Insights into the changing shape of the lender broker relationship

February 2017

Executive summary

- We asked four leading professionals from mortgage intermediaries and four leading figures from UK mortgage lenders to talk about how they saw the current state of the mortgage broker lender relationship and how they thought this might evolve into the future.

- **Mortgage Market Review (MMR).** Two and half years after the introduction of the MMR lenders and brokers seem broadly content with the new regulatory regime, at least in how it has clarified the role of lenders and intermediaries. The industry is now hoping for a period of relative stability in regulation after a few years which have seen unprecedented change.

- **Differences of opinion between lenders and brokers.** There was broad consensus on the areas of disagreement between lenders and brokers. These are the level and speed of service provided by lenders during the application process; the predictability of the lending decision; lender customer retention strategies; and broker removals from panels. Lenders felt that brokers were not always good at providing the right information needed to support an application.

- **Customer retention.** The single most contentious issue was lender customer retention strategies. Some lenders are being increasingly proactive at retaining customers by writing to them well in advance of the expiry of an initial deal. This reduces the likelihood that the customer will go back to their broker for advice. Brokers felt this would often be to the detriment of the consumer as a lender's execution only product switch may not compare well to other loans in the market, particularly for customers whose credit standing had improved since the original loan was made. But it was accepted that lender execution only product transfers were convenient for the customer.

- **Product transfers.** Closely related to customer retention is the issue of product transfers and the broader question of who owns the customer relationship. Some lenders are paying procuration fees to brokers where the broker has advised a client to switch products with the same lender rather than remortgage. But not all lenders are doing this and brokers are keen to see this practice adopted more widely.

- **Performance metrics.** Most brokers felt that the performance metrics lenders use to assess brokers were a positive influence as they helped the broker to understand how they were performing. However, brokers were not supportive of lenders varying procuration fees based on these metrics as some lenders do.

- **Procuration fees and trail commissions.** Lenders and brokers generally agreed that current procuration fee levels are unlikely to change significantly in the absence of a major change in regulation. Most lenders and brokers were sceptical about the introduction of trail commissions. Lenders would be unwilling to increase fees overall and brokers had a preference for being paid when the work was undertaken.

- **Mortgage segments where brokers excel.** There was general agreement on the areas where brokers were particularly useful to clients. It was agreed that clients with complex circumstances - which includes the self-employed and those with some past credit blemishes – could benefit most from seeing a broker as the broker would know which lenders are likely to accept an application. But brokers were seen to have a much wider role in being able to select the best deals for clients of all types.

- **IMLA AMI Lenders and Intermediaries Governance Framework.** Both lenders and brokers felt that the Governance Framework and the CML IMLA AMI Working Together document reinforced the good practice that most of the industry was already following. It was felt that the Framework had improved clarity around the process of removing brokers from lender panels.

- **Individual broker registration.** Some interviewees were keen to see a compulsory registration of individual mortgage brokers. But it was felt that the FCA did not have the resources to drive this forward or did not see it as a priority and industry attempts have failed as brokers and lenders have not been able to agree on whether the register should include advisers working for lenders. But it was also felt that the senior managers regime, which will come into effect in the intermediary sector in 2018-9, will supersede the requirement for individual broker registration.

- **Consolidation amongst intermediaries.** There were mixed views on whether the rather fragmented mortgage intermediary industry would experience more consolidation. Some interviewees thought that the cost of keeping up with technological change would drive consolidation while others saw smaller broker firms as being able to offer a service which many customers would continue to value.

- **Expected impact of technology.** It was felt that digital technology will shape the future of mortgage distribution but it was unclear whether direct lender sales or aggregator or online broker sites would be the main beneficiaries. One area that received comment was the possibility of integration between broker and lender systems. It was felt that this could speed up the application process and drive price competition.

- **Outlook.** There were mixed views on the outlook for the mortgage market. While some interviewees were cautiously optimistic others struggled to see where growth would come from with buy-to-let now constrained and insufficient housing supply holding back house purchases. Brexit did not figure heavily in interviewees' concerns but was seen as another negative influence.

1. Introduction

IMLA is the trade association that represents the views and interests of UK mortgage lenders involved in the generation of mortgage business via professional financial intermediaries. As such, as well as our interest in understanding trends in the wider mortgage market, we have a particular concern with the relationship between mortgage lenders and brokers and how this impacts on the wider mortgage market.

Consequently, this research report focuses on the relationship between lenders and brokers, the influences on this relationship and the way it may evolve in the future. The report diverges from our usual format as, on this occasion, we have asked four leading figures in the broker community and four leading figures from UK mortgage lenders to discuss the relationship between mortgage lenders and intermediaries and the issues shaping it.

We provided the interviewees with a serious of questions. These questions were designed to cover all the main topics affecting the relationship between lenders and brokers and they can be grouped broadly into three categories as follows:

- What could be called the push-pull factors that govern how and to what extent lenders work with brokers in the mortgage market.

- The framework of interaction between lenders and brokers, with issues that influence the structure of the relationship.

- Issues driven by the structure of the intermediary sector and how these affect the lender broker relationship.

We would like to thank the mortgage professionals who agreed to be interviewed for this report. The lender interviewees were:

Alan Cleary – Managing Director, Precise Mortgages
Brad Fordham – Managing Director – Santander for Intermediaries
Charles Haresnape – Group Managing Director - Mortgages, Aldermore Bank
Kevin Purvey – Director of Intermediaries, Coventry Building Society

The intermediary (broker) interviewees were:

Ray Boulger – Senior Technical Manager John Charcol
Patrick Bunton – Director London & Country Mortgages
Martin Reynolds – Chief Executive SimplyBiz Mortgages
Jon Round – LSL Group Financial Services Director

Push-pull factors

Different viewpoints between brokers and lenders

Interviewees agreed that brokers and lenders differed in their view of the level of service provided by lenders during the application process (for example, the speed that an application is dealt with), the predictability of the lending decision and around lender product retention strategies.

Lenders acknowledged that their levels of service and speed of decision making during the application process sometimes frustrated brokers as did the degree of clarity in lenders' decisions in principle. But equally lenders said that brokers sometimes failed to provide the information needed to make a lending decision in a timely fashion.

Brokers' wish list includes more transparency in lenders' mortgage lending decision making process and the payment of procuration fees on product transfers across the industry. Brokers also wanted to see more transparency when lenders remove brokers from panels. One broker said some lenders still were not following the industry guidelines around broker removals.

Product retention was seen as a key area with the potential for disagreement. It was noted that some lenders are now contacting customers several months before their initial deal expires with the offer of a new deal that they can switch to early, which reduces the likelihood of the broker being involved in the switch.

One lender felt that some brokers feared future possible changes in the marketplace brought about by the use of digital technology. In particular he felt some are concerned about lenders investing in digital distribution but he felt for lenders this is about enhancing customer choice.

Another lender noted that brokers that are used to dealing with the larger lenders who use credit scorecards can find dealing with smaller lenders using manual underwriting disconcerting because the process is more iterative. Another lender cited brokers' ability to keep up with regulatory changes as a source of concern as it could impact on the quality of advice given to the customer.

Who would you say now owns the customer relationship? Is this a concern?

Interviewees were in broad agreement that "the customer owns the customer relationship". They agreed that the customer should have a choice of channels to access mortgage deals and should not be considered to belong to either the lender or the broker.

Interviewees thought that the question of who owns the customer came into sharper focus with the issue of lender retention strategies. Brokers expressed concern about lenders that are writing to broker introduced customers several months before an introductory rate has expired and offering them a new deal without informing the broker. But some lenders felt the source of this disagreement was some brokers' belief that they own the customer, which created a mindset of discontent when lenders sought to deploy retention strategies to a keep a customer.

One broker noted that the customer is asking the broker to find the best mortgage product not the best lender. It was generally agreed that customers are looking for the most convenient way to transact and the best deal and thus typically do not have an attachment either to specific brokers or lenders.

Are you satisfied with lenders' approach to brokers for product transfers? Do you see the role of the broker changing with regard to product transfers?

Brokers were clear that they wanted to participate in the product transfer market and wanted to see a transparent process. Some lenders are already paying procuration fees to brokers who recommend a product transfer rather than a remortgage to another lender, but brokers would like to see this extended to the whole market.

Lenders generally felt that brokers should have the incentive to consider product transfers when advising a customer looking to switch mortgage deals. But they also pointed out a product transfer is significantly less hassle for the customer than a remortgage and that going direct to the lender is cheaper than paying a broker. One lender thought there might be a concern that where brokers are paid for a product transfer they could find it easier to recommend one even though the fees would be lower than they would be for a remortgage, because there would be considerably less work involved for the broker.

One broker stated said that the product transfer market is estimated at £80-100bn a year, of which some 15% involves an intermediary. He pointed out that where an intermediary is involved that customer will receive advice on whether a product transfer is the best option but that this is generally not the case where only the lender is involved, with most lenders conducting product transfers on an execution only basis. Another broker pointed out that the customer's circumstances could have changed since the loan was made and this would not be picked up by the lender offering an execution only product transfer, potentially disadvantaging the customer.

One lender pointed out that lenders have become very efficient at offering a smooth product transfer option to customers with online technology simplifying the process for consumers considerably. He said that some 40-50% of their product transfers are conducted by the customer online, with customers benefitting from a simple process that consumes little of their time.

Which segments of the mortgage market are brokers most effective in? Why?

There was broad agreement on the segments of the market where brokers had the potential to be most effective. Customers who do not fit lenders' standard criteria i.e. where their finances are complex or where the customer is self employed or has had credit impairments in the past were seen as those where the broker could add most value. Lenders recognised the benefit for all parties of such customers not having to approach numerous lenders direct before establishing which lender would be willing to lend.

Brokers felt that even in straightforward cases, one key advantage was their ability to scan the market for the best deal. However, one broker expressed concern that current regulations meant that most brokers do not cover all mortgage product segments. For example he cited lending to older borrowers where most advisers could advise on either equity release or the conventional market but not both.

Another broker pointed out that brokers play a particularly important role in the new build sector as well as buy-to-let. He said that first time buyers with limited experience of the market could also benefit from seeing a broker. Lenders agreed that brokers were helpful for first time buyers and other moving homeowners and for customers looking to raise additional funds when remortgaging. They felt that customers are paying for the broker's ability to scan the wider market for the best deals rather than specifically for advice on the most appropriate product features.

How do you see the broker lender relationship evolving?

It was felt that the MMR had enhanced the position of brokers and most interviewees expected the share of business that brokers introduce to remain roughly at current levels unless disrupted by further regulatory changes or by technology (see answers below). One lender saw scope for more targeted usage of brokers by lenders, with specific lenders and brokers working more closely together in the future.

Brokers felt that the regulatory environment was supportive for their businesses as it had clarified the position on advice in a way that enhanced customer understanding of the benefit that brokers offered in being able to advise on products across the market. One broker explained this by saying that the MMR had in effect stipulated that interaction with the customer equals advice because previously customers thought they were receiving advice from lenders when they were not.

Another broker stated that broker professionalism is now far higher than in the period before the financial crisis. He cited HSBC's decision to start using brokers and the fact that most new lenders had broker only mortgage distribution as evidence of the attractiveness of broker distribution to lenders in the post MMR environment.

How will technology change the broker lender relationship?

Interviewees agreed that digital technology is likely to alter the marketplace going forward but saw both lender online direct offerings and digital broker or aggregator sites as having the potential to be large beneficiaries. A number of interviewees expressed the view that online brokers could become large players, posing a threat to smaller brokers without the resources to invest heavily in technology.

It was felt that the market is moving gradually to the point where mortgages will be bought exclusively online. However, one broker pointed out that customers often had questions when filling out online forms and that the internet was often now the point at which the customer first interacted with a broker but that further on in the process contact with an adviser was still preferred. Another broker suggested that technology could speed up the mortgage application process by making it easier for customers to provide the information required before seeing the broker.

One lender pointed out that with regulators requiring banks to provide third-party access to customer account information he could see younger generations accessing mortgages via Facebook. He also thought that robo-advice could be available within a decade and that robo-advice could be attractive to regulators as an algorithm would provide more consistent advice than human advisers.

Several interviewees noted that lenders were now spending heavily on technology both on direct distribution and on their interface with brokers. They felt that lender online execution only sales were likely to become more prevalent but that the FCA may temper this trend if it felt this undermined consumer choice.

Brokers expressed the view that they would like to see greater connectivity between lenders' and brokers' computer systems as currently brokers were typing information from the customer into their system and some of this information was then having to be entered manually into the lenders' system.

One lender floated the idea that a group of large lenders could create an aggregator site with IT integrated with their own mortgage approval systems. This could enable customers to receive an agreement in principle from a lender online, saving the customer time. But one broker stated that lenders' desire to invest in systems that were integrated with brokers might be tempered by lenders' concerns that the market could become even more price driven if customers could get a quick agreement in principle through such integrated systems.

What is the outlook for procuration fees and will trail commissions become a significant feature of the market going forward?

Interviewees did not expect to see much change in procuration fees unless there was a major change in the regulatory environment. One broker pointed out that brokers have more work to do to complete a loan in the post-MMR world and it has become harder to secure mortgages for customers, all suggesting that procuration fees are unlikely to fall. Indeed one lender thought that procuration fees for buy-to-let mortgages may start to rise given the additional regulatory requirements coming in January 2017.

But another interviewee said that the FCA will not want to see much higher procuration fees and are broadly content with the current narrow band of fees as this limits the incentive for brokers to favour one lender over another.

There were mixed views on trail commissions with some interviewees suggesting that retention fees would make sense while others were sceptical about the likelihood of them becoming a feature of the market. As brokers' costs are mainly incurred upfront, it was felt that the bulk of fees would always have to be paid at the front end.

One lender thought that lenders were open to offering trail commissions but that brokers retain a preference for upfront fees as these support a market where customers switch regularly which benefits brokers. Others noted that trail commissions reduced brokers' incentives to remortgage customers which might not work in the customer's interests.

Another lender thought that trail commissions could encourage brokers to consider a wider range of products including longer term fixed rate mortgages in contrast to the current focus on 2 year fixed rate deals. However, he felt that regulatory requirements on brokers to undertake annual reviews when receiving trail commissions made a move to trail commissions less likely.

One broker thought that for firms of brokers with self-employed advisers, the advisers would resist trail commissions because of their lack of participation in the long term financial interests of the firm. A couple of lenders also pointed out that trail commissions were difficult for lenders to implement from a systems perspective.

What is the outlook for the mortgage market and how might this affect brokers and lenders?

Interviewees' views on the outlook for the mortgage market as a whole were mixed. While some were cautiously optimistic others thought it was difficult to see where growth would come from until there was a step change in new housing supply. Some thought that, with interest rates so low, customers might not feel the need to remortgage, depressing gross lending levels, especially if more customers chose product transfers instead.

There was more optimism about the prospects for the mainstream mortgage market despite the uncertainty engendered by the Brexit vote. However, there was markedly less optimism for the buy-to-let market, with interviewees expecting the market to shrink in the near term. One broker thought weakness in the buy-to-let market might require lenders to raise margins in the mainstream market to maintain overall profitability. Another broker pointed out that the increased complexity of buy-to-let, given the tax changes facing landlords and the PRA's new rules, should favour broker distribution.

One broker thought that brokers were likely to improve their share of product transfers from the current level of about 15% and that this could offset any loss of share in the remortgage market that might come from lenders' increased use of technology in distribution.

Framework of interaction between lender and broker

Is the IMLA AMI Lenders and Intermediaries Governance Framework working effectively? Are lenders' practices broadly in line with the statement?

Interviewees generally saw the IMLA AMI Governance Framework (statement of shared principles) and the IMLA, CML and AMI Working Together document as restatements of good practice that they would expect to be in line with practice before the documents were introduced. However, it was pointed out that the framework has helped to clarify the process when lenders wish to remove a broker from their panel.

Brokers agreed that the IMLA/AMI Governance Framework and the CML/IMLA/AMI Working Together document have helped to clarify how lenders and intermediaries interact. One broker pointed out that the MMR has played the largest role in helping to clarify the responsibilities of lenders and brokers. But another broker pointed out that some lenders still do not follow the industry guidelines with regard to removing brokers from their panels.

Are lenders too focused on broker performance metrics?

Lenders felt that performance metrics were an important element of knowing their broker and that brokers could benefit by gaining a better understanding of their performance. The metrics vary between lenders but cover areas like conversion rates and loan arrears. Santander links procuration fees to performance metrics for appointed representations (ARs) only, while Coventry Building Society, Precise Mortgages and Aldermore Bank do not link fees to such metrics.

Brokers had mixed views on whether lenders were overly focused on performance metrics. Some felt that objective measures of performance were a good thing for brokers as well as lenders as they help the broker understand where improvements can be made. However, it was felt that while performance metrics could reveal problems with business from certain brokers, such as high loan delinquency, the use of metrics should not engender an attitude of blame. It was felt that defaults should not be considered the fault of a broker as long as the broker had acted in good faith.

One broker thought that lenders could get a misleading view when looking at conversion rates e.g. from decision to application, because a number of factors influence conversion rates, not all of them under the broker's control. Another broker thought that the linking of procuration fees to performance metrics has not been a positive development, although he said this is less of a problem now.

How might regulation affect the lender broker relationship going forward and what could come out of the FCA competition review?

Interviewees felt that the MMR provided a clear framework for lenders and brokers and believed that it got the balance right in its degree of prescription. However, it was pointed out that the regulatory environment is always potentially subject to change as illustrated by the recent changes to buy-to-let regulation from the PRA. Although interviewees did not expect further major changes in regulation, one lender said that the worst scenario would be if the regulator was to require lenders to be responsible for the actions of brokers.

Interviewees did not expect the competition review to focus much on the commercial relationship between lenders and brokers, seeing this for the most part as healthy and competitive. Some interviewees thought it might consider concerns around estate agents' tactics to encourage buyers and sellers to use in-house mortgage brokers. Likewise, similar concerns were expressed about developers "cajoling" buyers, especially first time buyers, to use their nominated broker and conveyancer.

Others thought the review might help smaller brokers if large aggregators could no longer charge a procuration fee. One lender wondered whether the competition review might examine the difference between brokers that cover the whole of market and those with lender panels. But one broker thought the FCA competition review should look at barriers to customers switching loan and another thought it could look at product transfers.

What is the future for advised and execution only sales?

Lenders saw a continued role for execution only, albeit a relatively small one as the FCA has frowned on lenders when their level of execution only business has risen. However, it was felt there would be space for lenders to grow their execution only business for product transfers and it was felt that digital brokers or aggregators could use execution only in the remortgage market. One lender saw a future where robo-advice could tilt the market more firmly in favour of advice, albeit some years off.

One broker felt that brokers should be allowed to provide an execution only service. In contrast others thought that execution only should not be an option for most customers on the grounds that there will always be a risk that clients who receive an execution only service can still think they are receiving advice. One broker pointed to the risk that where a lender undertakes a product transfer for a customer on an execution only basis the customer’s circumstances could have changed since they took the loan out, leading to the risk of the client missing out on the possibility of switching to a loan better suited to their changed circumstances.

Issues relating to the structure of the intermediary industry

How does the changing importance of appointed representatives (ARs) and directly authorised (DA) firms impact the broader broker lender relationship?

Interviewees generally did not see that whether a broker was a DA or an AR made much difference when it came to its relationship with lenders. One broker pointed out that the larger lenders generally paid higher procuration fees to AR networks while smaller lenders tended to have a single procuration fee rate. He thought that larger lenders may use a differentiated fee because they think compliance standards are likely to be higher in AR networks.

Some lenders felt they could access brokers more easily where they are part of a network. But one lender said he could see a closer relationship with the larger DAs and the potential for differential procuration fees with more paid to large DAs because of the volumes of business they could generate.

Individual broker registration – has it gone away?

Interviewees acknowledged the problem with not having a register of individuals working as mortgage brokers, citing the risk that a person who had committed a fraudulent act in one firm might be able to gain employment elsewhere. It was thought that the FCA had dropped the proposal for a register due to lack of resources or higher priorities elsewhere. Brokers felt that a subsequent industry-led initiative to produce a register had failed because lenders were not willing to include their own mortgage advisers on the register.

One lender thought that individual broker registration should not fall off the agenda as controls on mortgage brokers should mirror those on other similar professionals. But the other interviewees thought that with the FCA not pushing for the introduction of such a regime the industry had no appetite to take on the cost and effort of introducing it voluntarily. It was also pointed out that the senior managers regime, which will come into effect in the intermediary sector in 2018-9, will supersede the requirement for individual broker registration by placing a clear responsibility on management within broker firms to monitor and control their staff.

Is the broker market likely to see consolidation or will the small local brokers remain a dominant force?

There were mixed views amongst the interviewees. Lenders felt that the intermediary industry would see consolidation driven by the cost of digital technology and the inability of smaller brokers to meet these costs. But one lender said he would not want to see too much consolidation amongst brokers as while the larger brokers are predominantly about efficiency smaller brokers can be better at dealing with complex customer cases. However, he felt there would inevitably be some consolidation.

One broker agreed with the lenders that there would be consolidation amongst brokers driven by the level of costs required to keep up with technological change. But others felt there would always be a mixture of large and small mortgage intermediaries to match the diverse requirements of customers. One broker thought that many smaller firms of brokers were happy with their setup, with no desire to be bought out by larger firms. Another stated that the FCA might object to too much further consolidation.

Media contacts

For further information please contact:

- Rob Thomas, Director of Research, on 020 7427 1406
- Barney McCarthy and Will Muir at Instinctif Partners, on 0207 427 1400 twc.imla@instinctif.com

About IMLA

The Intermediary Mortgage Lenders Association (IMLA) is the trade association that represents mortgage lenders who lend to UK consumers and businesses via the broker channel. Its membership unites 34 banks, building societies and specialist lenders responsible for over £180bn of annual lending across all distribution channels in 2015, including 16 of the top 20 UK mortgage lenders.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market. Originally founded in 1988, IMLA has close working relationships with key stakeholders including the Association of Mortgage Intermediaries (AMI), Council of Mortgage Lenders (CML) and Financial Conduct Authority (FCA).

Visit www.imla.org.uk to view the full list of IMLA members and associate members and learn more about IMLA's work.

About the author

Rob Thomas is a Director of Research at Instinctif Partners. He previously served as an economist at the Bank of England (1989-1994), a high profile analyst at the investment bank UBS (1994-2001) and as senior policy adviser to the Council of Mortgage Lenders (2005-12). He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme.