

Our Future Mission

Response by the Council of Mortgage Lenders to the Financial Conduct Authority consultation paper

Introduction

1. The CML is the representative trade body for the residential mortgage lender industry that includes banks, building societies and specialist lenders, including equity release providers. Our 141 members currently hold around 97% of the assets of the UK mortgage market. In addition to lending for home-ownership, the CML members also lend to support the social housing and private rental markets.
2. We welcome the opportunity to respond to the FCA [consultation paper](#) on its Mission. The CML welcomes the FCA's review and agrees that all stakeholders need a clear understanding of the FCA's remit and that the FCA needs to ensure this is well communicated.
3. We were especially pleased to see the discussion on the interface between public policy and regulation, an important but often neglected subject. When the interface works well, it can be very effective. The Help to Buy Mortgage Guarantee scheme arguably was helped to deliver on its objectives by the way in which the new mortgage affordability rules ensured that borrowers were not over-extended on the highest loan to value (LTV) mortgages. We cannot say that this was planned into the scheme from its inception, but it should serve as an encouragement for public policy and regulation to work closely together at an early stage. The regulator should have an ambition to ensure that this tension is always appreciated in advance of its arising and that there is an openness to finding solutions for its resolution. It is not appropriate that industry should be left to live with or resolve any contradiction.
4. This consultation also presents a good opportunity to build on the successes of existing FCA initiatives such as the regulatory sandbox.
5. When mortgage lenders came to consider a good outcome to this consultation, they identified the following characteristics:
 - a) **Stability:** the mortgage sector has been through a succession of regulatory reviews from the MMR onwards, covering the Mortgage Credit Directive and now the market study. The cost of continual regulatory change is substantial and needs to be factored in.
 - b) **Proportionality:** the regulatory system can grind very small (and we acknowledge that part of the reason is industry's perpetual quest for certainty). The regulator should decide at which level of detail it intends to work and stick to it. It also has to deal with the propensity of firms to latch on to random comments from the FCA (formal and informal; from the centre and by individual supervisors) and treat them as tablets of stone. For example, the mortgage market spent a lot of time assuming that interest-only mortgages were toxic because of a single comment by a senior regulator. The true position was much more nuanced. Interest-only mortgages delivered beneficial outcomes for many consumers and met customer demand. There is no ready solution to this beyond an awareness of the impact of an FCA comment. We acknowledge that this can work for good as well as ill.
 - c) **Co-operation between regulator and regulated:** the way in which the mortgage industry worked with the FCA on recent arrears treatment guidance (though not perfect) is a good template for the way in which industry participation on a particular exercise can enhance the final outcome.

- d) Smooth process: the FCA internal processes can seem never-ending (and are very opaque). A more streamlined approach will help deliver more industry engagement.
- e) Addressing the Law of Unintended Consequences: this is probably the greatest obstacle to good outcomes in regulation and the most difficult to avoid. Our only suggestion can be that the industry and its representatives can be the most adroit identifiers of these consequences and their views are worth listening to.
- f) Acknowledging the absence of silver bullets: no one solution answers all the questions to which regulators need to respond. But the history of regulation is littered with attempts to find a single bullet.

Questions within the consultation paper

Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?

This section throws up the question of how the FCA's competition powers mesh with its conduct powers, to deliver a well-functioning and effective market. We do not believe that the interplay between these regulatory approaches has been the subject of close analysis by any party. Whilst we strongly believe that it is appropriate for a conduct regulator to have these competition powers and that their exercise may often be the most cost-effective and efficient means of driving change, there is a risk that short-term pressures will push the FCA down the route of changing conduct rules (given that competition changes will take longer to have an effect); and then looking at competition impacts. We believe that the FCA needs to analyse (probably with external input) how these two regulatory tools can best be used in harmony.

The mortgage market is as described in the consultation paper; with a range of products and suppliers and widespread third party advice. In the consultation paper the FCA states that it believes that every well-functioning market requires the same conditions: engaged consumers, firms and employees that follow clear minimum standards, and well-judged, timely regulation. We agree with these characteristics and hold that the FCA has a central role, through the application of proportionate regulation, to ensuring that the supply side is functional.

It would be helpful to know what a "well-functioning mortgage market" looks like from a regulator's point of view.

Q2: Do you think our approach to consumer loss in well-functioning markets is appropriate?

We welcome the recognition that on occasion consumers will, through no fault of the adviser or lender, suffer some losses. Lenders agree that the preferred approach to regulation should be preventative and that regulation should address real, quantified harm.

Q3: Do you think we have got the balance right between individual due diligence and the regulator's role in enforcing market discipline?

In broad terms, the balance appears to be right. The FCA must concentrate its resources on where the most harm could occur and to provide additional support to those persons who have the least information or are more vulnerable.

Consumers must be provided with suitable advice and information about the products they are being sold, but they should also be expected to apply individual due diligence in deciding if the product is suitable for their circumstances.

Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?

The mortgage market shares the characteristics of retail markets described in the consultation paper and we agree with the distinction made.

Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?

Firms bear the cost of regulation and therefore want to know how the FCA is delivering against its objectives. The three tier approach appears to be sensible but it would be helpful to clarify which tools the FCA will use to achieve its objectives, for example explaining why a particular regulatory or competition tool is being used, and how those tools fit together.

In respect of the FCA's three tiered approach, it would be beneficial for the FCA to increase transparency about these measures. With the exception of operational efficiency of the authorisation process reported through service standards, it is felt that more could be communicated in respect of the three tiered approach.

Measuring outcomes in markets is a difficult challenge, however the FCA could be more open with the industry about what a good or effectively operating market is, the metrics that they use to assess this and progress made over time. It is noted that this is mentioned in the competition and market design section of the Mission Statement which is positive.

On a wider note it is difficult to see from the Mission Statement how the regulatory data submissions by firms are used by the FCA for the purpose of measuring the effectiveness of the market.

Q6: Do you think the way we interpret our objective to protect and enhance the integrity of the UK financial system is appropriate? Are there other aspects you think we should include?

We are broadly supportive of the FCA's interpretation of the objective to protect and enhance the integrity of the UK financial system. However one of the key concerns we have is that the FCA is not always proportionate to the actual or potential harm to consumers.

For example, there has been some concern that firms, who have been correctly advising consumers on debt consolidation mortgages, are being required to apply for a debt counselling permission which they do not need to will use, because of a highly technical interpretation of the rules. There is a concern that consumers will not understand what type of advice they are given and firms are considering withdrawal of debt consolidation mortgage products. This will result in less choice for consumers. To our knowledge, the FCA has identified no detriment to consumers arising from firms not having a debt counselling permission but firms are now incurring additional compliance costs.

Q7: Do you think our intervention framework is the correct one?

The FCA has said one of its priorities is making the way it works more efficient. We would welcome more clarity on the way the various strands of the FCA (policy, supervision and competition) coordinate their activities and determine when action needs to be taken. The development of the FCA's competition remit has made the picture less clear. For example, the recent Responsible Lending Review found there were no problems with the way that consumers were advised on debt consolidation mortgages, yet within months of the report being published firms were being told that they needed debt counselling permissions to provide a good customer outcome.

An obvious problem is the size of the FCA handbook. We applaud the objective of reducing the size of the FCA handbook but acknowledge the scale of the task. Firms will always press for certainty, especially at a time of change. We saw this during the introduction of the changes following MMR. Firms know that rules need to be followed but there is a perception that the guidance in the handbook is in fact rules.

The FCA faces an on-going challenge to get the balance right between being over-prescriptive and allowing firms to take risk-based judgements. Formal guidance may be difficult to give due to need to consult, but the FCA could be more open with frequently asked questions and the provision of informal interpretations of the handbook through case studies for example.

The interaction between FSMA, the FSMA regulations, the FCA handbook, the CCA and the CCA regulations and voluntary codes is highly complex. No other products regulated under FSMA are subject to this level of complexity. The conduct of business provisions for residential mortgages, for example, is contained within a separate section of the handbook, MCOB. The complexity of the current regime is neither in the interest of lenders nor customers.

Firms are told that they need to determine if they are meeting the requirements of the handbook when it is difficult to understand what is required. We would welcome fewer regulatory interventions where no clear detriment to consumers has been identified.

The FCA should also learn from past experience. For example, we witnessed some cases of over-reaction and seemingly unnecessary descent into detail in the early days of MMR followed by a gradual retreat to a more common sense place (in terms of information gathering), as FCA signals changed. The FCA should refine how it gives those signals to the market – as we also saw with the approach to engagement with interest only mortgage consumers. The current practice of setting out the areas that are giving concern to the regulator through less formal guidance in speeches or similar vehicles has been a helpful means of managing attitudes. We would welcome the FCA being clearer about how and why such guidance is given.

Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?

The FCA states that the role of conduct regulation is under scrutiny given today's challenges. We think this intervention is timely, and we urge the regulator to provide as much certainty and clarity as possible. The FCA is signed up to the principles of good regulation, which require that the regulator is proportionate; recognises the differences in the businesses carried on by different regulated persons; and exercises its functions as transparently as possible.

It has been difficult at times to see how the approach to regulation taken by the FCA fits within a wider public policy context. This raises the issue of how an independent regulator can and should work sensibly with other public policy influencers. This is very relevant to both the firms that are regulated and also to consumers. It will also inform the actions taken by firms it does not regulate (especially in UK housing market). For example the FCA's market study terms of reference focus on new build should be mindful of concurrent work from the Government on measures to increase housing supply.

The CML would like to see more explicitly joined up thinking. We appreciate it is not the regulator's role to promote government policy, but the two should at least be in visible constructive dialogue and aware of each other's work of relevance. The Help to Buy Mortgage Guarantee Scheme which facilitated high LTV mortgages at a time when these were unavailable commercially is generally regarded as a success, not least because it did not over-extend borrowers and did not in itself catalyse increases in house prices. This effect was in large part down to the coincidence of the introduction of MMR affordability criteria which dampened any tendency to exuberance by lenders, brokers and borrowers. It would be nice – but inaccurate – to claim that this was all intentional but it does illustrate the harmonious impact of regulation on other public policy goals. Conversely, there are cases where Government housing policy has clashed with regulation, especially capital regulation, for example in the area of shared ownership. Some tension is inevitable; but the regulator should have an ambition to ensure that this tension is always appreciated in advance of its arising and that there is an openness to finding solutions for its resolution. It is not appropriate that industry should be left to muddle through and resolve the contradiction.

In areas such as housing policy the FCA should state more explicitly that it is aware of its impact on public policy. The FCA's assessment of how its approach is working should explicitly factor in the impact on public policy; and other policy influencers should have the opportunity and be encouraged to explain these impacts in their contacts with the FCA.

Evidence based policy and rule making must be the watchword for the FCA. Before policy is changed or rules amended, firms want to see the evidence of consumer detriment. There has been a notable

positive shift in consumer attitudes towards mortgage products for older people without the need to change the handbook extensively.

As acknowledged in the consultation paper, in a dual regulation environment, there is a need for a good working relationship between the FCA and the PRA at all levels (not just senior levels). Most firms deal with both of the regulators, so minimising conflicting approaches to and views on the same issues would be welcome. Issues relating to older borrowers have been a recent example of conflicts occurring.

For example, the FCA and current government housing policy promote the need for consumer access to mortgage finance for a variety of borrowers and property types, but the 'tone' from the PRA can deter lenders from being more active in certain markets. Shared ownership, self-build and lending to older borrowers are cases in point. Although it is of course necessary for the prudential regulator to highlight risks associated with non-standard types of lending, dialogue between individual lenders and the regulator – during which the lender can make representation to the regulator on the rationale, including the risk management, control and governance procedures underpinning this business decision for entering a new segment of the mortgage market – is key.

The FCA should also share its insights with the Financial Ombudsman Service (FOS). FOS has access to a great deal of granular data which would be helpful to both the regulator and to firms. Firms feel frustrated when FOS makes decisions based on just one section of the handbook and suggest remedies that would infringe other handbook requirements. If the regulators do not appear to have a common view on what a good consumer outcome looks like this can make it more challenging for firms to gauge where lines should be drawn.

Q9: Is our understanding of the benefits and risk of price discrimination and cross subsidy correct? Is our approach to intervention the right one?

It is inevitable that some level of cross-subsidy takes place and it is welcome that the FCA recognises this. If the FCA does believe that cross-subsidies are resulting in harmful effects it is important that before any regulatory sanctions are imposed, the reason for the sanction or change to the handbook is made clear and, where appropriate, firms are given the opportunity to change behaviour. We note the FCA has signalled to firms that one of its priorities for 2016/17 is the treatment of existing customers and firms are adapting their behaviour as a result.

Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?

The very concept of conduct regulation arose in large part because more was being expected of individuals in the way of personal financial provision. So this question merely marks another staging point on the same road, not a step change. The principles set out in the handbook should be the basis of all regulatory activity undertaken by the FCA. Mortgages are long term products which are challenging to regulate appropriately and proportionately as noted in the consultation paper. Over time people's needs and aspirations will change and the lender may not know this unless the consumer tells them. Regulators should keep this front of mind in their deliberations.

Q11: Would a Duty of Care help ensure that financial markets function well?

We believe a Duty of Care would not bring additional consumer benefits as safeguards are enshrined in regulation.

The FCA handbook sets out the principles by which a firm must conduct its business. These are rules that firms must abide by. They must conduct their business with integrity; pay due regard to the interests of customers already and treat them fairly. Firms must also take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment. As well as these fundamental obligations, the FCA has built safeguards for consumers into the handbook (e.g. [MCOB 4](#)).

We also note that the FCA has previously argued that a duty of care is unnecessary. Imposing a duty of care on firms should only be considered if the FCA has evidence that consumers are being harmed by the actions of firms that cannot be dealt with through the FCA's existing supervision of firms and use of enforcement powers.

Q12: Is our approach to offering consumers greater protection for more complex products the right one?

We welcome the statement that “both firms and consumers have responsibilities”. The FCA has noted that as consumers’ needs, finances and financial literacy become more varied and complex, the need for appropriate, accessible advice and products is growing. Consumers may reject paid-for financial advice because of the potential cost. They may choose non-advised sales, even when support is better for their needs. Therefore some consumers may suffer detriment without firms being at fault.

We agree that the FCA should focus on riskier, more complex products and give greater protection to consumers with less capacity. On the other hand, firms should not be penalised for assisting consumers, sometimes contrary advice from supervision and policy can result in consumers being prevented from obtaining products that are suitable for the needs.

Q13: Is our regulatory distinction between consumers with greater and lesser capability appropriate?

The capabilities of consumers are (either individually or as a group) always going to be a matter of judgement. It is important the regulator explains why a consumer is considered to have lesser financial capability when making an intervention.

Q14: Is our approach to redress schemes for issues outside our regulatory perimeter the right one? Would more specific criteria help firms and consumers?

We appreciate that problems outside the perimeter often impact the public perception of the UK financial industry where the regulator has no regulatory tools it can use other than moral pressure. It is right that the FCA's primary focus is on regulated activities.

Q15: What more can we do to ensure consumers using redress schemes feel they are receiving the appropriate level of personal attention?

Redress should be meaningful – in terms of changing firms’ behaviour; the compensation paid being proportionate; and customers’ expectations being managed effectively.

One of the potential problems we have identified in terms of consumer redress is managing consumer expectations, especially following the sums involved in some PPI cases. A recent case of remediation for mortgage customers who may have been affected by the way firms calculate these customers’ monthly mortgage instalments has caused some concern. The need for proportionality and realistic timeframes for lenders to implement any proposed remediation measures is key. Approaches taken by the regulator here should not create disproportionate costs for lenders, nor unrealistic compensation expectations from customers, who could, for example, be informed that they may be in scope for a compensation payment, when it transpires that no compensation (or nugatory amounts) are due.

Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?

As the FCA has stated in its Occasional Paper No 8, vulnerability involves the interplay between individual circumstances, situations and market factors. A consumer’s state of mind can have a major impact on behaviour and decisions which can be brought about by a change in circumstances or multi-layered risk factors.

The need to identify and treat vulnerable customers appropriately, via MCOB as well as sharing best practice, e.g. the recent Financial Services Vulnerability Taskforce recommendations, remains front of mind for both the FCA and CML members. We welcome a continued commitment to sharing best

practice from the regulator, the mortgage industry and gaining insight from lessons learned in other sectors.

Q17: Is our approach to the effectiveness of disclosure based on the right assumption?

Consumers make better choices when they are provided with information that is accessible and useful. To improve the quality of information available to potential mortgage customers CML is working with its members to improve the transparency of mortgage fees and charges and will help consumers understand them better. This project is supported by Which? and we believe it will make a significant substantive contribution to helping customers choose the mortgage that suits their needs.

Just as there is the need for transparency between firm and customer so there needs to be transparency between regulator and regulated firms.

Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?

Intervention should only be considered if the FCA has evidence that consumers are being harmed by the actions of firms that cannot be dealt with through the FCA's existing supervision of firms and use of enforcement powers.

Q19: Do you think our approach to deciding when to intervene will help make FCA decisions more predictable?

The steps set out in the consultation paper are helpful and should assist firms to predict when an intervention may occur.

Q20: Are there any other factors we ought to consider when deciding whether to intervene?

The CML recognises the challenges faced by FCA in supervising 56,000 firms and agree that there is the need to have proportionality in terms of intervention, redress and disclosure. It is important that the FCA supervisors are or become expert in the areas they cover, to better ensure proportionate outcomes.

Q21: What more do you think we could do to improve our communication about our interventions?

Communication with firms and other stakeholders will need to be rethought to ensure that the policy objectives are explicit and the reasons for rule changes, supervision interventions and enforcement actions are transparent. As well as using speeches to set out policy direction for members have appreciated the use of more interactive methods of disseminating good practice such as the recent workshop on debt consolidation mortgage advice. In the age of mass communications we hope targeted and imaginative methods will be used.

In its engagement with firms on non-supervisory issues, the FCA should be mindful of how those it chooses to attend meetings may be interpreted by firms; and impact on the dynamics of those meetings, For example, having a supervisor present at a meeting for a non-supervisory, more policy focused discussion with a lender regarding innovation may not prove as conducive to constructive conversations, as firms will be uncertain where the boundaries lie.

Q22: Is there anything else in addition to the points set out above that it would be helpful for us to communicate when consulting on new proposals?

No further comment

Q23: Do you think it is our role to encourage innovation?

Yes, markets are more competitive when there are new entrants and incumbents are able to innovate to meet customer needs and expectations. Innovation is not restricted to digitisation, but may also

include improved methods of communication, products to meet the challenges presented by an ageing population for example.

The FCA does have a part to play in encouraging constructive innovation within the industry. Increased transparency of the type of initiatives that do or do not result in successful applications to the Regulatory Sandbox would be welcomed; to maintain intellectual property considerations, a possible way to achieve this would be to disclose the topics of innovative ideas as opposed to the specific details of product features. It would also be beneficial to understand the FCA's appetite for considering smaller changes that firms believe would improve customer understanding or experience.

We believe that the FCA should take a predominantly practical, as opposed to an overtly academic approach to issues; and that the mission should clearly set out the shape, pace and landscape of regulation going forward; and how the regulator plans to evolve to ensure it remains fit for purpose.

Q24: Do you think our approach to firm failure is appropriate?

Yes,

Q25: Do you think more formal discussions with firms about lessons learned will help improve regulatory outcomes?

Where investigations are opened there can be a general sense that "there is no smoke without fire". Therefore when no harm is discovered, or there is insufficient evidence to take action against the firm, the firm should be able to request a public statement of no further action.

In addition, recent workshops on regulatory priorities highlighted have been helpful in both spreading good practice, but also allowing firms to explain how industry practices have arisen. These practices may be an unintended consequence of previous policy statements or guidance in another area. An open discussion of the issues will assist everyone.

Q26: Do you think that private warnings are consistent with our desire to be more transparent?

Private warnings are helpful to individual firms, but there is the need to set out, in general terms the FCA's concerns. This could be done through anonymised reports similar to those produced following thematic reviews.

Contact information

6. We have prepared this response with our members. Please contact Sue Rossiter (sue.rossiter@cml.org.uk) with comments or questions.

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