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‘Norming’ the MMR

The market dynamics of MMR and its impact on T&C

Carl Redfern, Director at Redland Business Solutions

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The market dynamics of MMR and its impact on T&C – **Carl Redfern**, Director at Redland Business Solutions

The good news is that the mortgage market outlook for 2014 is positively positive!

Recent figures from the Council of Mortgage Lenders for lending in October 2013 shows a 24% year on year growth from an estimated £170 billion this year to £195 billion next year, and £206 billion in 2015. The CML anticipates that net advances are likely to rise from £10 billion this year to £15 billion next year and £20 billion in 2015.

In addition, the 'Help to Buy' schemes, and 'Custom Build' initiatives seem set to boost mortgage demand, with increasing house prices also stimulating the amount of remortgage lending.

Given the above, and the fact that intermediary distribution accounts for approximately half of market share, it must be a great time to be a mortgage broker! Business will soon be booming, more and more lenders are coming back to the market, with more products and a wide range of what used to be specialist lending is coming to the fore – 'Buy to Let' schemes not the least.

However, MMR is also coming – April 26th is not far away.

The MMR set out to reform the mortgage market to address concerns regarding conduct of business, issues surrounding distribution and advice, a revisit of the disclosure requirements and a desire to move to responsible lending for all. The intended outcome is a both a sustainable market and one which encourages and protects consumer engagement, and critically also works for firms.

Lenders are now responsible for affordability but there has been much discussion on how this is practically applied. Many mortgage brokers will argue that even post MMR they continue to need to check affordability for their clients, after all, how can you give good advice to enter into a contract the client can't afford or sustain?

The need for the majority of all 'interactive' sales processes to be advised is another area where the practical impact of the rules has been open to vigorous debate. The loss of the 'non-advised' sales process is not in itself very significant for most intermediaries, who probably provided advice in most cases any way and have done for years.

'Advice' after all for the independent mortgage broker is their unique service proposition, it distinguishes them from the distribution channels of the lenders and helps embed value in the eyes of the consumer. One practical consequence of MMR for advisers is deeper more intrusive fact finding and a longer time spent on the advice process, potentially further eroding the profitability of the loan.

Each of the lenders will be imposing their own standards on affordability checks, that won't all be consistent and will require more detail than before, especially when considering the information needs for and exception policies for:

- ❑ Interest rate stress tests
- ❑ Interest only acceptability
- ❑ Income evidence requirements
- ❑ Credible repayment strategies
- ❑ Business loans

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Firms will also need to comply with the new requirement for advisers to hold appropriate qualifications. Most advisers will already be qualified, although those who have only passed part of the required exam can only continue to provide advice as 'trainees' acting under supervision. Firms will need to carefully track and monitor progress towards qualification and the extra supervisory requirement could stress existing spans of control. This is an area the FCA have already indicated they intend to monitor post MMR.

Particularly given the new focus by lenders on business quality potentially driving fees and influencing agency permissions, intermediaries must evolve their processes under MMR and accept they may be doing more work without necessarily being paid any more for it.

Hence we are faced with a challenging dynamic, in that in a market which is getting busier, with more clients applying for more mortgages, wanting to complete more quickly, intermediaries will also be:

- ❑ Recruiting new staff
- ❑ Training and evolving their own new processes
- ❑ Doing more work on each case
- ❑ Working harder to market the value of their service to clients
- ❑ Digesting and accommodating lender's new criteria and policies
- ❑ Managing their increasing Advice Risk
- ❑ Managing the new focus on 'Conduct Risk'

Add to this landscape that the FCA intends to specifically monitor the success of the MMR initiative and wants to see evidence that the new 'Responsible Lending Policies' are being adhered to, and are achieving the desired customer outcomes.

Lenders will be regularly reviewing their new policies which will require that intermediaries need processes to check that they understand the latest versions.

Firms need to ensure and evidence that consumer outcomes have an appropriate priority within their businesses. A bit like TCF this could be considered quite 'nebulous' but what it means in practice is that you regularly assess the potential impact on customer outcomes within your firm and document it! Meeting minutes, process changes, risk management policies, T&C schemes, file checks, competence assessments etc. should all refer to an assessment of customer outcomes and the risk of potential detriment.

Part of the regulator's approach will focus on making forward looking judgements about a firm's business models, and product strategies. At a recent event an FCA spokesperson confirmed that under their new 'Three Pillars' supervision approach, they will focus on a firm's 'culture' and how things are being run from the top. This will involve "greater use of judgement" rather than a comparison against quantified metrics.

The result is that firms will themselves need to exercise more 'judgement' over what is required and appropriate. They (the FCA) want to see evidence of how a Firms' people are adopting and demonstrating appropriate values both practically by their actions, and through a regular assessment of resultant customer outcomes. Intermediaries as well as lenders need to be certain their systems and controls represent the 'focus and priority' they are placing on ensuring their people are delivering good customer outcomes.

In practice this means, reviewing your policies (and documenting them), updating appropriate new KPIs and documenting the regular measurement of them. It is also essential that any resulting 'remedial' actions are documented and followed up to prove they have been successful.

Firms will also need to be able to respond flexibly to thematic issues that may arise from the regulator's 'forward looking approach' to consumer and market risks, and evidence such responses accordingly.

FCA supervisors will specifically examine T&C arrangements during a visit, including recruitment and 'on boarding' and how competence is assessed throughout induction. Ongoing competence is critical because this directly links to how a firm is managing their 'Conduct Risk' exposure. In a market where demand will be increasing, firms would be well advised to check they have robust and appropriate T&C controls in this area.

Certainly, keeping accurate and consistent records of case reviews, observations, and risk assessments for individuals will be essential, but the firm will also need to demonstrate how it is monitoring, analysing and mitigating against potential risks on a company wide basis .Development needs of the individual and risk to the business will need careful management as MMR 'beds in'. Firms, networks and lenders may find their initial controls need tailoring and refining, in fact, it is probably wise to accept now, and plan for resources to evolve your system and controls during the year.

Going forward lenders and firms will need to monitor the types and quality of business being transacted with increased scrutiny on customer related outputs. Such outputs could include customer surveys, complaints analysis, and analysis of KPIs such as:

❏ Execution Only cases

❏ Cases where fees added to loan

❏ Sales to vulnerable clients

❏ Interest Only loans

❏ Sales to 'High Net Worth' clients

❏ Rejected advice

They may also need to revisit their sampling and monitoring protocols of the business placed on their mortgage books. Both types of analysis will help them to confirm that their post MMR compliance policy is delivering the required outcomes and that in practice it is being adhered to.

However the adoption of the required culture and internal policy is a key issue for lenders and firms alike. At a recent conference a senior spokesman for a major lender described that although they had tackled the tangible training for their MMR changes early on, in retrospect that was 'the easy part'. Achieving consistent behaviour and creating a 'new stuff becomes the Norm' result in terms of culture, principles and daily behaviours had proved to be a massive business challenge.

Their spokesman's advice to the conference was to invest early on in:

❏ Assessment processes

❏ Feedback loops

❏ Root cause analysis

❏ Supervisors and supervision

Changing culture, changing behaviour, changing 'the Norm' takes persistence, and perseverance and the results need to be evidenced! Investing in these things provides both.

Many Intermediaries may not need significant degrees of change – the right result for the customer has always been at the heart of their business model. While this may be true, following MMR the firm needs to both evidence that fact and demonstrate they place high priority on keeping it true.

At Redland we have seen an increasing degree of recognition for the need for a system based approach to some of these regulatory and governance challenges. The requirements of HR, performance management, T&C, Compliance and Business Quality are blurring in response to the needs for more efficiency and closer management that these market changes are creating.

Our Insight product continues to provide strategic support for our clients within the UK financial services and mortgage markets and is actively helping them face the challenges of this demanding market dynamic with confidence.

So in 2014 we can expect a growing market with more compliance considerations for intermediaries, and a new regulatory regime requiring better judgement, consistent behaviours and good customer outcomes.

Surely, that's just 'the Norm' isn't it?

insight - Adviser Supervision and Risk Management

Do your Risk Management controls support all of the FCA Requirements and Guidelines?

If the answer to this question is '**NO'**, then you need to speak to us and see how Redland's **Insight** solution can allow you to confidently say **'YES'** to all of these questions and more!

Do your **supervisory processes and procedures** meet and deliver the required standards ?

Are you able to access all key information within the business for effective **Risk Management** ?

Do your controls ensure that **remedial or developmental** actions are captured and acted upon ?

Can your firm evidence a **supervision framework** that is applied to all ?

Are you able to identify "trends" to prevent **risk and performance management** issues ?

Is your **performance management** framework effective, comprehensive and consistent ?

Do you have adequate controls for improving data collection and **management reporting** ?

The answer is Redland's insight Solution

Insight provides a valuable set of tools that enable the organisation to manage the potential risks to its business reputation.

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Formed in 2001, Redland Business Solutions is the leading provider of specialised GRC (Governance Risk and Compliance) IT solutions to the financial services and insurance industries. The company has received widespread acclaim for its Insight solution which ensures effective management in the T&C (Training & Competence) arena. The Insight platform enables critical business applications to be developed and deployed rapidly to support specific processes within financial services; including a leading edge T&C system.

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