will address who is allowed to opt out of aspects of the rules.

“High net worth clients are usually intelligent people but they are not experts in the mortgage market and their cases are often complicated so they use brokers,” he says. “They are also used to paying fees for accountancy and legal services.”

High net worth broker Enness Private Clients supports the exemptions but believes the definition is too high.

It points out that the Consumer Credit Act defines high net worth individuals as earning £150,000 a year income or having assets of no less than £500,000.

Hugh Wade-Jones, director of Enness Private Clients, says that given the nature of many high net worth individuals' income and assets, it is right to treat them separately.

“We are certainly not advocating lending to individuals without any income,” he says.

“But if we have someone who, under normal mortgage rules, has a non-standard income, yet can put down five years' worth of mortgage payments on account on day one, we feel they should be viewed as just as secure a lending prospect as someone who is borrowing on the back of their income alone.

“The proposals for high net worth clients on interest-only also make perfect sense. The high-street lenders’ obsession with putting loans over £500,000 on a capital and repayment basis has got out of hand and is a little confused,” he adds.

Always look on the bright side of life

Some in the industry have been frustrated by the fact that there is no mention of individual registration in the paper. This was the measure announced in the original MMR discussion paper in 2009 that received almost universal praise.

Assigning all brokers a number would have helped to ensure that rogue brokers had no place to hide. But to the bafflement of many in the industry, in December 2010 the FSA announced that it was putting this move back until 2012/2013.

“It is disappointing that a concrete timetable for individual registration was not announced, but the FSA says this remains on its radar, so hopefully we’ll hear some news soon,” says Paul Shearman, proposition director at Openwork.

But overall, there’s no getting away from the fact that these concerns seem minor compared to the huge positive of the FSA moving to wholeheartedly support advice.

It is the first time the regulator has really put its neck on the line to say that non-advised sales are unsafe for consumers.

This is surely tacit recognition of the important role of mortgage advisers, and brokers in particular, in creating a safer market.

It also shows recognition of broker concerns that consumers are confused as to whether they have received advice or not when entering a branch.

Brokers have been making this point at events ever since there was confusion in the October 2010 distribution and disclosure paper.
There is also reason to cheer the extra clarity the latest paper bring even if the rules have not yet been finalised.

Lenders can now set their lending policies with greater confidence and there is hope that those who rushed to implement policies that have since been dropped may think again.

Lenders had already begun to act upon rules applying to interest-only changes, the 25-year-term affordability assessment and mortgages for the over 75s.

Boulger believes the increase in clarity means lenders could relax their criteria slightly in these areas.

“Lenders have claimed they are under FSA pressure to make changes but when we ask the regulator, it says there is no pressure,” he says.

“Noticeably, Woolwich has been assessing affordability on 25-year terms but that is no longer a proposal in the MMR so it will be interesting to see what it does.

“Lenders cannot hide behind the regulator as an excuse any more for some of their lending policies.”

So there is much to be pleased about, with some brokers positively crowing about the move to ban non-advised sales.

It's a positive development in a dour market and evokes Mark Twain's famous comment upon reading reports that he had died.

"Rumours of my death are greatly exaggerated," he quipped. Moving into 2012 and post-MMR, the broker market can echo that sentiment.

Then and Now: What has changed?

The FSA has changed its stance on a number of key MMR issues. Here is a breakdown of what has changed since the last MMR papers in 2010.

Key Facts Illustration

THEN: Initially set to be replaced with IDD and separate KFI needed for direct deals
NOW: KFI needed for each product offering but no separate one needed for direct deals

Affordability checks

THEN: All affordability for mortgages to be assessed on 25-year terms
NOW: Proposal axed in consultation

Mortgage prisoners

THEN: No mention of any help for those in negative equity
NOW: Beefed up transitional arrangements and more relaxed criteria allowed to help those in negative equity who are struggling to move home

Advised sales

THEN: Non-advised sales were allowed in branches with a vague appropriateness test
NOW: Non-advised sales banned altogether unless expressly requested in detail or for high net worth clients

Interest-only

THEN: Fears the clampdown on interest-only meant it was effectively banned
NOW: Interest-only remains as a niche product, although more concrete repayment vehicles are needed

Bridging

THEN: Largely ignored in previous MMR papers
NOW: Wide-ranging clampdown on the booming sector, defining it as a 12-month loan or less and banning speculative
bridging