

Discussion Paper Response

FSA DP09/3: Mortgage Market Review

January 2010

1. Our General View

The Chartered Insurance Institute is the world's leading professional body for insurance and financial services with 95,000 members in more than 150 countries. We are committed to protecting the public interest by maintaining the highest standards of professional and technical competence and ethical conduct. Our Charter remit is "to secure and justify the confidence of the public and employers" in insurance and financial services. Our membership includes 4,158 members¹ of the CII Society of Mortgage Professionals (SMP) which is the UK's largest society of mortgage broking, adviser and related roles.

There is a clear need to improve public trust and confidence in the mortgage market, and this links directly to our Charter remit. The FSA's Mortgage Market Review could go a long way towards bringing this about. While other post-Turner Review regulatory measures such as those related to prudential supervision may have the added effect of improving lending practices, other reforms will be necessary to create a sustainable market in the future.

While it is essential that this review primarily focuses on improving firm-level conduct, the financial crisis has also illustrated a need to improve the ability and behaviour of individual practitioners. For example, some issues worth considering include:

- Do practitioners consider the longer-term interests of their customers?
- Or are they driven by the commercial desire to make a sale and meet their customers' short-term interest.
- Are practitioners demonstrating appropriate technical competence in the areas in which they practice?

This is why we emphasise raised standards of conduct and professionalism including qualifications, a mandatory code of ethics, continuing professional development, and a disciplinary regime. Many of the proposed reforms will address key aspects of mortgage product design and distribution process. However we are concerned that there should be more proposals related to individual professional conduct.

To better reflect the views of existing professionals, we have undertaken a survey of SMP members. The survey ran from late December 2009 to 22 January 2010, and about 5% of total membership responded. 87% of respondents were mortgage advisers, of which the majority (85%) were independent brokers or IFAs. The 12% of non-adviser respondents came from compliance, sales or technical functions. The questionnaire was designed to match the specific consultation questions wherever possible. Please see Appendix A of this paper for full details of our survey response.

2. Conduct of Business Reform

We support the inclusion of Mortgage Conduct of Business rule reform within the wider MMR. The FSA's approach on being cautious about product regulation is a sensible one. Although there are merits to imposing limits for certain types of consumers, this needs to be done very carefully considering the potential implications:

- No matter how well targeted, imposed product limits could have serious unintended consequences. They could do more to block appropriate lending than prevent unsustainable practices. More seriously,
- Such regulation could send the inadvertent message that the regulated products are inherently safe and that assistance with distribution in the form of advice is not necessary.

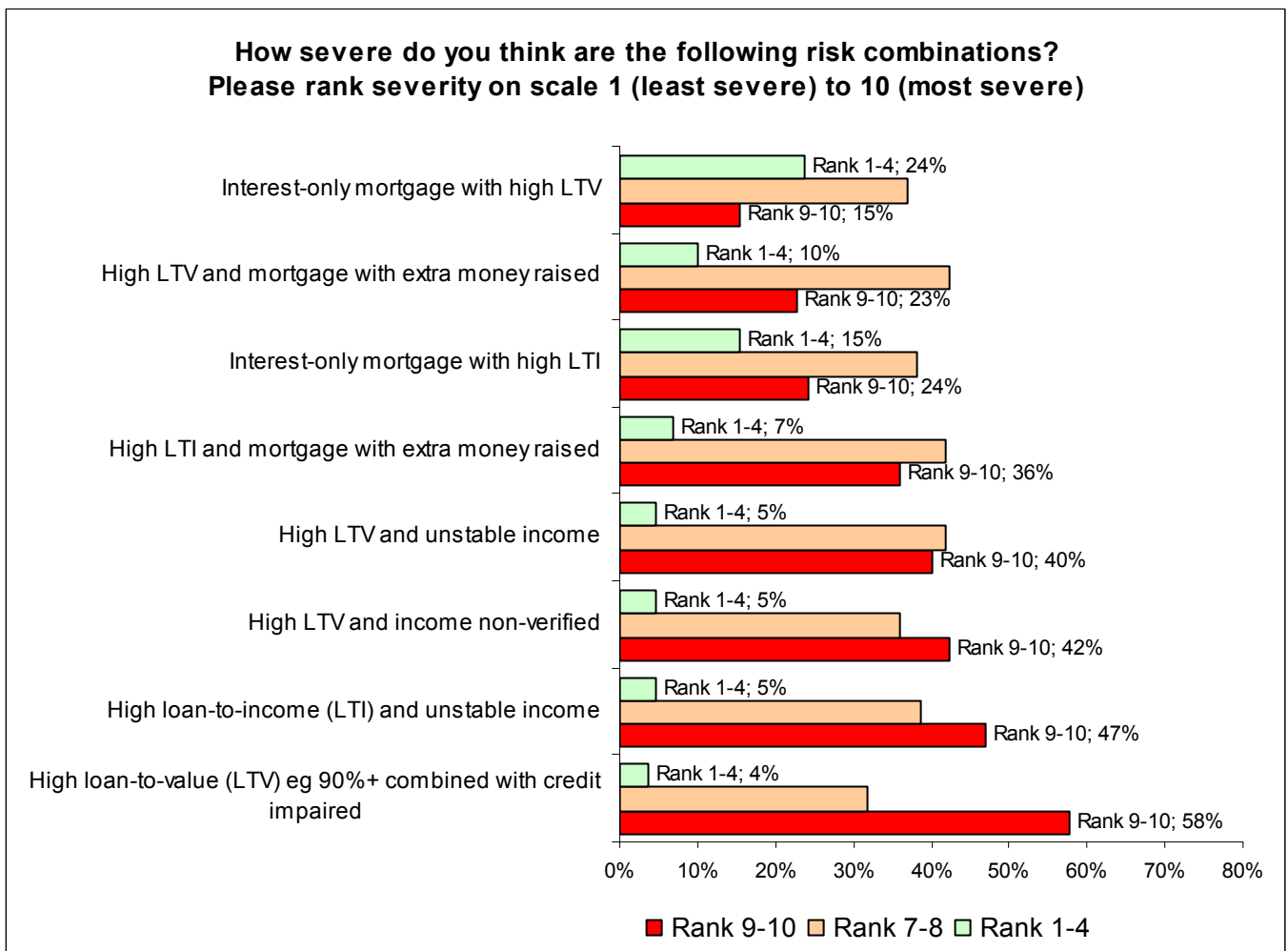
¹ This includes all members, qualified and otherwise, as of 22 January 2010.

Therefore our perspective is that we favour focusing on managing the conduct of individual practitioners. By individual practitioners, we mean not just advisers but others with authority, who must exercise sound judgment on a case-by-case basis. Efforts to enhance professionalism would equip practitioners both technically and ethically to approach their complex tasks.

Prohibiting loans to borrowers exhibiting certain multiple high-risk characteristics

Q6: Do you consider that the FSA should prohibit the sale of mortgages to borrowers with multiple high-risk characteristics? If yes, what particular combinations of risk factors should the FSA consider prohibiting and why?

The suggestion of only prohibiting lending to borrowers who exhibit certain multiple high risk characteristics is more sensible than imposing ceilings on single measures. Nearly four-fifths of our members agreed that multiple high-risk characteristics should be the correct approach, and when asked to rate which risk combinations were most severe, top scores were given to high-LTV combined with credit impaired or unstable income.



While multiple high-risk characteristics may help inform lending policy, we would be concerned of any product regulation that imposed blanket restrictions along these lines. Any widespread restrictions would be a blunt instrument given the complexity and diversity of the mortgage market, and these could do more to damage the mortgage market than enhance confidence in it. We would favour placing the burden of responsibility on the relevant practitioner to assess affordability and exercise professional judgment on a case-by-case basis.

3. Distribution and Advice

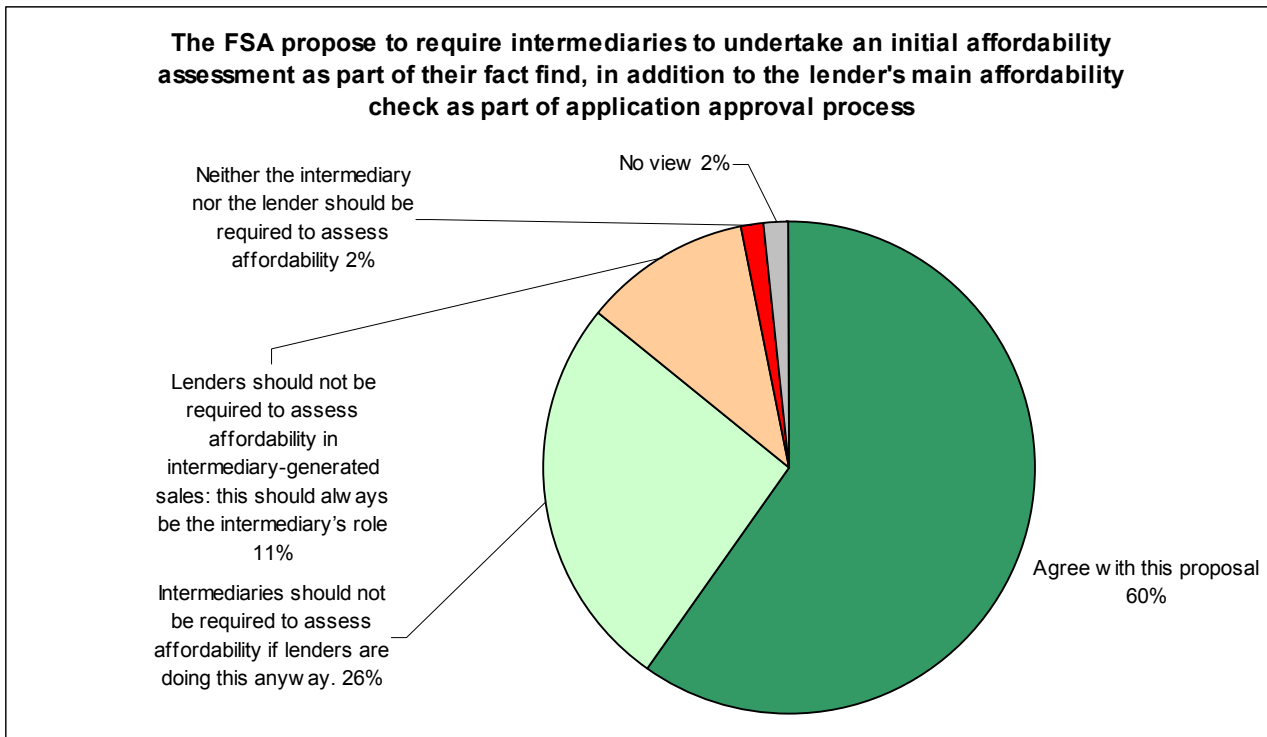
This section which covers the conduct of practitioners, as opposed to specific processes, forms the core of our interest in the FSA mortgage market review. Generally we take the view that enhanced professional conduct of all mortgage practitioners, not just those advising or selling the products, will improve public trust and confidence in the market.

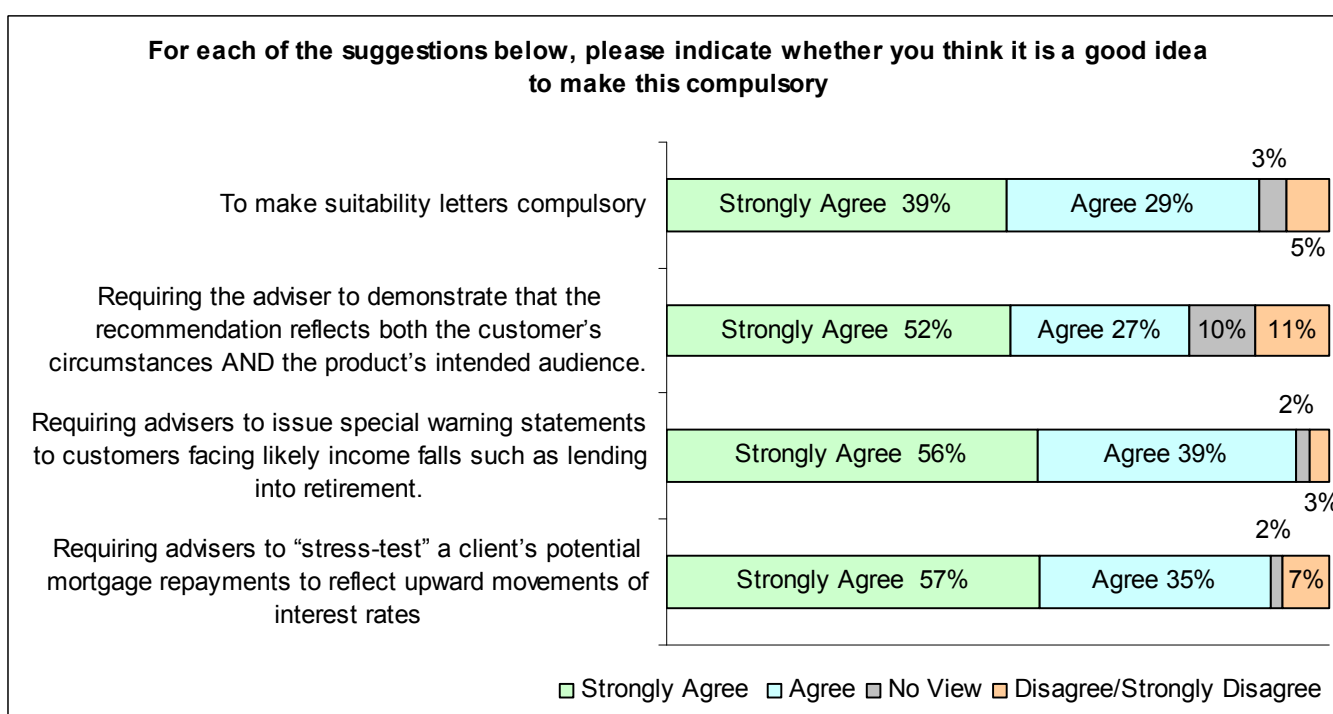
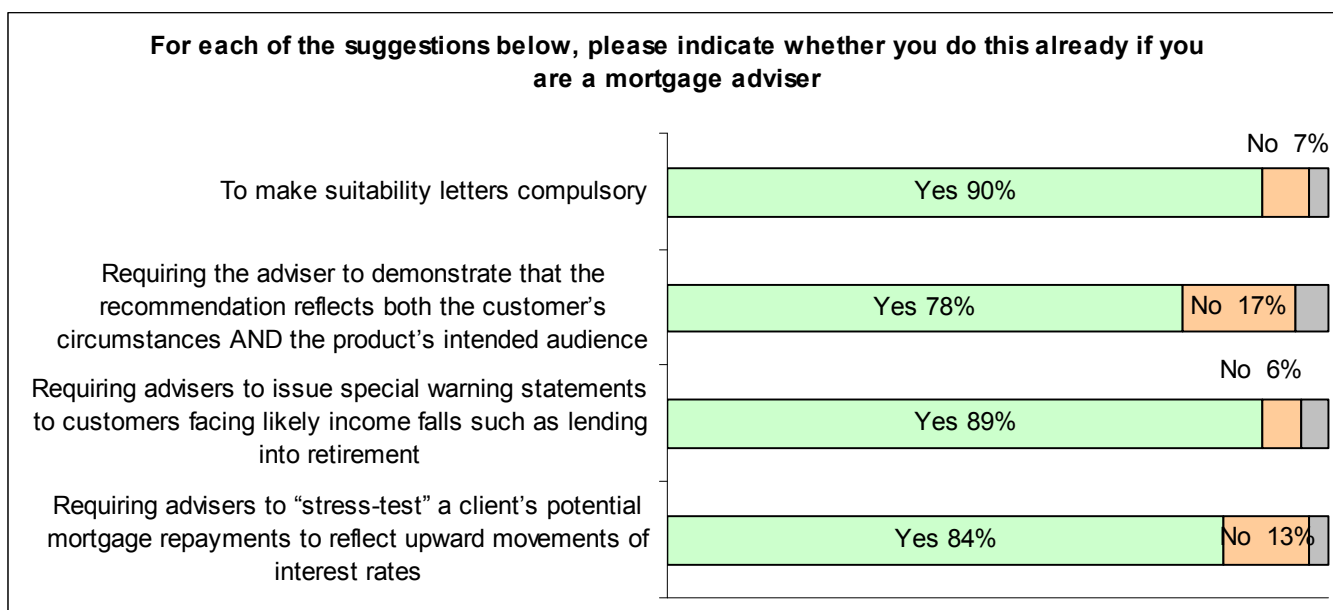
There is a case for reading across at least some of the proposals currently considered under the Retail Distribution Review (RDR). The FSA correctly points out that many of the issues present in the retail investment market are not necessarily relevant to the mortgage market. Nevertheless some of the professionalism proposals may be applicable, and the FSA should consider supplanting them in a targeted fashion.

Intermediary affordability assessments for advised sales

Question 15: To what extent should intermediaries retain responsibility for assessing a consumer's ability to repay? How could this work in practice?

We agree that intermediaries should retain a key role in assessing affordability as part of the advice process. The suggested approach of requiring the adviser to undertake a preliminary assessment and then making the lender ultimately responsible for the lending decision combines the best aspects from both parties. This was the view of the majority of our SMP members in the survey: 60% of respondents (who were mainly mortgage advisers) agreed with the FSA proposal. Of the remainder, more felt that it was the lender's role to assess affordability (25% took this view) than the adviser (11%).





Moreover there was very strong support from SMP adviser members for many of the measures suggested in the discussion paper to improve the sales process:

- suitability letters:** nearly as many (93%) agreed or agreed strongly that these should be made compulsory, and 90% issue these already to their customers.
- demonstrating appropriateness of recommendations:** the vast majority (79%) support requiring the adviser to demonstrate that the recommendation reflects both the customer's circumstances and the product's intended audience. A similar proportion do this already.

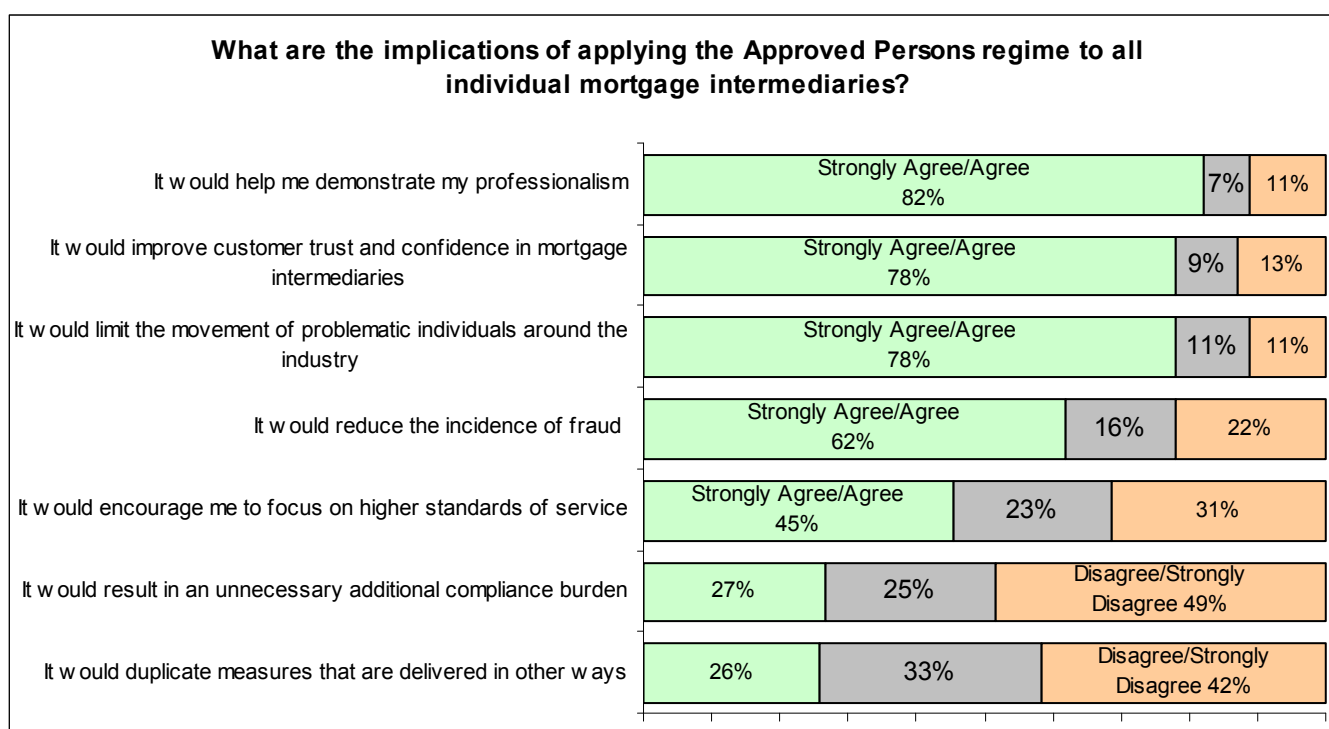
- **requiring advisers to issue special warning statements:** there was near-unanimous support (95%) in favour of issuing such letters to customers facing likely income falls such as lending into retirement. 89% of respondents do this already.
- **stress testing:** a similarly high proportion (92%) agreed that checking a client’s potential mortgage repayments in this way to reflect upward movements in interest rates is a good idea. 84% do this already.

Extending the Approved Persons regime

Extending the Approved Persons regime to mortgage advisers is an entirely logical step. Adherence to a Code of Ethics would demonstrate integrity. Similarly, undertaking approved training and ongoing continuing professional development (CPD) would evidence ongoing competence.

There was overall strong support for this among our members:

- 82% felt it would help them demonstrate their professionalism
- 78% felt it would help improve consumer trust and confidence in mortgage intermediaries
- 78% felt it would limit the movement of problematic individuals around the industry
- 62% agreed that it would reduce incidence of fraud in the market;
- Only 27% agreed with the statement that it would result in an unnecessary additional compliance burden;
- Only 26% agreed that it would duplicate measures that could be delivered in other ways.



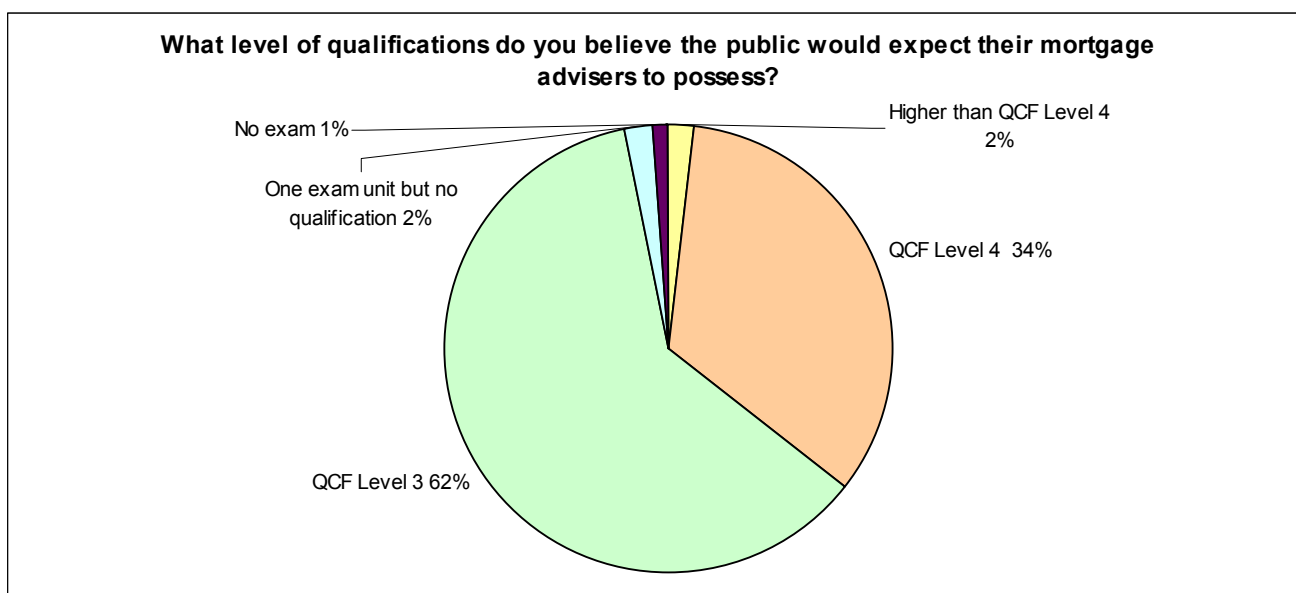
Professionalism

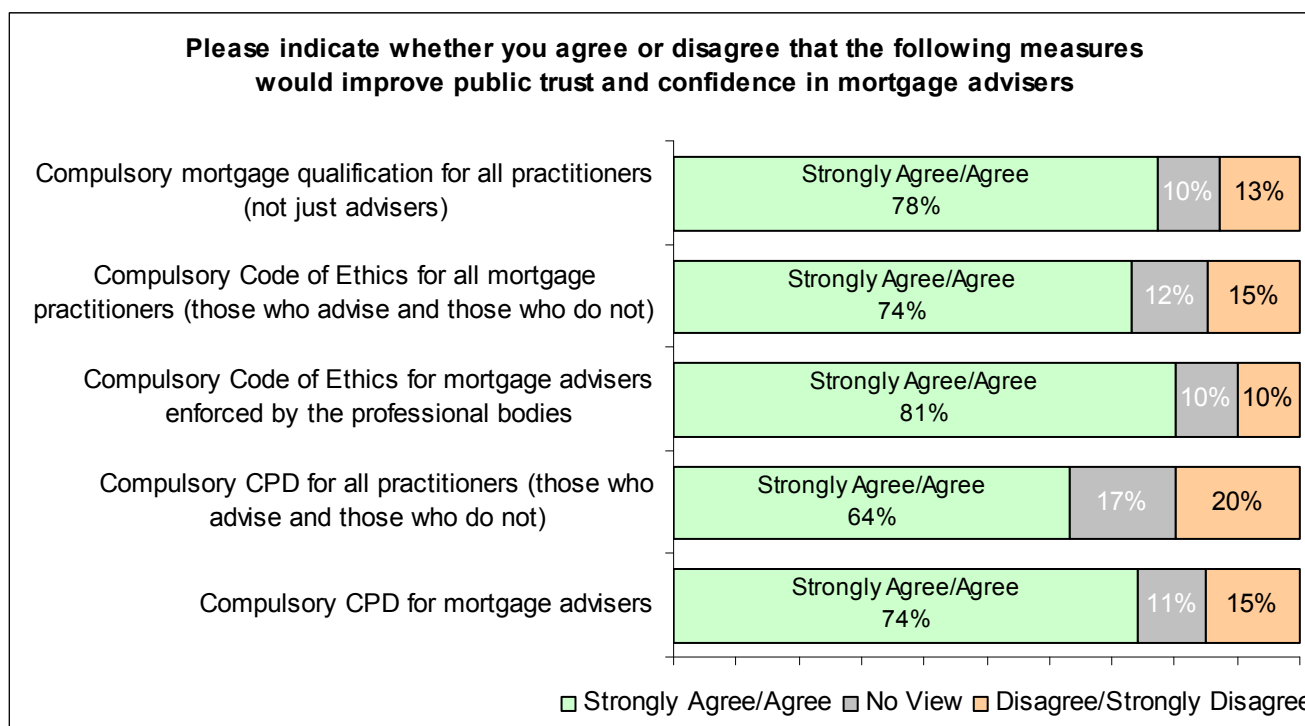
Qualifications: Although the FSA may not be able to find evidence to suggest lack of training and competence among mortgage advisers, we still argue that the TC 2.1.6 mortgage appropriate exam qualification requirements should be enhanced in terms of technical knowledge and skills:

- **technical knowledge:** the exam requirement should include more content on topics such as legal aspects of property ownership, investment issues for interest-only mortgages, and mortgage funding (ie: a basic knowledge of how lenders securitise mortgage credit in the financial markets).
- **skills:** the exam’s skills requirement should be enhanced to test communicating the financial risks of the transaction including arrears and debt management, as well as product suitability and product selection.

Once these revised elements are incorporated, it should then be up to the industry to differentiate what level the benchmark mortgage qualification that meets this requirement would be in terms of size and difficulty within the Qualifications and Credit Framework. So we suggest the FSA instruct the market to review the current mortgage appropriate exam requirements accordingly. A working group involving mortgage industry, consumer groups and professional bodies might be a useful way forward in this regard.

Our survey contained a question on the level of qualification. The majority (62%) felt that the current QCF Level 3 was the level of qualification they think the public expect their mortgage adviser to possess. However interestingly over a third (34%) felt it should be QCF Level 4 akin to the proposed RDR adviser benchmark qualification. Moreover, the vast majority of respondents (78%) believed that there should be compulsory mortgage qualifications for all practitioners, not just advisers.





Continuing Professional Development (CPD): In our August submission, we stated that “the FSA should work with professional bodies to develop a robust CPD regime for mortgage professionals.” We maintain that a comprehensive programme of CPD should be undertaken by all advisers to ensure that their skill and knowledge levels are kept current. Standards for CPD should be set by the FSA’s proposed professional standards function (as mentioned in the latest RDR consultation), and delivered by the professional bodies.

There was very strong support amongst SMP members for a package of professionalism:

- 74% favoured compulsory CPD for mortgage advisers, though not much less 64% favoured this for all practitioners in the mortgage industry.
- 81% believed there should be a compulsory code of ethics for all mortgage advisers enforced by the professional bodies, and 74% believed this should be applied across all mortgage practitioners.

Code of Ethics: we suggested in our August discussion note that the FSA consider requiring mortgage professionals to adhere to a code of conduct as is currently being consulted on as part of the RDR. We therefore fully support the case for the application of a Code of Ethics, as it is logical that a parallel regime be introduced to that applied under RDR. It is vital that the observation of the Code is monitored and that an effective disciplinary process is put into place.

Question 20: *To what extent should the proposals for a PSB outlined in the RDR be extended to the mortgage market?*

The CII would support the extension into the mortgage market of the RDR proposals in this regard, in particular compliance to a Code of Ethics including a commitment to a comprehensive CPD programme.

Scope of Service Labelling

Question 21: *Do you agree with the simplified scope of service labelling, limited to “independent” or “restricted advice” and also describing non-advised services as “information-only” will result in better consumer understanding of the services on offer?*

We still believe that there should be a clear distinction, from the public's perspective, between "advice" and "sales". Much of the lack of market confidence in recent years has been rooted in confusion from the customer's point of view over the type of service offered.

Advisers should clearly disclose the status of their provider-distributor relationship. Again, much confusion in recent years has centred on a lack of understanding of who the adviser represents, and this has not been resolved by the Key Facts written documents currently in place. The proposals for the mandatory use of the terms "restricted" and "independent" to describe the extent of advice, though not as clear as sales and advice, are helpful and we support their proposed introduction.

In conclusion we will continue our work to promote professionalism among mortgage practitioners and would be delighted to work with the FSA on these aspects as the mortgage market review continues. For more information on our policy or the member survey, please contact Laurence Baxter, CII Head of Policy & Research, tel 020 7417 4783; email laurence.baxter@cii.co.uk.

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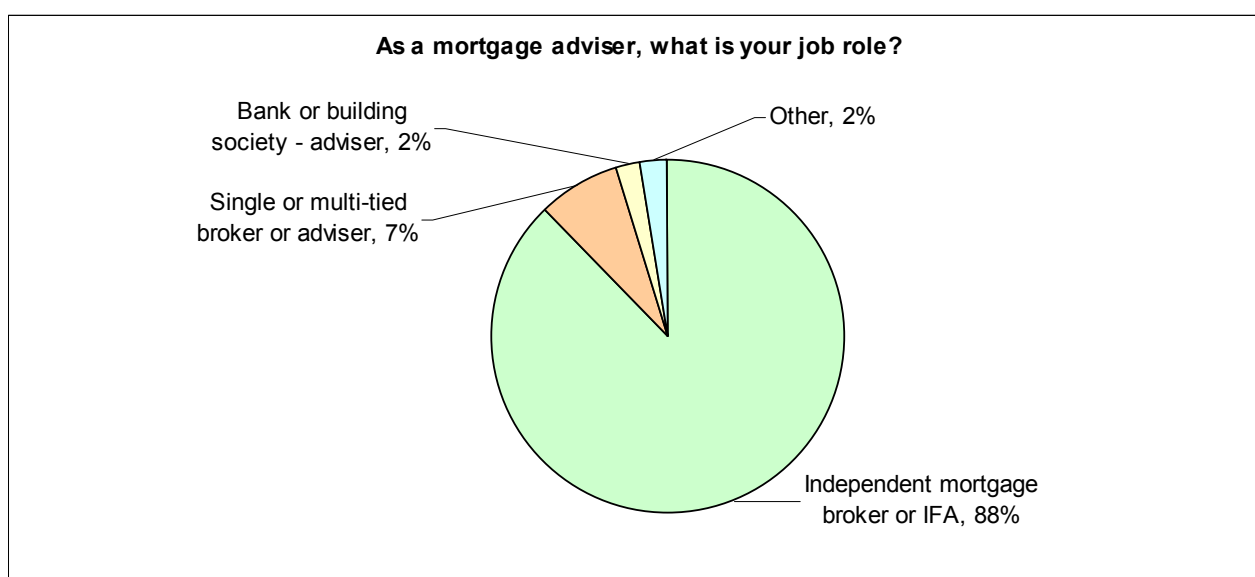
Appendix A: CII Society of Mortgage Practitioners Member Survey

1. About the Respondents

(i) Are you a mortgage adviser? Total 193 responses, on-line survey 16 Dec 2009 closing 22 Jan 2010.

- Yes 87%
- No 13%

(ii) [If answer to (i) = Yes] As an authorised adviser, what is your job role?



(iii) [If answer to (i) = No] What is your job role?

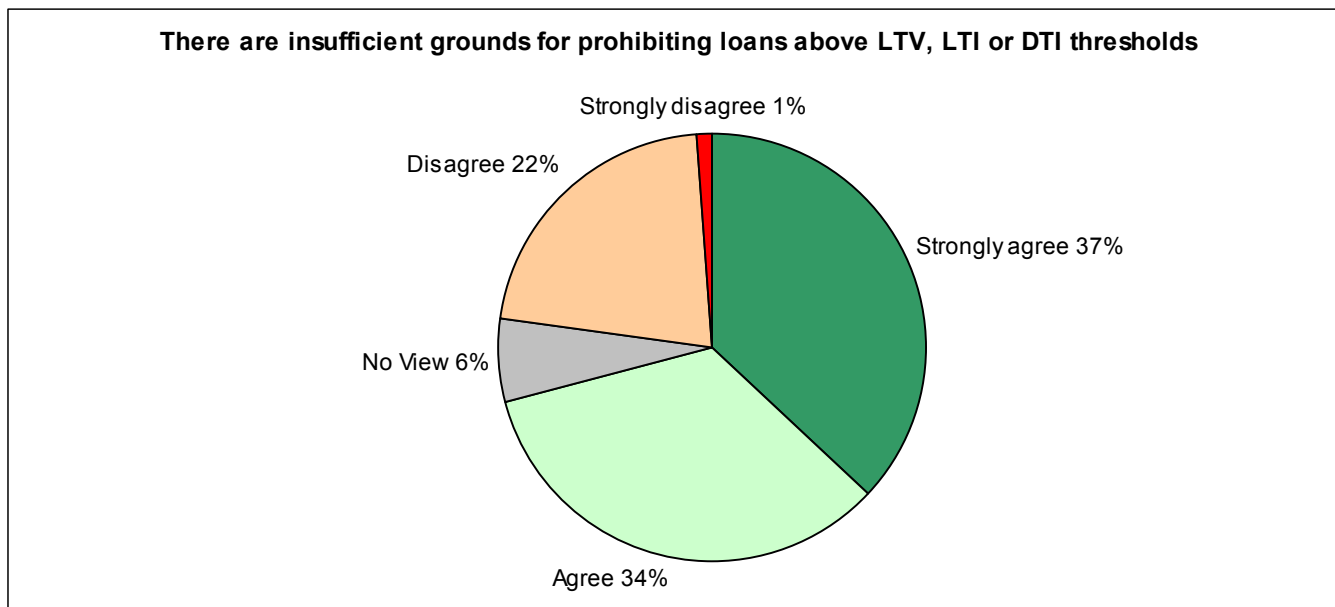
- Technical function 13%
- Compliance function 42%
- Sales function 17%
- Manager 21%
- Director 17%
- Other 13%

(iv) What qualifications do you hold?

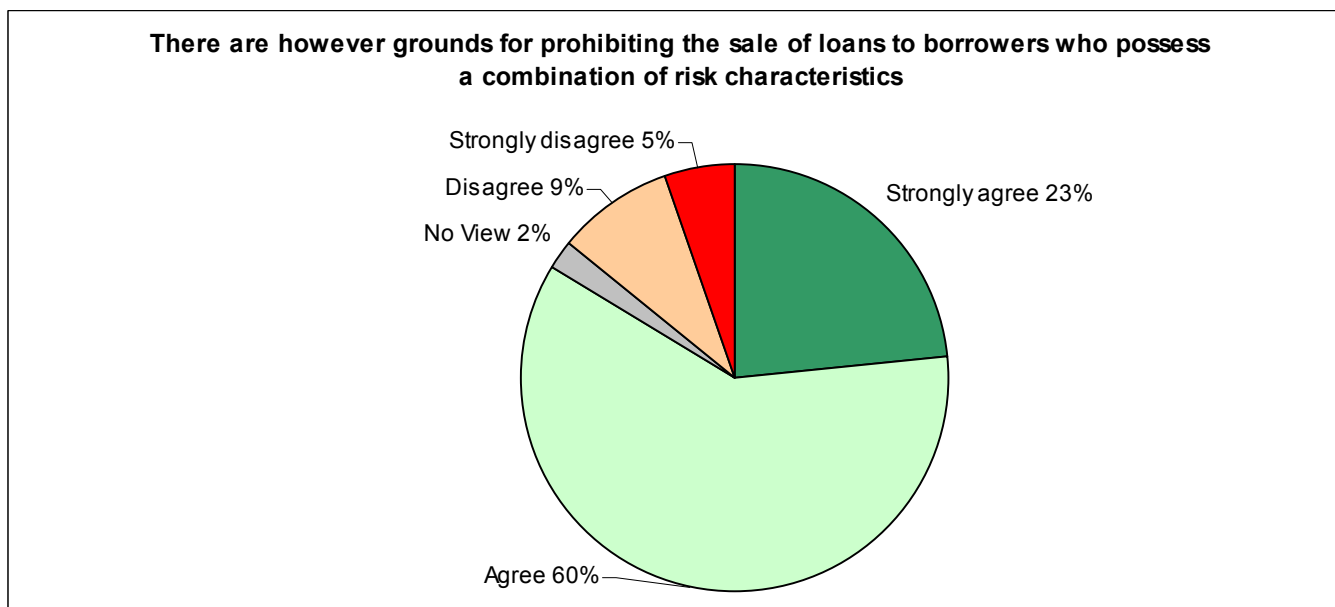
- Chartered Financial Planner 5%
- Diploma in Financial Planning 20%
- Certificate in Financial Planning 71%
- Certificate in Mortgage Advice 82%
- Certificate in Mortgage Advice (Equity Release) 47%
- Other 26%
- Don't know 0%

2. Responses linked to DP Questions

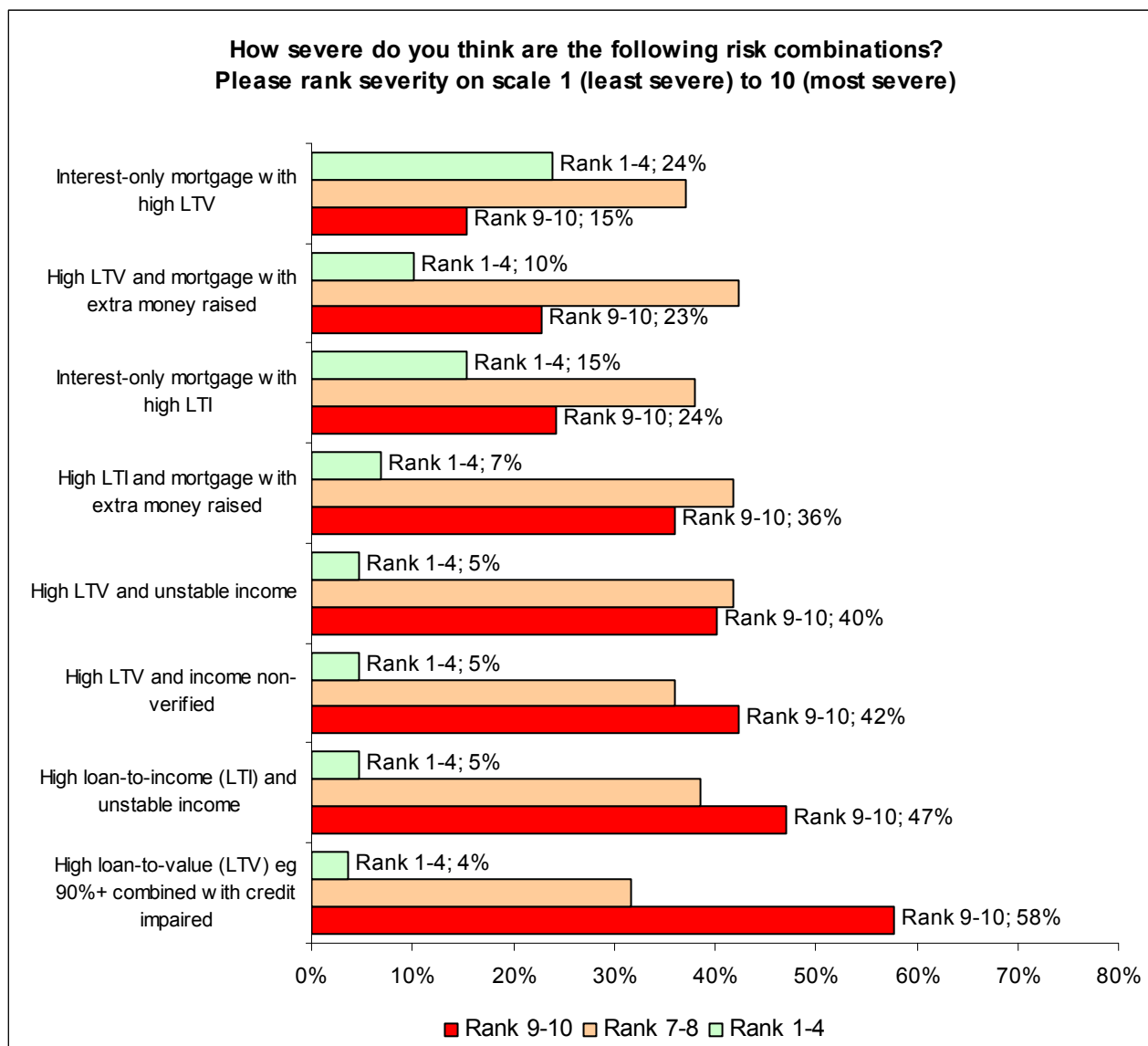
Question 5: Do you agree with our analysis that, on the grounds of consumer protection, there is no case for prohibiting the sale of loans above certain LTV, LTI or DTI thresholds?



Question 6: Do you consider that the FSA should prohibit the sale of mortgages to borrowers with multiple high-risk characteristics?



Question 6A: If yes, what particular combinations of risk factors should the FSA consider prohibiting and why?



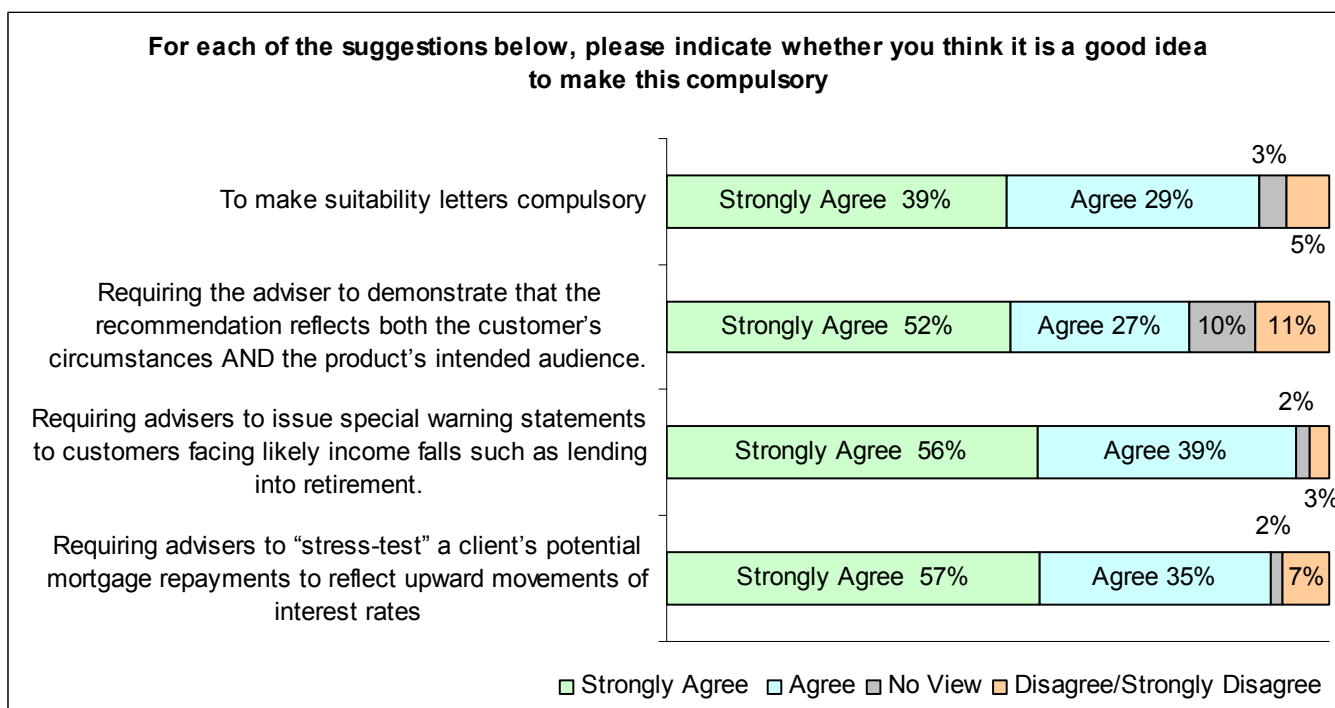
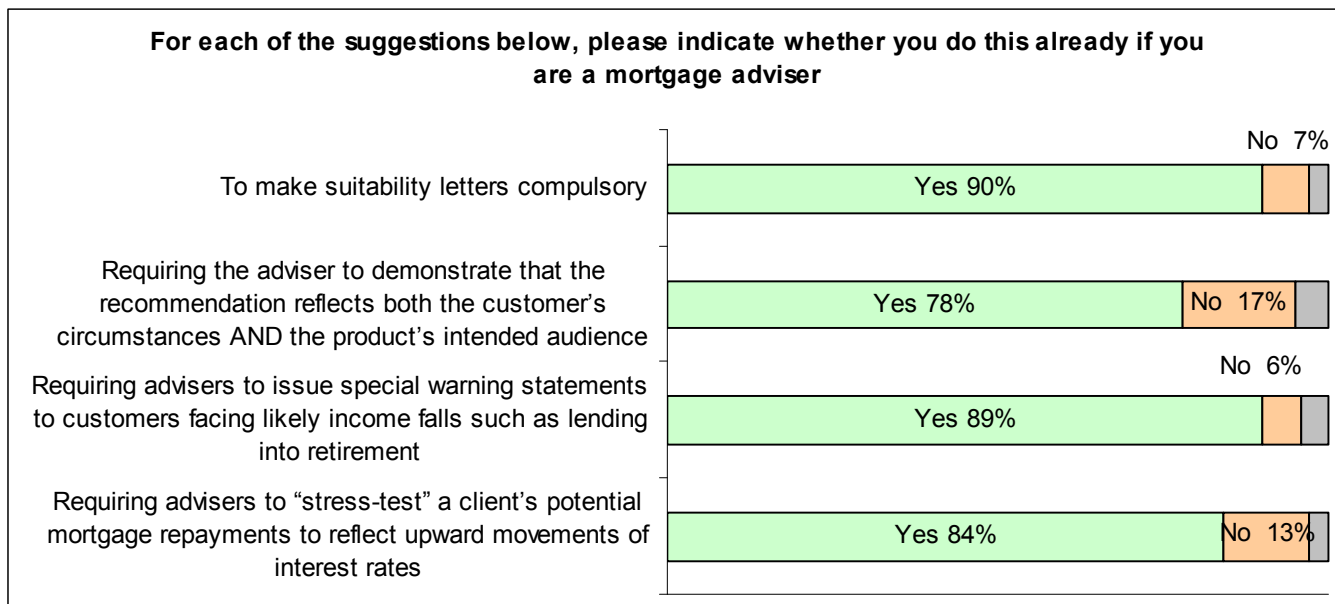
Question 13: Do you agree that we need to strengthen the selling standards for non-advised (information-only) sales to ensure consumers are only entering into contracts which are both affordable and appropriate?

The FSA suggest strengthening the selling standards for non-advised (information-only) sales to ensure consumers are only entering into contracts which are both affordable and appropriate. To what extent do you agree with this statement?

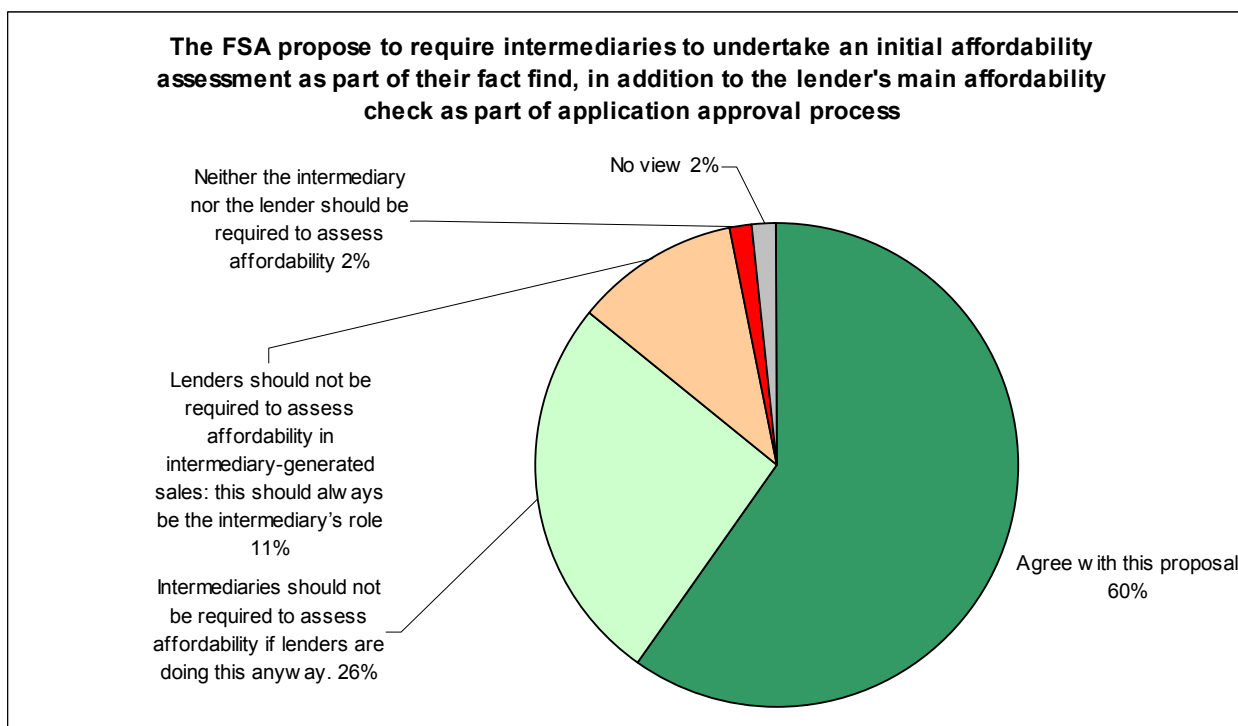
Strong agree 56% Agree 31% Disagree 6% Strongly disagree 3% No view 4%

Question 14: What measures should the FSA take to ensure sales standards in advised sales meet the needs of the market and appropriately protect consumers?

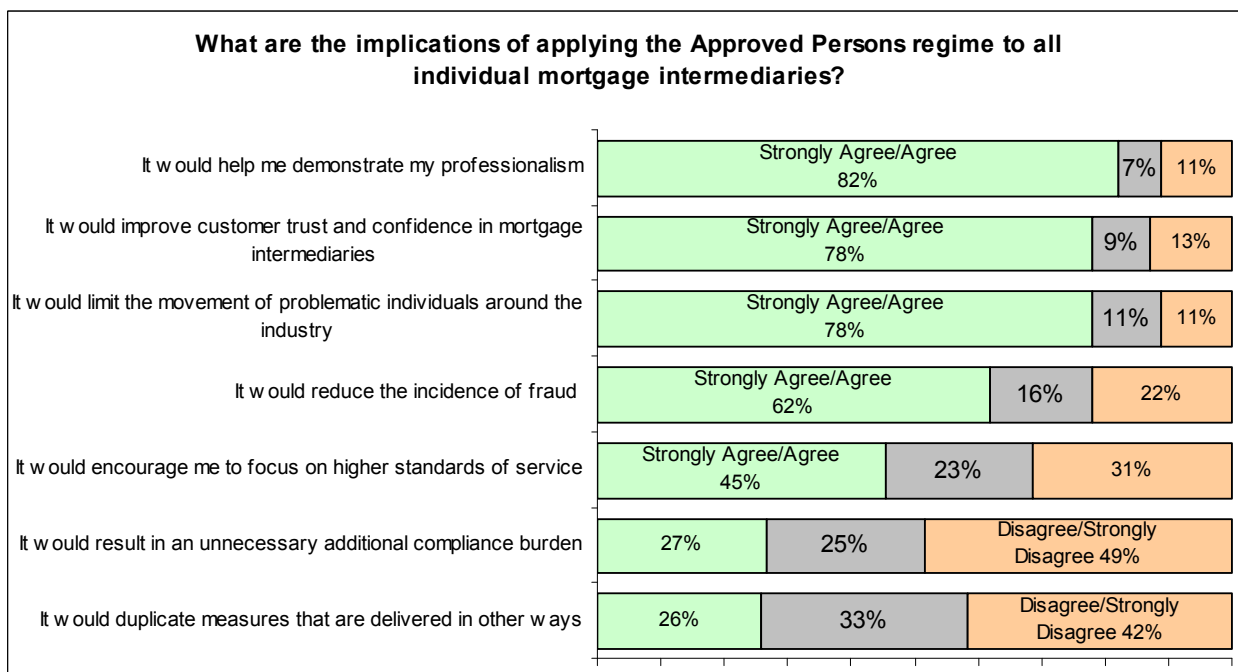
Question 16: Do you agree that suitability letters should be introduced as a compulsory standard?



Question 15: To what extent should intermediaries retain responsibility for assessing a consumer’s ability to repay? How could this work in practice?



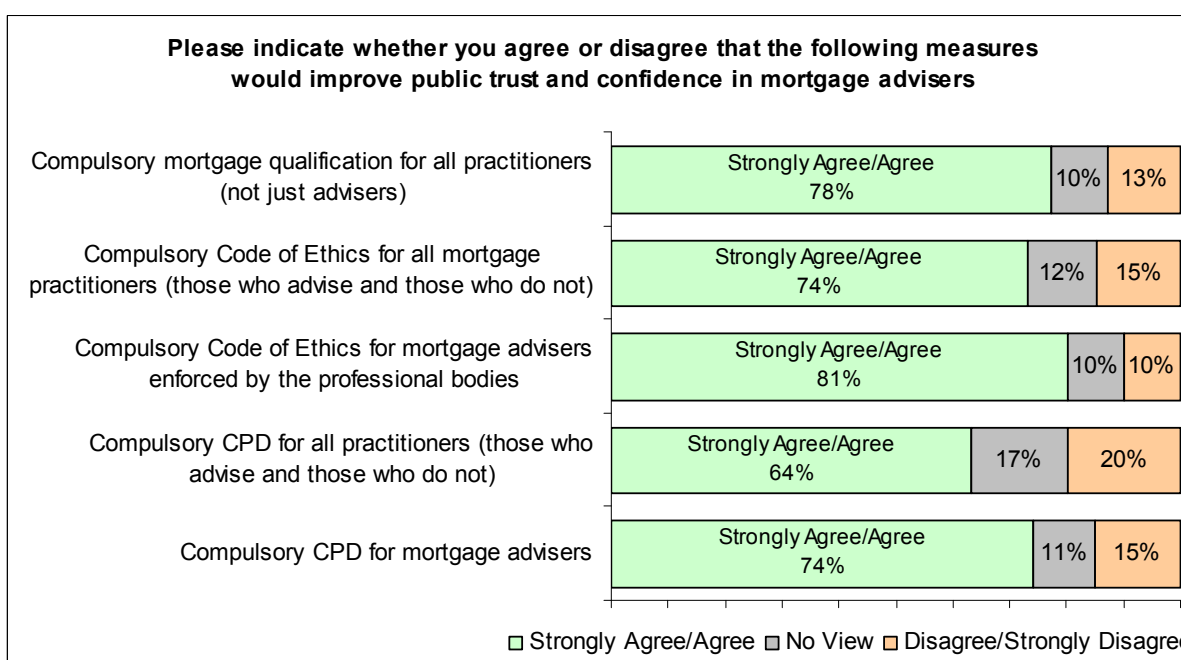
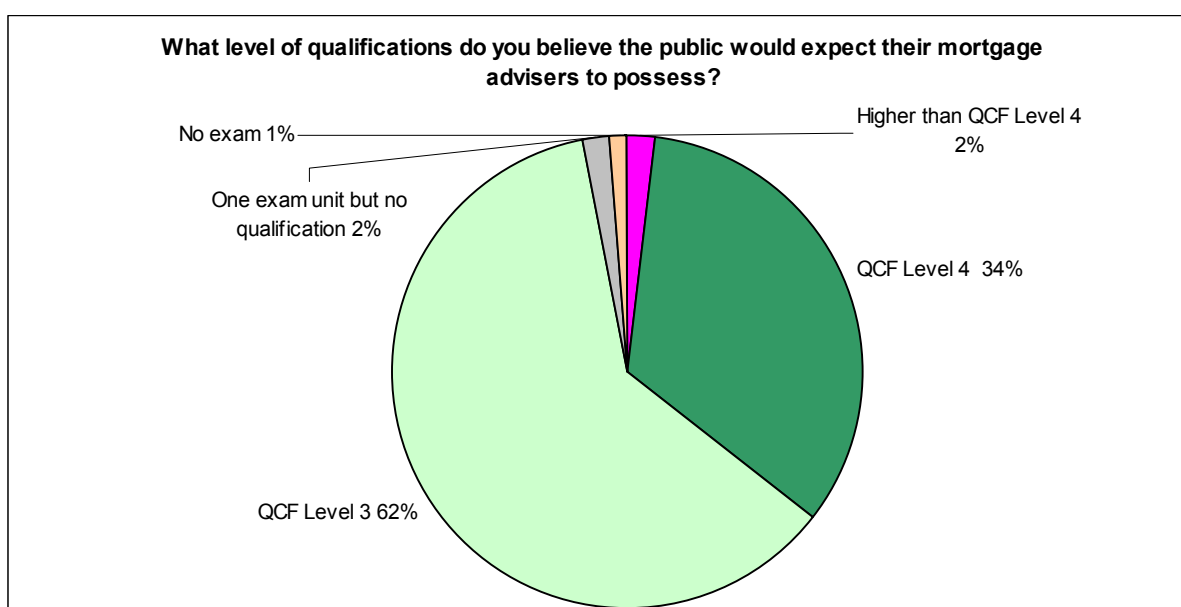
Question 17: What are the implications of applying the Approved Person’s regime to all individual mortgage intermediaries?



Question 22: Do you agree with the proposals to; (i) remove the requirement for the IDD and replace with disclosure of key messages; (ii) retain use of the KFI; and (iii) require elements of disclosure to be carried out on an oral basis?

	Strongly agree	Agree	SA/A	No View	Disagree	Strongly disagree
a) Remove the requirement for the Initial Disclosure Document (IDD) and replace with disclosure of key messages	16	26	42	25	25	6
b) Retain the use of the Key Facts Illustration (KFI)	50	43	93	6	1	0
c) Require elements of disclosure to be carried out on an oral basis	10	18	28	31	27	15

3. Professionalism and Labelling



4. Overall

For each of the following, please indicate the extent to which you agree or disagree with the following statements.

