

CLIENT MEMORANDUM

UK Financial Conduct Authority Launches Mortgage Market Study

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AUTHORS

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On December 12, 2016, the UK Financial Conduct Authority (FCA) announced that it is launching a market study into the UK mortgage market. The study will focus on first charge residential mortgages and will analyse two broad questions:

- i. at each stage of the consumer journey, do the available tools help mortgage consumers make effective decisions? The reference to available tools includes price comparison websites or best buy tables, mortgage calculators, as well as advice (whether provided by a lender or a broker); and
- ii. do commercial arrangements between lenders, brokers and other players (such as estate agents, developers, providers of ancillary services and third-party administrators) lead to conflicts of interest or misaligned incentives to the detriment of consumers?

The FCA is carrying out the market study under powers granted to it by the Financial Services and Markets Act (FSMA). This means that the FCA has greater flexibility in terms of its timetable than if it were carrying out the study under its concurrent competition powers under the Enterprise Act 2002. However, it should be noted that the FCA may only use FSMA powers to mandatorily require information from firms that it regulates and certain persons connected with them.

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The FSMA also provides the FCA with the power to impose remedies following a market study without having to make a Market Investigation Reference (MIR) to the UK Competition and Markets Authority (CMA).

AREAS OF FOCUS

The market study follows the FCA's Call for Input (CFI) in October 2015. The FCA notes that the CFI assisted it in identifying areas where competition can potentially be improved for the benefit of consumers and notes that it will focus on the specific areas set out below.

- **Demand-side issues with decision-making tools:** The FCA is concerned that some consumers may be unaware of particular tools that would enable them to make more effective decisions, or that they may not make best use of them.

This may be for a number of reasons including, for example, that the available tools may not overcome the complexity of products and charges; they may fail to address, or may even exacerbate, behavioural biases. Additionally, they may fail to provide incentives or triggers for the consumer to shop around or switch.

- **The role of advice and intermediation:** The FCA notes that some respondents to the CFI raised concerns regarding certain features of the advice process. The FCA is interested in understanding how consumers determine whether or not to obtain advice and how they choose an adviser and will ask a number of questions in this regard.

The FCA will also study how the increased provision of advice has affected outcomes for different types of consumers, including whether consumers who obtain advice typically obtain better outcomes than consumers who don't.

- **Firm conduct issues:** Respondents to the CFI noted that customers focus on headline rates when making purchasing decisions. Respondents also observed that switching prompts received by consumers from lenders and/or brokers may affect consumer behaviour.

The FCA will consider the approach lenders and brokers take to incentivizing consumers to switch products, with a particular interest in whether lender practices might reinforce consumers' behavioural biases.

- **Impact of existing FCA regulation:** As a result of the FCA's previous Mortgage Market Review (MMR) in 2009, the great majority of mortgage sales involve advice. The FCA will consider whether firms face regulatory barriers to providing tools and guidance or developing innovative sales channels and whether firms have little incentive to develop tools that support consumer decision-making.

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The FCA will also analyze whether advice, including the requirement that firms recommend a suitable product, rather than the *most* suitable product, has had an impact on the value of advice and whether the rules are imposing unnecessary costs on consumers.

- **Commercial arrangements between market participants:** The FCA will study the impact of inducements paid by lenders to brokers and by brokers to estate agents and developers and to other third parties including price comparison websites. Specific issues that the FCA is interested in include:
 - the impact of inducements paid by lenders to brokers and if this may influence brokers' advice and limit the number of lenders both on their panel, and those they recommend;
 - whether smaller brokers experience difficulties in accessing products to distribute from certain lenders because it is not cost-efficient for lenders to distribute their products through very large numbers of brokers;
 - whether large broker networks have significant influence over the market because they control visibility and access to lenders' products;
 - the impact of incentives estate agents have to refer consumers to use their in-house broker and whether this leads to worse outcomes for consumers;
 - the impact of incentives that exist in the new-build sector between lenders/brokers/estate agents and large developers, and whether this limits the number of firms on panels run by lenders/brokers or restricts consumer choice;
 - whether inducements from lenders influence how search results are ranked and displayed on price comparison websites; and
 - whether relationships between lenders and mortgage sourcing systems prevent more innovative products from entering the market.

Potential Outcomes

If the FCA finds that competition is not working well in the UK mortgage market and it needs to take action, it could impose a range of possible measures, including:

- imposing market-wide remedies, such as rule-making, including changing or potentially withdrawing existing rules;
- publishing general guidance;

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- proposing enhanced self-regulations;
- imposing firm-specific remedies; or
- referring one or more issues to the CMA for further in-depth investigation.

Timetable

The FCA will now embark on an intensive fact-finding exercise, approaching a wide range of market participants for data and information relating to the issues set out above. Following the fact-finding phase, the FCA will publish its interim report in 2017 setting out its analysis, preliminary conclusions and potential remedies (if any). The FCA's final report will be published in early 2018.

The launch of the mortgage market study follows the FCA's recent findings in a separate study of the asset-management industry. It marks an important intervention by the FCA into the UK property sector and demonstrates the FCA's willingness to consider changing rules and regulations in sectors where competition is not working well.

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