**UDATED NETWORK PROCEDURES (AUG 2020): COMPARING THE COST OF A MORTGAGE AND RECOMMENDING THE CHEAPEST**

# BACKGROUND

The FCA have implemented a new rule that impacts on the way products are sourced and the recommendation given to customers.

## What rules have the fca changed and why?

During 2015-16 the FCA carried out an in-depth study of the mortgage market, which resulted in them consulting on some proposed changes. One of the issues they highlighted was that customers were not always offered the cheapest mortgage available to them. In a policy statement issued at the start of 2020 they implemented a rule change to ensure that customers were told when they were not being recommended the cheapest mortgage and the reasons why. They also set out requirements on how mortgages should be compared to establish which is the cheapest.

## What does the new rule say?

The new rule is contained within the Mortgages and Home Finance Conduct of Business (MCOB) handbook (rule 4.7A.23.A) and can be found by following this link: <https://www.handbook.fca.org.uk/handbook/MCOB/4/7A.html#D713>

The rule is set out in 3 parts: part 1 means it is applicable where the adviser has a range of products to offer a customer; part 2 requires the adviser to explain why the product they are recommending is not the cheapest available to the customer (where this is the case); and part 3 shows how the cheapest mortgage is calculated.

Part 3 states; a mortgage is cheaper “*if the total amount payable under contract A in respect of the relevant period is less than the total amount payable under contract B in respect of the relevant period*”

It also goes on to say the comparison based on aggregated monthly payments over the relevant period (the initial product rate term) and includes any product or arrangement fees if the customer proposed to pay the fee directly [at outset] rather than add it to the sum.

## When is the rule effective from?

The new rule is effective from 31st July 2020.

# PRODUCT SOURCING

Whilst advisers have access to different sourcing systems, we set out below the best system to use and how to access this.

## WHAT SYSTEM DOES HLP RECOMMEND?

The network requires advisers to use TWENTY7TEC’s Source system.

There are two versions of this system available to advisers – a version that is **integrated** within the HLP 360 CRM system and a ‘**stand-alone**’ version that still links to the CRM but is more flexible and links with other tools that advisers will find useful (such as Mortgage Broker Tools’ affordability calculator).

HLP highly recommends using the stand-alone version; this is also known as ‘hand-off’ souring.

This version uses data captured in the fact find to pre-populate a stand-alone mortgage sourcing solution that, when combined with affordability modelling with Mortgage Broker Tools (MBT), and criteria search plus MortgageApply from Twenty7Tec, makes it one of the most Adviser focussed technology platforms currently available in the market today.

## How do i access the stand-alone/hand-off version of twenty7tec source?

If you have not used this version of Source before you can do so by first activating the hand-off version within HLP 360 CRM, then granting access within the settings. Once you have done this you will create a link to launch TWENTY7TEC Source within the fact find.

For full details and instructions, go to web page <https://hlpmarketingsuite.co.uk/wp-content/uploads/2020/05/Twenty7Tec-Integration-Setup-Guide.pdf>

## how do i use twenty7 tec source?

HLP has produced a useful user guide to help you easily navigate your way around the Hand-Off Twenty7tec, how to produce your research, illustrations and bring back the necessary documents to your CRM system 360dotnet.

To access the Guide: <https://hlpmarketingsuite.co.uk/wp-content/uploads/2020/05/Twenty7Tec-Hand-Off-User-Guide.pdf>

# FREQUENTLY ASKED QUESTIONS

Since implementing the new rule there have been a lot of questions, queries and even some concern about the rule itself. We have collated the questions into this document to help you understand what is required, how to implement the changes and how HLP will support you through file checking over the coming months.

Scroll down the list of questions until you find the one that most closely matches your own question or questions and click on the box to expand it and show the answer.

This document aims to be an exhaustive list of answers to the questions we have received. That said, the guidance may change as the FCA and also our trade body, the Association of Mortgage Intermediaries (AMI), provide new guidance.

If you cannot find an answer to your question below then please email compliance@hlpartnership.co.uk and we will endeavour to respond to you as quickly as possible.

## CAN I CONTINUE TO SOURCE THROUGH 360 AND other sourcing systems?

You can continue to use the integrated Twenty7 Tec Source system if you prefer but we have to acknowledge that the 360 integrated sourcing has some limitations in meeting the new requirements; it doesn’t allow you to remove fees from the calculation. Stand-alone (Hand-off) Source also has better connectivity to other tools, so we have been recommending to members for some time to use the hand-off version if possible.

If it has been agreed that you may use any other sourcing systems then we expect best efforts to comply and our understanding is that all the main sourcing platforms (Trigold, Mortgage Brian, etc.) do allow for the calculation to be done in the same manner. It will be for you to speak to your sourcing provider to understand how their system will enable you to source and produce evidence in line with the new rule.

## How long do we have to get used to the changes and how will this affect cases currently in the pipeline that haven’t been submitted?

The new procedures are required to be followed for all new business where a recommendation has been made on or after the 31st July 2020 but case checkers will be taking a light touch approach to these new rules; cases won’t be downgraded and no fines will be imposed due to cases not complying with the new requirements until 1st January 2021.

## when sourcing should I CALCULATE THE “TRUE COST” IN SUCH A WAY THAT it takes account of THE FULL COST OF a **product FEE** OVER THE TERM OF THE mortgage?

The calculation introduced by the FCA (as stated in rule 4.7A.23.A) must be used when calculating the cost of one mortgage against another. This calculation means that, where an arrangement fee is added, the full cost of repaying that fee over the life (full mortgage term) of the mortgage is not taken into account.

Remember, the rule states the calculation: “*includes any product fee or arrangement fee if the customer proposes to pay that fee directly rather than add it to the sum advanced under the contract (and such a fee must be treated in the same way for contract A and contract B when comparing the two contracts*”

If, however a fee is added to the loan, you would calculate the cost of the mortgage (over the incentive period) as follows:

AGGREGATED MONTHLY PAYMENTS (with fee added) multiplied by RELEVANT PERIOD equals COST

Whether the customer is intending to pay the fee up front (always the FCA’s preferred approach) or add it to the loan, the key is to make sure the comparison with other products is done on a like for like basis.

Many people have expressed that they feel this methodology is flawed and it’s hard to argue against that. Remember, however, what this rule is doing is allowing a comparison of the total amount payable over the incentive period. Whilst it seems odd to treat the arrangement fees in this way – after all they still have to be paid either up front or at a later date, the comparison is more focussed on the repayments over the period rather than the cost of additional fees. We do believe that there may be further guidance in this regard in due course as the rule is probably not well considered and badly written.

FINAL sourcing must be done in the way set out in our Step by Step Guide however; if your customer makes it clear that they also want the balance at the end of the term to be considered and this leads you to recommend a mortgage that the calculation suggests is more expensive, it is still acceptable to recommend it as long as you explain to the customer that it is more expensive over the incentive period and document this in your suitability letter.

This should also prompt advisers to have a detailed discussion about the potential benefits over the term of the mortgage to paying arrangement fees up-front. Remember this was already an MCOB requirement. Where fees are being paid upfront the full cost of the fee is taken account of in the calculation so makes for a fairer comparison over the term of the mortgage as well as over the initial incentive period.

## What fees should be excluded from the true cost calculation?

The rule itself states that only **product** and **arrangement** fees should be included in the calculation. In the Policy Statement that introduced the rule the FCA also stated: ‘*The calculation only includes product or arrangement fees and does not include* ***other fees*** *such as* ***valuation fees***’

We can be certain that valuation fees should be excluded from the calculation but we have had to interpret what other fees we feel should also be excluded based on the guidance given. We have concluded that the following fees should be excluded where possible as they are not product or arrangement fees:

* Valuation fee
* Broker fee
* Disbursement fee
* CHAPs fee
* Other penalty fees and ERCs

We understand that you are not able to do this when sourcing through 360 so we accept that the true cost calculation will include these fees but we do not expect you to manually deduct them as this would be a disproportionate level of work as you would have to manually re-calculate the true cost for all mortgages being compared.

We understand that it is difficult to understand why these fees should not be considered when making your recommendation, again we feel this was not properly considered by the FCA and therefore more guidance will be provided in due course. If the calculation suggests contract A is (for example) £100 cheaper than contract B but you know that contract B has a free valuation whereas the valuation fee is £250 under contract A then we are happy for you to recommend contract B. Your calculation should still be done as required but you file notes and explanation to the customer and the Suitability Letter should explain that you recommended contract B because of the free valuation.

## If I want to recommend a mortgage with a 27 month incentive period the true cost for a deal with a 24 month incentive period will look more expensive as it will have 3 payments at svr in the true cost, is that correct?

We do recognise that the rule does throw up some issues in this area. Is difficult to compare products with similar incentive periods where one is for a fixed period (e.g. 24 months) and the other is fixed to a defined date. The latter may seem more attractive as could appear to have 27 months at the fixed rate, but if they do not complete the transaction for 6 months, in reality they only benefit from 21 months on the incentive.

That said, the rule is clear that the calculation must be done over the incentive period of the product being recommended and states that the monthly payment used is based on the assumption that it were applied immediately.

 So, if you are comparing a deal with 27 month incentive period, it is likely to appear cheaper than a 24month deal as that deal will include 3 months on SVR however if you are recommending the product with a 24 month incentive period then that is relevant period for the calculation and should give a fair outcome. Like we mentioned before, this is unlikely to dictate your recommendation; if you feel that the customer is not going to receive the full benefit of the 27 months because they are the beginning of a purchase transaction then this is fine as long as it is explained to the customer and included in your SL if the deal recommended ‘appears’ more expensive according to the calculation.

## if it is possible that the completion date is known and is not for (say) 5 months and you have recommended a product with a 27 month incentive period at the point of recommendation, shouldn’t the calculation be done over 22 months?

Whilst this is logical there is not much of an argument to suggest that this isn’t a fair way to compare but the rule and the guidance really hasn’t been specific enough for us to tell you whether that is acceptable. Therefore, going by the ‘spirit’ of the rule we have to recommend that you should still calculate over the period of the deal you are recommending i.e. 27 months in the example given. If that means that you choose to go for a deal that doesn’t have a fixed end date such as a Nationwide deal with 24 months on completion this is an acceptable reason to do so but with the caveat being that it is explained to the customer if the calculation shows it to be more expensive and why therefore you are making your recommendation and why that is better for the customer.

Whilst the rule may lack some clarity in certain areas, the main thing is to ensure that if there is an apparently cheaper product then you explain why you are discounting it and any other products that fall into this area.

## Are we asking advisers to source initially on cost over initial period rather than e.g. 24/36/60 months which would give a better initial indicator?

The original Step by Step Guide was confusing, so it has now been updated to recommend that advisers do initially calculate the true cost over either 24/36/48/60, etc. to reflect the product period being compared i.e. 2/3/4/5 years. This does give a more indicative ‘initial’ source result. This only applies to how you initially source and does not change the additional steps that require you to amend the true cost calculation period to the incentive period specific to the product being recommended. See answer to previous question for more info.

## Does the rule apply to product transfer cases?

Yes, the rule applies to product transfer applications.

Where a customer’s personal situation means they would be able to remortgage to another lender then you should compare the current lenders retention product(s) with those available to the customer, based on their circumstances, in the usual way and also apply the ‘why not the cheapest’ rule and explanation.

In this situation we already expect advisers to evidence their whole of market research to demonstrate what was available from the wider market. We would now expect this to be done in the manner set out so with the total cost calculated over the incentive period of the product transfer product. As is already the case, you should justify why you are recommending the PT if it is more expensive. The difference now is simply the calculation.

Include the PT product in the sourcing where possible but if it isn’t possible then you will have to do the calculation manually for the product recommended just to make sure that you are justifying correctly. This is how it will be checked so it would make sense if you evidence this calculation but we haven’t made that compulsory at this point.

However, where the customer’s personal situation means they would NOT be able to remortgage to another lender and Product Transfer is the only option open to them, then you do not need to evidence WoM research. You will still need to do the calculation to compare similar deals that are available from their existing lender that meet their requirements – there will typically be an option with a fee and without a fee so these need to be compared using the calculation.

## does the rule apply to ported applications?

With porting the key is to calculate the cost of any ERC applicable for early repayment. There is a (albeit unlikely) possibility that paying an ERC to move to a much cheaper product could be in the customers interest in the long run. This would typically be the case where the customer has fixed on to a much higher rate of interest than is now available on the market today and the savings would outweigh the penalty.

Therefore we would expect some evidence of what products were available at the time and if it looks like ther could be a possible saving to the customer by remortgaging and paying an ERC then you should complete the calculations as described to compare deals.

If the calculation suggests there is a potential saving then we would expect that to be fully discussed with the customer but doesn’t mean that you must recommend it. If you do not recommend what could be a cheaper product then, as usual, you would explain why and note this on the record and include the reason(s) in your Suitability letter.

## What if it is more complicated such as top-slicing on BTL or cascading on 2nd Charges, am i still required to do the calculation?

It is worth re-iterating that, although technically the rule only applies to regulated mortgages, we do expect advisers to apply this rule on non-reg business where possible, maintaining the spirit of the FCA’s expectations. Remember that, although FCA and FoS may have more limited jurisdiction for non-regulated contracts, it is still possible to bring a claim by customers either through FoS or via the court system.

We do however understand that it may not always be possible to apply the rule in some circumstances, such as where top-slicing is required or on second charges where cascading applies. If a customer requires a mortgage from a BTL lender that will allow top-slicing and this leads you to ignore cheaper lenders that do not this would, of course, be an acceptable reason; as usual your file should reflect your reasoning. In these circumstances you would not need to explain this to the customer or include in your Suitability Letter as the rule only requires you to compare the costs of deals that the customer would qualify for.

All that we ask is you make your best efforts to comply with the spirit of the rule in these circumstances and explain fully what you have done. The rule should be applied at the point that the advice is given initially so we wouldn’t expect you to re-do the calculation unless there is a significant change that would require you to revisit your advice in which case you should re-do the calculation at that point and justify why, if sticking with something that is now appearing more expensive. In most cases this will be after discussion with the customer and they would prefer to continue with the existing solution rather than start the process over to make a (often small) saving.

## WHAT IF NO PRODUCTS APPEAR IN MY SOURCING/ CAN I APPLY FILTERS SO THAT ONLY THE DEAL I WANT TO RECOMMEND APPEARS?

If no products appear then, assuming your filters are accurate then you have nothing to justify. If the product you want to recommend doesn’t appear then you would need to contact 27Tec or HLP tech support to understand why it does not appear.

We do not want or expect advisers to apply filters to a degree that manipulates the outcomes or where it excludes all deals other than the one you want to recommend. That would be against the spirit of the rule. For example, we don’t really want non-high street lenders to be excluded because this was a customer preference – we believe the intention of the rule would mean those lenders should appear and for you to offer an explanation to the customer as to why they haven’t been recommended and as much as anything to demonstrate to the customer potentially how much this preference is costing them and therefore see whether it is actually a preference that they are willing to pay for. Only hard, non-negotiable preferences should be included in filtering e.g. a requirement to have no up-front fees.

## are twenty7tec and 360 being updated to help us meet the requirements?

As stated in the earlier section you are advised to use stand-alone / hand-off Twenty7Tec Source, which provides the most flexible solution and offers additional features such as integration with Mortgage Broker Tools.

Twenty7Tec have updated their Source systems (both stand-alone and integrated) to allow for the calculation to be done in the manner required to meet the rule. We continue to have a very strong relationship with both Twenty7Tec and 360 and regularly engage with them about improving systems. If there are areas identified that can be improved, we will feed back to 27Tec and 360. Feel free speak to your RCM or the Partner Support Team and they will ensure your ideas are passed on to our partners.

## Do we now need to justify why we aren’t recommending all cheaper products individually?

The short answer is no, we don’t expect this.

In most situation the number of products that source ‘cheaper’ than the one you are recommending is likely to be only a small number, one or two. If that’s the case it is obviously easier to go into more detail about each and why you didn’t recommend them.

Where there are a larger number of products that appear to be available to the customer (based on your sourcing parameters) then you might need to add more customer requirements to narrow your final outcome.

If you have done this and there are still a large number of apparently cheaper products, but there is a common reason why you are disregarding these lenders then it would be acceptable to use this reason (or reasons) to cover disregarding multiple lenders/products.

In general, you should explain in detail why you have recommended the deal you have, we don’t expect you to explain chapter and verse on every cheaper deal that has been discounted. But, as said before, if you are regularly finding that you have a large number of apparently cheaper deals, then you may need to ensure that you are entering more customer information and product requirements information into the sourcing to reduce the number of available products.

Where there are deals that customers obviously wouldn’t qualify e.g. retention products, then you don’t need to explain why these haven’t been recommended anyway; under the rule you are only required to compare deals that meet the customer’s needs and circumstances. We understand that this isn’t always easy to establish from the evidence of research on Twenty7Tec because it doesn’t always confirm the product description on the output but we have a very sensible case checking team who will take the approach of trusting what you have said to be accurate in these circumstances.