StepChange Debt Charity response to FCA Mortgages Market Study Interim Report MS16/2.2

July 2018

StepChange Debt Charity London Office
6th Floor, Lynton House, 7-12 Tavistock Square, London WC1H 9LT
Policy Contact: Alison Blackwood
Tel: 0207 391 4583
Email: Alison.blackwood@stepchange.org

Introduction

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2017, 620,000 people contacted our telephone helpline or online debt remedy tool for advice and information, an increase of 3.5% from 2016. We delivered 357,386 detailed debt advice sessions, up 5% on the previous year. 57% of clients used our online advice services rather than telephone advice. Of the clients who we provided with debt advice in 2017, 21% who had a mortgage had mortgage arrears.

In 2017, 30% of our clients had a negative budget, which means their income was not sufficient to cover their essential expenditure. This had increased from 25% in 2014. 16% of clients with a negative budget had mortgage arrears and only 2% owned their home outright.

We are concerned that a combination of high housing costs and limited support for people struggling to maintain their homes is causing more people to resort to high cost credit or other forms of borrowing to cover mortgage or rent payments. This could make their overall financial position significantly worse. 29% of clients we surveyed said they were using high cost credit to cover their rent or mortgage payments[1]. These are households who might be managing for now, but are increasingly at risk of falling deeper into long term financial difficulty.

StepChange Debt Charity's Financial Solutions service is established as a separate organisation, which offers advice and the arrangement of both equity release plans and mortgages aimed at helping people out of problem debt. Any net proceeds generated by the Financial Solutions service through procuration fees from lenders are distributed via Gift Aid back to the charity. In 2016 this service gave advice to 1,993 clients who had a problem, with 76% having a problem mortgage. We also identified that 50% of monies being released by these clients in a re-mortgage or equity release solution were being used to repay outstanding debts or help with regular bills.

This further strengthens our view that many households with mortgages are managing at the moment, but at risk of struggling, particularly if there is an interest rate rise and/or a fall in current property prices.

Overview

StepChange Debt Charity's response concentrates on our clients who are in problem debt and their needs in relation to the mortgage market. Our clients with mortgages are more likely to be vulnerable have poor credit ratings and be older than those in the general population. There are also particular issues for our clients who are on low or fluctuating incomes. We recommend that the FCA specifically considers providing greater protections to these vulnerable consumers, who currently suffer the greatest detriment when choosing mortgage products, as part of any changes in its regulation of the mortgage market. In particular our concerns could be addressed by ensuring:

---

[1] StepChange Debt Charity (2017) The High Cost of Credit: the need for more affordable alternatives to high cost credit

- No reduction in consumer protection measures and more support for these clients through free-to-client mortgage advice services, as well as greater transparency in the fees charged for advice by intermediaries.
- More consideration given to different channels of support such as telephone and face-to-face services, while also improving the accessibility of online tools for vulnerable consumers and better signposting to free-to-client mortgage advice services.
- Specific impact assessments of any new FCA proposals focussing on customers for whom the mortgage market is not working well, including those with poor credit ratings, those on low and/or variable incomes and those of, or approaching, retirement age.
- Further consideration given to changing the FCA's mortgage advice rules around requiring firms to consider price when assessing whether product(s) are suitable for a consumer's needs and circumstances.
- Greater and more timely data sharing and consistency in providing information about products and their eligibility criteria by mortgage lenders.
- The introduction of "soft credit checks" that do not affect a person's credit score to allow more requests for quotes across different mortgage products, particularly to address current penalties for those with poor credit ratings.
- Greater transparency on referral fees and more consistent deals offered by lenders across intermediaries and to consumers, as well as greater focus on ensuring competition delivers good consumer outcomes through monitoring exclusive deals between a single lender and intermediary.
- A proactive approach by lenders to providing customers switched onto standard variable rates with accessible and timely information about other options available to them.
- An industry-wide agreement of an internal switch for all customers, who meet certain criteria, who are currently automatically switched on to standard variable rates after their initial deal has ended. This should be subject to regulatory requirements, if lenders do not voluntarily address the problem.

Consultation questions

Making it easier for consumers to find the right mortgage

Q1: Could mortgage lenders make sufficient information available (in consistent format) to established and emerging intermediaries to support the development of tools that, early on in the sales process, give consumers a much clearer understanding of the products for which they qualify?

The Mortgages Market Study Interim report evidence finds that tools currently available to help consumers find a mortgage "are less useful for consumers where qualification is less certain (such as those who are newly self-employed, have a low or volatile income, or adverse credit)". We also note the limitations of many mortgage price comparison sites that do not make clear the limited options on which their searches are based, for example including only a limited number of lenders.

Our clients are likely to be affected by adverse credit ratings and many are on low or volatile incomes. So we would welcome regulation by the FCA to ensure that mortgage lenders make sufficient information available in a consistent format to allow these consumers to have a clearer understanding of the products for which they qualify.

In relation to lenders providing greater transparency on mortgage fees and charges we support the previous CML and Which? Recommendations cited in the interim report that lenders should:

Inform customers about mortgage fees and charges at an earlier stage of shopping around for a mortgage

Provide a standardised industry tariff of mortgage fees and charges, to help customers compare mortgages

Establish the use of a common terminology for fees and charges and descriptions of what they entail.

Provide additional information on their websites, as part of their mortgage product pages, to enable customers to compare mortgage costs more effectively.[2]

Q2: Do you think tools of the kind outlined could help consumers find more easily the best mortgage for them?

We welcome the FCA's endorsement of the development of tools by the industry that support customers to compare how monthly mortgage payments are affected by different product rates and fees, the effect of different interest rates on monthly payments and showing existing mortgage customers whether and when they might save money by switching.

However, the FCA specifically states that it wants to: "foster an environment where innovation that meets the consumers' needs can flourish without undue regulatory barriers". This is despite research cited in the interim report from FCA occasional paper 33[3] showing that around 30% of consumers are not currently picking the cheapest mortgage deal available for them. We acknowledge that in some cases this may be because of other considerations, such as service fees and flexibility. However, what is striking from the research is that these clients are more likely to be on low incomes, be older and have low credit scores, and overall this is associated with increased consumer vulnerability.

For our own clients who are in problem debt, credit scores are an issue across all age groups, but lenders' threshold credit score limits are not shared. We support the FCA's proposal that "in the next stage of our work, we want to explore with lenders, intermediaries and mortgage sourcing system providers how the market could develop tools that make it easier for consumers to identify at an early stage those products for which they qualify". The lack of transparency about qualifying criteria is probably contributing to the research findings that because of uncertainty around credit score eligibility, rather than looking at cheaper deals where their credit score is just within the lender's eligibility criteria, consumers with poor credit scores are applying for deals for which they are more certain of being accepted. This can often mean that they end up paying more than they need.

---

[2] file:///C:/Users/a7bla/Downloads/final-report-to-hm-treasury-november-2015-amended-24.11.15.pdf
[3] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-33.pdf

It is the most financially vulnerable consumers that are also least likely to use, or be able to use, the type of online tools that the FCA is recommending.[4] Relying on online tools is therefore more likely to exacerbate the inequality in higher mortgage costs being paid by vulnerable consumers compared with higher income, more technically competent consumers. The FCA needs to give more consideration to how innovative technology can specifically address the needs of these consumers. We welcome the fact that the interim report includes consideration of how online advice can be integrated with support by telephone and face-to-face advice services and more work should be conducted in this area.

In addition, if lenders provide improved information to support online tools we agree that this would also help intermediaries to provide more tailored mortgage advice. In turn, this could help to reduce mortgage payment costs for consumers with poor credit scores, and those with vulnerabilities. They could automatically be referred to a free-to-client intermediary, who can help them use such tools, to support their choice of mortgage deal.

Q3: What do you think would be necessary for this approach to work and what do you see as the main challenges? (eg what would be required to ensure that lenders can provide intermediaries with the means of identifying (earlier) products for which consumers qualify? Are there any technical barriers to further development? What is needed to give consumers meaningful outputs, even if they don't qualify for products?)

18% of StepChange clients with mortgages said that their credit rating had negatively affected their ability to buy a property, with a further 21% saying they didn't know whether it had (Figure 1).[5] Although this was lower than the proportion of our clients who rented accommodation, it is still a substantial proportion of our clients with a mortgage. This provides evidence that there is a need for consumers, especially those, such as our clients, who are financially vulnerable and have a low credit rating, to be able to more quickly and easily identify mortgage products for which they would qualify despite a poor credit rating.

> "*Credit rating at 147 so no chance [of getting a cheaper mortgage deal] ….. already had flat while going through this and working so I haven't tried yet [to see what a remortgage would cost] if I was to move*."
> StepChange client, March 2018

---

[4]https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/FutureofDigitalComparisonTools%20(1).pdf

[5] Question answered by 603 of 1000 StepChange clients surveyed by e-mail in March 2018

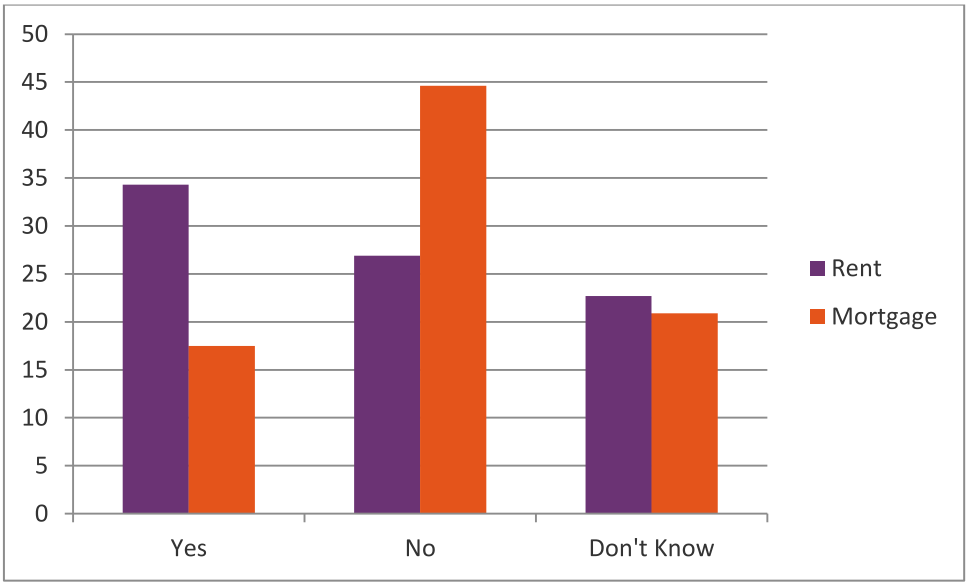

Figure 1: The proportion of StepChange clients surveyed who answered the question: "Has your credit rating ever, to your knowledge, negatively affected your ability to start renting or buying a property?" split by those who currently rent and those who currently have a mortgage.

This suggests that ensuring better mortgage outcomes for vulnerable consumers will be an on-going challenge for the FCA and an approach of fostering technological solutions will not by itself address the problem. A stronger regulatory approach over the data lenders must provide to price comparison sites and intermediaries, as well as access to free-to-client advice, may be required to better protect and enhance the mortgage deal choices of these consumers.

The FCA should ensure:

- that lenders are more transparent about making their necessary eligibility and other qualification criteria available to other market participants at an earlier stage;
- that lenders share any changes to products or new product information as soon as possible with comparison sites and intermediaries;
- that price comparison sites that compare only a limited range of products are regulated to ensure that any such limitations on products compared are clearly highlighted.

Simply allowing innovation and competition to address customers' needs has not to date been successful with regard to the mortgage market nor other markets, such as energy.[6] To address all consumers' needs, the FCA may need to regulate to ensure that organisations developing comparison tools have: access to particular sets of lender data, including all eligibility and other qualification criteria, within specific time frames; that comparison tools refer to telephone and face-to-face advice services; and that customers identified as vulnerable are supported through the process by a free-to-client mortgage adviser. The FCA should play a role in ensuring that all data provided on mortgage deal comparison sites is accurate and transparent.

"My husband suffers with depression and our issues with getting a mortgage and being in debt affect him greatly. This impacts on myself and my children."
StepChange Debt Charity client, March 2018

[6] https://www.ofgem.gov.uk/press-releases/ofgem-refers-energy-market-full-competition-investigation

Q4: Could there be any unintended consequences? (eg do our ideas in this area present any risks to consumers or industry? Does this dampen incentives to innovate?)

There are circumstances where consumers cannot be expected to take responsibility for their decisions. This includes where someone is vulnerable, a product or service is particularly complex or where there is uncertainty. As the FCA states: "When a consumer faces barriers accessing financial services, this undermines their ability to take responsibility for their own financial security, which in turn, potentially damages their longer-term wellbeing" [7]. This particularly applies to the mortgage market where there are a huge number of complex products to meet a variety of different needs, the costs of making the wrong decision can involve large amounts of money, or even risk the loss of a home, and there is considerable uncertainty around future interest rates and property prices.

The FCA has recognised in its Consumer Approach[8] the limitations of consumer responsibility and the explicit expectation that firms must exercise extra care in certain circumstances, such as where consumers may be vulnerable. It acknowledges that vulnerable circumstances can also make it more difficult for people to understand information, make decisions or articulate their needs to firms. StepChange has previously welcomed the clear commitment made by the FCA in its Consumer Approach document to prioritise the needs of vulnerable consumers, particularly those with low resilience.

However, there is a danger that the FCA's proposed approach of using technological innovation to make it easier for consumers to find the right mortgage could have the unintended consequence of increasing the detriment already experienced by vulnerable consumers in the mortgage market, or at least increasing the gap between outcomes for vulnerable and more financially capable and resilient consumers. Targeted additional regulatory intervention may be needed in the mortgage market to ensure that lender and intermediary firms treat their customers fairly and adapt their products and services to meet the needs of different consumers, particularly those who are vulnerable. The FCA's evidence that a greater proportion of vulnerable consumers are currently more likely to be paying more for their mortgage than the cheapest available offers, suggests that innovation through technology alone is unlikely to reduce the inequality in consumer outcomes currently seen across the mortgage market.

A wider range of tools giving consumers more choice about the support (including advice) that they need and offering greater convenience

Q5: Do you think consumers would benefit from more choice on the tools they use (including advice) and the support they receive in the way outlined above? (if so, which categories of consumer? Or if only some consumers should have more choice about whether or not to receive advice, which categories of consumer are these? What else could we do to encourage the development of online advice?)

We have some concerns that the FCA is considering reviewing the advice and suitability rules introduced by the Mortgage Market Review, based on the argument that these are restricting

---

[7] https://www.fca.org.uk/publications/corporate-documents/approach-consumers
[8] *ibid*

consumer choice. The interim report cites the increasing number of first-time buyers and home movers taking mortgage advice that has not resulted in any increase in the numbers of those that have signed up for the cheapest available deal for which they are eligible. The FCA interim report suggests that this points to some consumers spending time on, and in some cases paying fees for, advice that they do not need.

The Mortgage Market Review rules on advice were introduced to provide greater consumer protection and have resulted in a re-building of consumer confidence in the mortgage market since the 2008 financial crash, when many mortgage products were sold to people for whom they were simply unaffordable.

We are concerned that firstly, too many consumers (30%, according to the FCA's research) are not getting the cheapest mortgage deal, even when they have received advice. Although for some this may be the most suitable deal for them, such a high proportion suggests that in at least some cases the quality of advice is not sufficient to meet their needs. Further consideration should be given to changing the FCA's mortgage advice rules around requiring firms to consider price when assessing whether product(s) are suitable for a consumer's needs and circumstances.

Secondly, that vulnerable clients will be adversely affected by any weakening of the current protections around referral to advice. It is these clients who, as a result of their circumstances, are least likely to understand and be able to make decisions about different mortgage products and are more likely to have complex circumstances, which make advice even more essential. Vulnerable customers are currently more likely than average to have a mortgage deal that is more expensive than the cheapest available to them. They are unlikely to be able to navigate the market themselves and will still go to intermediaries and rely on what they are told – but they won't have redress if this is outside an "advice framework".

MCOB 4.8.2A states that: "Subject to certain limited exceptions, where the *rules* in *MCOB 4.8A* apply to a *firm* they restrict *execution-only sales* (which term is defined to include variations of existing contracts) to cases where:

1. (1)
   there is no spoken or other interactive dialogue between the *firm* and the *customer* during the sale; or
2. (2)
   if there is spoken or other interactive dialogue between the *firm* and the *customer* during the sale:
   1. (a)
      the *customer* is a *high net worth mortgage customer*; or
   2. (b)
      the *customer* is a *professional customer*; or
   3. (c)
      the loan is solely for a business purpose;

   and in each case the *customer* has positively elected to proceed with an *execution-only sale* and (in the case of a *professional customer*) identified the product he wishes to purchase;"

There are several categories of consumer where we think these regulations should be broadened to ensure that firms assess the need for mortgage advice, and ensure they refer to free-to client advice if required. This would ensure more appropriate consumer protection in the mortgage market. In most cases this should cover vulnerable consumers and those with additional complex needs or in complicated circumstances. For example, we have already argued in a previous FCA consultation response that all those considering the choice between a retirement interest-only mortgage or equity release product should receive advice.

An additional advantage of mortgage advice is the prompt for consumers to consider unforeseen events such as losing their job or falling ill which may affect their ability to keep up with their mortgage repayments. In a recent survey of StepChange clients, only 5% of our clients who had a mortgage were currently or had in the last two years been on benefits. But these clients reported that they had found the welfare support was insufficient to cover their housing costs:

"[My Support for Mortgage Interest] covers half of my mortgage interest. I am expected to find the rest from my benefits. The Govt now also expects me to pay this back. It is designed to place my family in poverty and then keep it there"

"DWP paid towards the interest of mortgage with us finding the shortfall."

[Benefit support is] "Ridiculous when you have a mortgage."

Comments from StepChange clients with mortgages on their experience of benefit support with their housing costs, March 2018

Advice may prompt customers to pursue insurance or saving options to cover them against a temporary income shock, so better protecting them against having to use credit to cover their housing costs.

Q6: What do you think would be necessary for this approach to work and what do you see as the main challenges? (eg should we trial an approach to give consumers more information about whether to receive advice? Are there other regulatory barriers to the development of tools to help consumers choose a mortgage more effectively?)

There are concerns about any weakening of the current regulatory requirements around mortgage advice. However, the FCA's proposal to develop new tools to support better comparison of mortgage products, mortgage advice services and mortgage applications could have positive outcomes in improving consumers' financial capability and ensuring they are more engaged in any decisions they take.

StepChange, itself provides debt advice that is subject to FCA regulation. Despite this, clients can choose between receiving telephone debt advice from a trained adviser or online advice, underpinned by a high level decision logic system. This demonstrates that with sufficient investment expertise it should be possible to deliver regulated mortgage advice services, although at the moment none of the existing online mortgage brokerage services provides a wholly online service.[9]

Q7: Could there be any unintended consequences? (eg do you have any views on the impact of reduced regulatory consumer benefits for those consumers who would no longer seek advice? Could there be any unintended consequences to increasing provision of online advice? If so, how might these risks be mitigated)

The FCA has argued that mortgage advice brings no cost benefit to consumers in the Interim report, to explain their finding that almost a third of borrowers who receive advice are still failing to get the cheapest suitable mortgage, a similar proportion to that before the Mortgage Market Review when, in some cases, the number of mortgage customers receiving advice was 30-fold lower. There could be other explanations for this finding. The FCA should research the possible risks of reducing advice requirements before introducing any changes.

StepChange Financial Solutions advisers have collated several client case studies that show that there is also a problem with mortgage lenders not accepting some of the solutions developed through their advice process, particularly for clients who have reached the end of their mortgage term but have not fully repaid their loan (Appendix 1). In some cases, these seem to be in breach of FCA regulations around forbearance and “treating customers fairly”. If lenders do not accept viable solutions that consider an individual’s unique circumstances, the outcome for the consumer will be considerably worse, including in extreme cases the loss of their property.

In an environment where the long period of record low interest rates looks set to end[10], the risk that customers choosing their own mortgage without the aid of an adviser, get stuck on poor value deals is likely to increase, as the standard variable rate rises and fewer suitable fixed rate products are available. Relying on tools to help consumers choose a mortgage more effectively, without the support of an adviser, could prove even riskier in the next few years. There is a danger of considerable consumer detriment if regulatory protections for mortgage customers are reduced, based on evidence collected when interest rates remained low and stable, and this relaxation of advice regulation is introduced at a time when interest rate levels are likely to rise, and with the added economic uncertainty created by Brexit.

“I own my property [and would benefit from a] decrease in mortgage payments but it’s just about manageable. Bit worried about interest rate rises.”
StepChange client, March 2018

Helping consumers choose an intermediary on an informed basis

Q8: Do you think consumers should be given more help to assess intermediaries’ strengths and weaknesses in the way outlined above?

[9] http://www.thisismoney.co.uk/money/mortgageshome/article-4151248/How-mortgage-online-digital-brokers-try.html
[10] https://www.theguardian.com/uk-news/2018/jun/21/bank-of-england-moves-closer-to-august-interest-rate-rise

Recent research by a free-to-client mortgage intermediary firm estimated that 75% of mortgage borrowers using a broker were paying a fee for the advice they received, despite their adviser receiving a commission payment from the lender too (the procuration fee). Many less experienced buyers believe this is the norm across the board and that they have no choice but to pay for advice.[11] We recommend that all mortgage market consumers should be advised of the availability of free-to-client mortgage advice.

We welcome any support that helps people to be better aware of their choices of intermediary, to assess their strengths and weaknesses and provides a way of effectively comparing the fees charged. More publicly available information about intermediaries' service quality might also ensure that poor quality providers were driven out of the market.

Q9: What do you think is necessary for this approach to work and what do you see as the main challenges? (eg what information is needed for this to be of practical value to consumers, such as the price, service and quality factors? How can we ensure the information gains traction with consumers?)

Q10: Could there be any unintended circumstances?

The interim report investigates the impact of different commercial relationships between firms engaging in the mortgage market to see if these were harming consumers. The evidence presented suggests that the level of procuration fee or retention procuration fee paid by a lender to an intermediary does not influence the intermediaries' mortgage or lender recommendations to clients – leading to the conclusion that procuration fees are not harming consumer outcomes. In fact, the FCA notes that a small number of intermediaries have eliminated the financial incentives for recommending products that have higher procuration fees by using salaried advisers with a bonus scheme that pays out an equalised bonus amount for each procuration. A fair comparison of intermediaries should allow access to the procurement fees paid for each mortgage product.

As an intermediary, StepChange Financial Solutions service reaps the benefits of the procuration fee system, which allows the service to be provided free to clients, whilst ensuring it does not bias its recommendations. If procuration fees were to be banned, because of the incentives they offer to recommend products with higher fee levels, the FCA would need to ensure there was some replacement payment by lenders, for mortgage advice that was free to clients. If no such alternative funding was introduced, an unintended consequence of banning procuration fees is the risk that all mortgage advisers would need to charge advice fees and millions of lower income mortgage customers could end up unable to afford any advice.

The interim report also notes that around a quarter of mortgage customers are referred to intermediaries by their estate agents, and this is often an in-house service with the estate agent receiving a fee for each referral. Evidence for the FCA's 2017 Financial Lives survey[12] shows that around a quarter of these customers felt obliged to use this intermediary service to ensure they got property viewings and were able to make a quick offer. Although consumers who used an

---

[11] http://www.thisismoney.co.uk/money/mortgageshome/article-4873476/Mortgage-advisers-accused-double-dipping-borrowers.html

[12] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults

intermediary that had a commercial agreement with their estate agent did not have significantly different mortgage costs from those who used an intermediary without such an agreement, the pressure to use a particular intermediary may reduce the effectiveness of the FCA's proposals to help consumers to choose an intermediary on an informed basis. Many in-house mortgage advisers working for estate agents charge an advice fee to clients and only offer mortgage products from a club of lenders (the Interim report notes that restricting mortgage recommendations to a smaller number of lenders is associated with more expensive mortgage recommendations for consumers). But, if borrowers feel pressurised by estate agents (that are not strongly regulated) to use the in-house mortgage adviser, they may not get the intermediary most suitable for their needs.

Finally, we welcome the FCA's conclusions that one of the commercial relationships that raises concerns about competition issues is the exclusivity clauses between lenders and intermediaries that limit access to mortgage products.

StepChange Financial Services advisers have reported on two such deals that they feel disadvantage consumers, resulting in them paying more in the long run.

Negative impact of exclusivity deals on consumers: case study 1

> ***A building society lifetime mortgage product is only available to customers through one intermediary firm, which also offers free mortgage advice specifically in relation to this product. However, if, after this advice, the customer is found not to be suitable for this specific mortgage product they are referred to a second intermediary firm which charges clients for further advice – which is available for free from other intermediary firms.***

Negative impact of exclusivity deals on consumers: case study 2

> ***A bank, insurance company and intermediary firm have signed an exclusivity deal which ensures that clients of the intermediary are offered a much lower interest rate on their mortgage rate product by the bank than is available to customers referred to the bank from any other intermediary firm. Thus, this mortgage product is only available to clients of one intermediary firm.***

The FCA has simply drawn "firm's attention to" the rule on the use of exclusive distribution and non-compete and non-solicitation clauses. We would recommend the issue of exclusivity clauses in commercial contracts between mortgage market lenders and intermediaries continues to be pro-actively monitored by the FCA in terms of consumer detriment and anti-competitive practice, and an analysis made of whether any such clauses breach current regulations. If not, but they still result in harm to consumers and/or a reduction in the competitiveness of the market, the FCA will need to consider revising regulations.

Fair treatment of those consumers who do not or cannot switch

Q11: Do you think it should be made easier for consumers with active lenders to switch?

Yes. Consumers should not face detriment because of regulatory changes in the mortgage market and lenders' risk-averse interpretation of some of these changes.

Q12: Which consumers should be covered in our approach? (eg do you have views on whether any intervention in this area should be limited to consumers who took out a mortgage or last switched prior to a tightening in lending criteria post-crisis? If so, what would be an appropriate date? Also, should we include other groups of customers such as who have fallen into financial difficulty because of being unable to afford payments on a reversion rate, but would otherwise satisfy the remedy constraints/criteria? Or should we leave customers in arrears to be considered under our rules and guidance in MCOB 13 which set out how we expect firms to treat customers in payment shortfall fairly given the customer's individual circumstances?)

Q13: What do you think is necessary for this approach to work, and what do you see as the main challenges? (eg How could any changes be effectively communicated to the relevant consumers?)

Q14: Could there be any unintended consequences?

Money Saving Expert is working closely with many of the consumers who cannot switch mortgage products whether these deals are with active lenders or with firms not authorised for lending.[13] We support their recommendation that the FCA should reintroduce an affordability criteria waiver for customers with active lenders, who have had no change in their circumstances and have kept up their mortgage payments but when their deal ends find they are "mortgage prisoners transferred on to a standard variable rate because they no longer pass new stricter affordability checks". This waiver should apply to the existing lender as well as all other mortgage lenders, so these customers can explore the suitability of many different mortgage products as possible.

For those lenders who have mortgages with firms not authorised for lending, the FCA should work with HM Treasury to develop a scheme that allows them to switch to a product with a cheaper rate than their current standard variable rate.

This is an issue that the Interim report shows affects tens of thousands of people, who are losing more and more money the longer it continues. The FCA needs to take urgent action to ensure these lenders can switch to cheaper mortgage products as soon as possible.[14]

> *[I'm] "unable to change mortgage providers. Initial mortgage meant higher interest rates."*
> StepChange client, March 2018

Long-term inactive customers

Q15: Do you think we should do more to encourage long-term inactive customers to switch in the way outlined above?

---

[13] https://blog.moneysavingexpert.com/2015/04/im-taking-on-the-eu-mortgage-credit-directive-its-going-to-create-many-mortgage-prisoners/?_ga=2.94885276.1430018131.1533214265-413277265.1498128567

[14] https://www.moneysavingexpert.com/news/mortgages/2018/06/regulator-under-fire-for-lack-of-urgency-on-mortgage-prisoners

Yes. StepChange Financial Solutions service advisers have reported seeing clients who have been switched to a standard variable rate when their mortgage deal ended, who have received very little proactive information about what this means for them from their lenders either before or after the switch is made. We recommend that lenders should be expected to do much more to proactively inform their customers of the implications for them and the benefits of switching to other products for which they are eligible. In support of this proposal, Citizens Advice reported that 69% of respondents to their survey of long-term inactive customers who had been switched on to a standard variable rate said that they had never been informed that they could save money by re-mortgaging.[15]

The interim report finds that there are 800,000 customers who could benefit from a switch but have remained inactive, while a further 160,000 may see some benefit from switching. The FCA estimates that up to 10% of UK residential mortgage borrowers may be affected. Citizens Advice calculates that the penalty for each customer is £439 per year for those who were previously on a two-year fixed rate deal and £393 per year for those at the end of a five-year fixed rate deal.[16] The total consumer detriment could be conservatively estimated as at least £23.6million pound per year. And it is estimated that 53% of standard variable rate payers have been on their current mortgage deal for over ten years bringing the consumer detriment to thousands of pounds in total for each of these customers.[17]

Our advisers report that a barrier to switching to better fixed rate or lower rate mortgage products is the large product fee, which many of our clients cannot afford, although they would benefit from the cheaper monthly mortgage payments. Another barrier to switching for those with mortgage arrears: most lenders will only allow switches to a new product if mortgage payments are up-to-date. However, switching to a cheaper deal would help many of our clients to begin to, or more quickly, repay their mortgage arrears.

As a debt advice charity, we are particularly concerned that the higher mortgage payments on switching to a standard variable rate may lead to those affected taking out credit to cover the difference or falling behind on other bills because they do not want to fall into mortgage arrears. Either path risks escalating financial problems that could push people into problem debt, with its associated social costs – when more information about, and support to switch on to, a cheaper mortgage deal could prevent this cycle of events.

“Everything goes on the mortgage, so little for food, heating, entertainment for me and my daughter.”

StepChange client, March 2018

Again, it is the most vulnerable consumes who are more likely to remain on a standard variable rate: older people, those with less education and lower-income groups are those who are most likely to not switch to a better deal. Another group of customers, those on an interest-only mortgages, were the ones who saw the biggest financial penalties for not switching. [18] Vulnerable customers are those

---

[15] Bank of England/ NMG survey, 2016

[16] https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/exploring-the-loyalty-penalty-in-the-mortgage-market/

[17] *ibid*

[18] *ibid*

whose needs the FCA has committed to prioritise in its Consumer Approach document, so should be prioritised in any review of regulation in the mortgage market.

The level of consumer detriment caused, the disproportionate impact on vulnerable consumers and the poor response by lenders provide a strong argument for the FCA to go further than its current proposal to address this. Simply asking lenders to contact affected customers by letter, a year or so after moving onto a reversion rate, giving them a simple and straightforward means of moving to a cheaper mortgage is too little, too late.

Q16: What do you think is necessary for this approach to work in the mortgages sector and what do you see as the main challenges? (eg is this something that could be delivered by the industry or would it require new or amended rules or guidance to prove effective? What would be an effective alternative where no suitable product is offered by the customer's existing lender? Do you have any views on how affected consumers could be offered a better deal?)

We recommend that the FCA should co-ordinate an industry-wide agreement for an automatic internal switch to a more competitive rate for all customers ending a fixed term mortgage deal meeting certain criteria. To make this effective for the most vulnerable customers, the FCA should do more research into the impact of introducing regulations around the maximum interest rate, pegged to the standard variable rate, for automatically switched accounts of consumers judged to be vulnerable and, perhaps more widely.

We also recommend the following proactive measures for lenders:

- Introducing a requirement for lenders to contact standard variable rate payers regularly to let them know about the possible financial benefits of switching to products they offer for which they are eligible. Lenders should use the communication channel (mail, telephone, e-mail or SMS) for which customers state a preference to provide this information. Information from lenders needs to be provided in a consistent, easily accessible and transparent way so that comparisons can easily be made between the standard variable rate mortgage and other mortgage products, including any differences in fees, flexibility, eligibility criteria and minimum loan amounts.
- Ensuring that all mortgage products that the lender offers are available to all eligible customers. There should not be different deals for new and existing customers, especially if these penalise the existing customer who hasn't switched, as this is itself is a sign that they are more likely to be in vulnerable circumstances.

Q17: Could there be any unintended consequences? (eg any impact this could have on prices for new customers)

The FCA suggests that any measures to address the negative impacts of not switching from a standard variable rate mortgage will reduce profits for lenders. They argue that this could increase the prices new customers have to pay for their mortgage deals.

However, at present, it is those on low incomes or with less education, who are subsidising the lower priced mortgage deals for new customers who may be much more financially capable and resilient and may be more likely to shop around for the cheapest deal when their current mortgage term ends.

If the FCA wants to prioritise the needs of the most vulnerable consumers, this seems a fair trade off. Further research into the total consumer detriment caused to specific categories of consumer, through remaining on a standard variable rate mortgage and an impact assessment of different regulatory solutions aimed at protecting specific groups, or across the whole customer base, would develop the evidence base further. This should inform decisions about how far the balance of protection should tip between vulnerable existing mortgage customers and new borrowers, although protection of the former should remain the FCA's priority.

Appendix 1

Examples of StepChange clients with poor outcomes in the mortgage market

Case study 1

The client has a reserve account with bank X that matured in January with £75,000 outstanding on the mortgage. The client stated that she had been to see a financial advisor in branch who agreed to a monthly repayment arrangement in the region of £1400 to start to clear the capital balance. The client began paying the arrangement and was then later told by the litigation team at Bank X that the advisor in branch should not have offered the arrangement and it was void. Bank X then told the client that they intend to continue with their collections process and that the client should seek independent advice.

The client did not want to consider an Equity Release (ER) product unless completely necessary. She advised that she had previously looked in to ER and the costs/charges involved put her off the product.

She also advised Bank X that she was owed around £40,000 from her son who was in a process of selling a property. She had guarantees from her son that the money would be with her by June at the latest. The client thought that if she was going to require ER in the long run, it would be more beneficial to clear part of her reserve balance with the funds from her son which would mean that she did not need to borrow as much overall through ER. Bank X refused to consider this in their decision as they felt that the money owed to the client from her son was not guaranteed.

Essentially, the client was looking for a temporary or on-going arrangement with Bank X which avoided the ER route completely. She had already proved affordability/viability with the financial advisor in branch.

The client felt that she had got inconsistent advice before speaking to StepChange and intended to make a complaint to the lender officially.

Case study 2

The client had an interest only mortgage (IOM) with Bank Y which was due to mature in March 2018. The lender had advised the client that they would pass the case to litigation if the mortgage balance was not cleared in full by the 9th March. The lenders refused to extend the term of the mortgage.

The client would like to stay in the property ideally but was aware of the situation. She was making overpayments to try to reduce the capital balance and the property was on the market.

The property was valued at around £450k and the balance of the IOM was around £325k. Bank Y referred the client to StepChange Financial Solutions, even though the shortfall in capital repayments was far too large for Equity Release to be a viable option at the time.

The client advised that she also had a property that she owned in Barbados worth around $500k. She had a meeting set up in March with a real estate agent in Barbados to sell the property. If the property sold, she would have most (if not all) of the funds that she would need to clear the IOM. If a shortfall was left over, Equity Release would certainly be a solution at that point. Bank Y refused to acknowledge the potential sale of the overseas property in their decision to go to litigation.

A simple approach to this scenario would have been to allow a short-term extension of the IOM. The client was doing absolutely everything she could to address the situation and would potentially be able to clear the mortgage within months.

Case study 3

The client has an interest-only mortgage (IOM) with Bank Z that is due to expire in June 2019.

When the mortgage matures, the client will be left with a shortfall of around £20k. The client advised that she was very concerned about the shortfall and is keen to get a solution in place.

She is a vulnerable client and advised that she suffers from several health issues. She stated that the situation with her IOM was causing her great stress and making her health issues worse.

The client spoke to Bank Z over the phone and they advised her that they are not willing to discuss arrangements until after the IOM expires. She also visited staff at a local branch, but they refused to help her with face to face advice.

Case study 4

Bank Q referred this client to us. The client and her partner have an 'offset' mortgage which is due to expire in 2 days and this has left a shortfall of £51k.

The client advised that they had not saved enough to cover the remaining balance. They approached Bank Q to ask if they could discuss alternative options directly, but Bank Q refused to deal with them.

They stated the reason for this was that the product was at an end. Bank Q advised that the clients had 'left it too late' to ask them for help. The client stated that the lender would not discuss options, as there was not enough time to book them in with an in-house mortgage advisor before the expiry date in two days.

It seems that some form of breathing space and at least a basic discussion with the client would be a fairer approach in these circumstances.