

## MORTGAGES UPDATE

- FCA publishes Mortgage Market Study Final Report (MS16/2.3)
- FCA consults on proposed changes to responsible lending rules and guidance (CP19/14)
- Update on ECJ judgment on mortgage arrears

## Introduction

There have, over the past couple of weeks, been a number of developments in the UK residential mortgage space.

### Regulatory developments

The Financial Conduct Authority (**FCA**) publishing two key papers:

- ▶ [Mortgage Market Study MS16/2.3](#), providing the final report on its Mortgage Market Study (**MMS**). The MMS was originally launched in December 2016 to review how the mortgage market is working and whether competition could be improved to bring greater consumer benefits.
- ▶ [Consultation paper CP19/14](#) proposing changes to its responsible lending rules to reduce the relevant regulatory barriers for consumers who cannot switch to a more affordable mortgage, despite being up-to-date with payments, as found in the MMS.

This note provides a summary of the key areas of focus for the FCA and how this may impact on the firms' businesses.

### CJEU developments

The Court of Justice of the European Union (**CJEU**) have published judgment in the case of *Abanca Corporación Bancaria SA v. Santos Bankia SA v. Mendoza and Ramírez (C-70/17 and C-179/17)*. The CJEU have ruled that standard consumer mortgage contracts which allow possession proceedings to be started where a consumer has only missed one payment are unfair.

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# FCA Final Report on MMS

The MMS was originally launched to review how the mortgage market is working and whether competition could be improved to bring greater consumer benefits.

The report explains the FCA's final findings and provides a progress update on the proposed remedies.

The key aspects of the market considered by the FCA are:

- ▶ at each stage of the consumer journey, do the available tools help mortgage consumers make effective decisions?
- ▶ do commercial arrangements between lenders, intermediaries and other players lead to conflicts of interest or misaligned incentives that could harm consumers?

## *Overview of findings*

Overall the FCA found a mortgages market that works well in many respects with high levels of customer engagement and switching.

However, they do identify key areas where the market could work better which will set the direction for their regulatory focus on mortgages.

In the first instance, the FCA are seeking to address these issues through market led solutions, collaboration with the industry and voluntary measures. However, the FCA are clear that they are going to continue to monitor the market and, to the extent that these measures don't address the harm identified, it is likely that the FCA will move to more intrusive remedies consistent with what we have seen in other markets (for example, overdrafts and cash savings).

## *1. Choosing the right mortgage for consumers*

The FCA's criticism of the market is that although borrowers typically get a suitable mortgage, they don't necessarily get the cheapest mortgage. In this assessment, the FCA's focus is very much on price at the expense of other factors. For example, they fail to take account of soft factors – speed of service, trust in brand etc.

The FCA identified the following main failings in the market:

- ▶ There are many mortgage products available, but no easy way for a consumer to identify (at an early stage) the products for which they qualify and therefore to identify the best value product for them. In the FCA's view, this lack of information hampers both consumer and intermediary ability to shop around meaning that borrowers miss out on finding cheaper mortgages.
- ▶ There are strong incentives on intermediaries to find customers a mortgage and to do so as quickly as possible to generate a procurement fee. Incentives on intermediaries to search extensively for the best value mortgage are weaker.
- ▶ Consumers tend to choose more expensive mortgages due to lack of clarity on whether they will meet certain eligibility criteria. Mortgages with less demanding eligibility criteria tend to be more expensive. To keep borrowing costs down, a consumer should buy a mortgage for which they just meet the eligibility criteria, otherwise they are likely to pay a premium for the unused "buffer". The difference can be explained by transparency – some eligibility criteria is not transparent and a consumer (or intermediary) can be less confident they will meet it and be accepted.
- ▶ Missed savings are also significant where intermediaries search across fewer lenders.

A key requirement identified by the FCA therefore is looking at ways in which to improve the ability of consumers and intermediaries to shop around on products and, in particular, in making it clearer for which products a consumer is likely to qualify, which should help consumers find a better deal.

The expectations of the FCA in relation to this are:

- increased lender participation in developing innovative new tools (such as an API) to allow intermediaries to more easily identify the products a consumer is likely to qualify for, earlier in the sales process.
- tangible outputs from the effort firms have put into giving and/or getting access to qualification information.

The FCA established a working group in July 2018 of lenders, intermediaries and fintech trade bodies to consider how to make it easier for intermediaries to identify, at an earlier stage, the products customers are likely to qualify for. This group identified that the information which is not widely shared is lender's approach to affordability, risk appetite and credit scoring with a concern amongst lenders in relation to the sharing of this proprietary information.

At this stage, the FCA are keen for the solution to be market led. The FCA believe that there are models which would potentially mitigate the lenders' concerns of sharing this proprietary information while still helping consumers to understand, at an early stage, for which mortgages they are likely to qualify. This includes intermediaries providing consumers with indicative decisions in principle from multiple lenders via an API which works well in other sectors (for example, general insurance).

The FCA are wanting to see tangible outputs from firms over the next couple of months of giving and getting access to qualification information and will continue to monitor traction of new innovative tools gain with lenders, intermediaries and consumers and will keep under review whether more direct intervention (in the form for FCA rules) is required.

## ***2. The requirement for advice***

The FCA recognise that since the changes to the advice requirements made as part of the Mortgage Market Review in 2014, the vast majority of mortgages are pushed through an advised sales route. They acknowledge that consumers are potentially being channelled unnecessarily into advice and this is hampering digital innovation in the mortgage market.

The FCA's view is that there has been limited appetite for firms to develop online advice propositions and they consider that there is nothing in the rules which prevents barriers to online advice. They are to consult on specific changes to the advice rules and guidance in Q2 2019.

## ***3. More help for consumers choosing an intermediary***

The FCA recognise that the choice of intermediary can have a material impact on cost of borrowing for borrowers and it is difficult for consumers to choose an intermediary. They identify that the more lenders on an intermediary panel the cheaper mortgage a borrower is likely to obtain.

Therefore the FCA is looking at an approach to deliver an effective tool for comparing different intermediaries utilising the Single Financial Guidance Body (**SFGB**) to develop and host a broker choice tool aligned with its existing Retirement Adviser Directory. These activities of SFGB will be funded by the existing financial services levy. The tool will pull data from the FCA register and firms will be encouraged to provide information voluntarily.

Currently the preferred approach of the FCA is to incentivise firms to participate because it is in their own commercial interest rather than introducing rules to mandate participation.

## ***3. Switching: fair treatment for long-standing customers***

The FCA recognise that switching in the mortgage market is relatively high and in this respect the market is working well – the majority of borrowers are engaged with the market and switch frequently to move onto better deals at the end of product terms.

However, there is a population of borrowers who don't switch when it would benefit them to do so (please note this is different to "mortgage prisoners" who can't switch and are discussed further below).

Although this population is relatively small (800,000), the impact of not switching on this population is significant with borrowers missing out on an average saving of £1,000 per year.

This is connected to the FCA's focus on fair pricing in financial services where firms charge different prices to different consumers based solely on differences in consumers' price sensitivity (price discrimination) and firms charging existing customers higher prices than new customers (sometimes called "loyalty" pricing). Loyalty pricing is common in the mortgage market and can disadvantage consumers significantly.

The FCA is continuing to research to better understand the characteristics of those customers who do not switch (when they would benefit from doing so), including whether these consumers have particular needs or common

characteristics or whether the numbers are concentrated in specific lenders, such as, those who do not proactively offer internal switches.

The FCA are to report back later in the year together with their ongoing work on [fairness in pricing in financial services](#).

#### ***4. Fair treatment of consumers who are unable to switch***

The treatment of mortgage borrowers who, albeit up to date with mortgage payments, are unable to switch mortgage provider due to tightening of lending requirements since the financial crisis is high up the FCA regulatory agenda.

These borrowers are typically referred to as "mortgage prisoners". Some of these are with active lenders but most are with inactive firms – being firms who have acquired or have a mortgage book in run off. Some of these firms (legitimately) are not FCA authorised themselves and administer the mortgages via an FCA authorised administrator.

The remedies the FCA is putting forward are:

- Mortgage prisoners with active lenders – lenders, on a voluntary basis, have already agreed to commit to help existing customers who previously didn't qualify for a switch find a better deal (assuming they meet minimum criteria, including: first charge; active lender; up to date with mortgage payments; looking for a like-for-like mortgage);
- Mortgage prisoners with inactive firms – the approach to this cohort is consulted on in [CP19/14](#) (see below).

# FCA Consultation on 'Mortgage Prisoners'

As highlighted above, mortgage prisoners are high on the FCA's regulatory radar as suffering harm as they are paying higher than necessary mortgage payments.

The FCA is particularly concerned about:

- ▶ customers of authorised firms that are no longer actively lending (inactive firms); and
- ▶ customers of firms who are not authorised to lend.

The FCA want to help remove potential barriers to consumers switching to more affordable mortgages. Under the proposed rules:

- mortgage lenders can choose to carry out a modified affordability assessment; and
- inactive lenders and their authorised administrators are required to review their customer books and contact relevant customers.

The deadline for feedback to the CP is 26 June 2019 and the FCA will publish a Policy Statement in Q4 2019.

## *Modified affordability assessment*

The proposed rules loosen the affordability requirements and will enable mortgage lenders to undertake a **modified affordability assessment** to allow these borrowers to switch to a more affordable mortgage deal. While these proposals are intended to make it easier for firms to lend to these consumers, they **do not** require firms to do so, as the FCA recognises that lending is a commercial decision and some of these consumers will fall outside the risk appetite of many lenders.

The FCA is proposing the following:

- ▶ Lenders **can choose** to carry out a modified affordability assessment for consumers who are up-to-date with mortgage payments and who want to switch to a more affordable mortgage on their current property without borrowing more;
- ▶ Restricting the use of the **modified assessment** to those active lenders that operate a policy for offering their existing customers the ability to switch to a more affordable mortgage product. The CP contains worked examples of the modified assessment;
- ▶ Lenders using the modified assessment are required to demonstrate that the new mortgage is **'more affordable'** than the consumer's present mortgage. The FCA sets out what would constitute as 'more affordable' mortgage;
- ▶ Lenders using the modified assessment can dis-apply some of FCA's existing rules, such as, verification of income and expenditure. The FCA is proposing new rules and guidance in such cases;
- ▶ Lenders are required to tell these borrowers the basis on which their affordability has been assessed and provide some additional disclosures about potential risks and lenders are required to report back to the FCA which sales have involved the modified assessment.

## *Inactive lenders*

The FCA has identified a group of consumers who hold mortgages with firms that are no longer actively lending or their mortgages are currently owned by unregulated entities.

The FCA is particularly concerned about these consumers as they can only get a more affordable mortgage deal if they are able to switch to an active lender. **Inactive lenders and administrators acting for unregulated entities are therefore being required to review their customer books and contact relevant customers informing them of the rule changes.**

The FCA has set out a criteria for the customers who should be contacted. The FCA is proposing that this communication is a one-off requirement which administrators and inactive lenders will have to send within 13 months of the introduction of the new rules.

# CJEU case on unfair terms and mortgage arrears (*Abanca Corporación Bancaria SA v. Santos Bankia SA v. Mendoza and Ramírez* (C-70/17 and C-179/17))

## Overview

The CJEU have ruled that standard consumer mortgage contracts which allow possession proceedings to be started where a consumer has **only missed one payment are unfair**. The proceedings concerned two respective actions (C-70/17 and C-179/17) relating to the conclusions to be drawn from the finding that an accelerated repayment clause set out in Clause 6a of the respective loan agreements secured by a mortgage concluded between the respective parties was unfair. Clause 6a of the respective contracts provided for the early termination of the loan contracts in the event that the debtor missed a single monthly repayment.

## Facts

In C-70/17 Mr García Salamanca Santos brought an action for annulment before the Spanish court of first instance on the ground that those terms were unfair under the 1993 Unfair Terms in Consumer Contracts Directive. The claim was successful and the bank's appeal was also dismissed. Consequently, the bank appealed on a point of law to the Supreme Court, Spain (the referring court). The referring court decided that Clause 6a is unfair in as much as it provides for the early termination of the mortgage loan contract in the event that the debtor misses a single monthly loan repayment. However the referring court questioned whether it is possible, in the light of Article 6(1) of Directive 93/13, to declare a contractual term unfair in part, retaining the part of that term which is not regarded as unfair, and accordingly referred this question to the CJEU for a preliminary ruling.

The Santos case was joined with Mendoza and Ramírez case (C-179/17), where the applicant bank brought repossession proceedings against the borrowers, who were three years in arrears, under the mortgage contract which contained the same clause. The borrowers claimed such a term was unfair and that the mortgage was unenforceable against them. The referring court noted that in such scenarios the case laws of the Supreme Court of Spain allowed the repossession proceedings to continue by replacing the unfair term with a term permitting the early maturity of the loan in the event of failure to pay at least three monthly repayment instalments. However the referring court questioned whether it is consistent with the provisions of Directive 93/13 to apply a provision of national law as a supplementary provision in order to enable the continuation of mortgage enforcement proceedings launched on the basis of a term concerning the early termination of a loan contract which has been declared unfair by a national court. Accordingly, this was referred to the CJEU for a preliminary ruling.

## CJEU ruling

Articles 6 and 7 of the Directive should be interpreted as precluding an accelerated repayment clause of a mortgage loan contract, that had been found to be unfair, from being maintained in part, with the elements which made it unfair removed, **where the removal of those elements would be tantamount to revising the content of that clause by altering its substance**.

Further the CJEU ruled that although the contract term permitting enforcement where only one instalment has been missed is unfair, nevertheless arts 6 and 7 do not preclude the contract to be rewritten so that enforcement could only be brought when a borrower was at least 3 months in arrears. These proceedings are considered more favourable to consumers than ordinary enforcement proceedings, where consumers could be exposed to 'particularly unfavourable consequences'.

## Further guidance on fairness of terms

The FCA's paper on the 'Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015 ([FG18/7](#))' provides further guidance on fairness of contractual terms. The FCA noted in that paper that a term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.

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