FINANCIAL REGULATOR
Rialtóir Airgeadais

PO BOX NO 9138
College Green
Dublin 2
T +353 1 224 4000
F +353 1 671 6561

19 September 2007

Re: Consumer Protection Code ("the Code") – Survey re Mortgages Sales Process

Dear <<Greeting>>

As you may be aware, the Financial Regulator recently conducted a survey of a number of regulated mortgage lenders in relation to how they were planning to comply with Code provisions regarding mortgage suitability. The scope of the survey excluded sales through intermediary channels and also "execution only" sales (where the consumer specifies both the product and the provider, and receives no advice). The purpose of this letter is to provide general feedback to the industry, which we hope will be of assistance to your firm in relation to its compliance arrangements.

In selecting mortgage suitability, we are recognising that a mortgage represents a significant and complex lending transaction for most consumers, however, the observations below may be useful with regard to the sale of other consumer products also. We would like to make the following observations with regard to mortgage suitability:

- **Suitability and affordability** – During the Suitability Workshop, which was conducted in conjunction with the Irish Banking Federation in November 2006, the Financial Regulator emphasised that whilst affordability was a prime component of suitability, a fuller consideration of a consumer's individual circumstances and needs would be required in order to comply with the suitability provisions of the Code.

Having carefully considered the responses to the survey, we would again like to highlight the key distinction between suitability and affordability.

We note from the responses to the survey that factors such as the following are considered when assessing suitability of mortgage sales:

- purpose of borrowings;
- type and length of loan;
- plans for early redemption;
- attitude to fixed/variable interest;
- age;
- savings track record;
- LTV;
- employment;
- income;
- repayment capacity.

The Financial Regulator is of the opinion that factors such as, but not limited to those listed above should be considered when assessing suitability in relation to mortgage products.

- **Suitability statement/reasons why letter** – (Chapter 2, Common Rule 31)
  Because suitability is specific to the circumstances and needs of every individual consumer, all institutions should be satisfied that written statements reflect an assessment of each individual client's specific circumstances and needs, thereby meeting the 'Knowing the Consumer' requirements of the Code, and must set out why the product is considered suitable, or most suitable, as appropriate.

- **Affordability considerations** – As you are aware, regulated lending institutions have recently received revised guidance on stress testing of residential mortgages. However, as stated in our letter of 6 July 2007, this guidance does not impact on an institution's obligations under the Code.

From a consumer protection viewpoint, the ability to meet future repayments is clearly customer and product specific. Institutions should therefore consider the future ability of each individual customer to service the product being purchased. Where a particular customer's actual mortgage interest rate is higher than the guided testing margin over the ECB base rate, the ongoing affordability should also be considered at point of sale in the context of that actual rate rising. We note that a number of institutions are currently doing this.

We also note that some institutions periodically review and update their credit policies, including the approval of applications as exceptions, in light of changing market and economic circumstances. We would like to emphasise that the suitability (incorporating affordability) of each individual loan approval should be carefully considered under any such policy changes.

Furthermore, we believe that where a mortgage product is initially priced on a temporary/introductory basis (at an initial discount, fixed for a period or interest only for a period), the affordability post this initial arrangement should also be considered at point of sale, in light of each individual's circumstances and needs.

- **Sales interface roles** -– Where a front-line sales role incorporates a sales target (in this case for mortgages), institutions should ensure that appropriate management controls are in place in order to prevent inappropriate selling behaviours and to actively monitor compliance with the Code. A number of responses to the survey indicated that assurance from independent sources (internal audit, mystery shopping) forms part of a suite of controls and also that some institutions assign compliance goals to sales staff in addition to sales goals, thereby explicitly recognising the compliance agenda as a performance indicator. We believe that such controls merit consideration by all institutions.

- **Transparent disclosure of the service provided** -– The Code provides under its common rules for all institutions that "*A regulated entity must ensure that the name of a product or service which it provides is not misleading in terms of the benefits that the product or service can deliver"* (Chapter 2, Common Rule 1). The Code also requires that the terms of business provided to the consumer prior to providing the first service, must include *"a description of the services that the regulated entity provides"* (Chapter 2, Common Rule 8e). Furthermore, the Code requires that all mortgage products or services offered to a consumer (other than execution only sales) are suitable to that consumer (Chapter 2, Common Rule 30).

In the context of the Code provisions mentioned above, and having regard to the significance and complexity of the product in question, we are therefore of the opinion that regulated mortgage lenders should clearly disclose the nature and extent of the services they provide, including any limitations to those services. For example, in response to the survey, a number of institutions stated that they do not provide advice or recommendations, rather that they present and explain information, following which the consumer selects the product. However, websites, documentation and job titles reviewed during the course of the survey contain references to "advisers", "advice", "advice proposition" and "customer advisory tool". The Financial Regulator is concerned that these references are potentially confusing and misleading for the consumer. Again, we feel that the nature and scope of any advice given in relation to mortgage sales should be clearly disclosed to the consumer.

By highlighting the issues above, the Financial Regulator is seeking to actively promote compliance with the relevant Code provisions. The information in this letter is provided solely for the purpose of assisting your firm with compliance and does not represent a benchmark or standard of compliance in relation to the sale of mortgages. We hope that you find the information useful in that regard.

Should you have any queries on the contents of this letter, please contact Ms Helena Mitchell at helena.mitchell@financialregulator.ie.

Yours sincerely

Bernard Sheridan
Head of Consumer Protection Codes Department