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Dear Chief Executive Officer

FCA Supervisory strategy for Lifetime Mortgage Providers

We have reviewed the key risks of harm for Lifetime Mortgage Providers, their consumers and the markets in which they operate as part of our Approach to Supervision. This follows on from our previous review, and our letter to you in October 2020. In this letter, we:

- Provide an updated view of the current key risks of harm and outline our expectations of firms
- Provide an overview of our supervisory strategy and programme of work to ensure that firms are meeting our expectations, and harms are being appropriately remedied

We expect you to consider the degree to which your firm presents such risks, review your strategies for mitigating them and be able to demonstrate that you and your senior managers are taking reasonable steps to mitigate these risks.

The lifetime mortgage provider sector, alongside the rest of the financial services industry, has faced significant challenges in the last 2 years as a result of the coronavirus pandemic (Covid-19). The response to the pandemic so far has shown the FCA and firms working well together to give consumers security and protection in the face of sudden instability and uncertainty.

<u>The Rising Cost of Living</u>

Many consumers will feel the impact in their personal finances, but we are particularly concerned that consumers least able to bear the rises will be hardest hit. While the headline average inflation rate is at 9% and rising, the Institute of Fiscal Studies estimates that the poorest households may face average inflation rates as high as 14%. This is in the context of a quarter (27%) of the population having low financial resilience, a figure likely to increase over the coming months.

At the same time, we expect to see higher demand for credit, although rising interest rates, and lower disposable income, may make borrowing less affordable, or unavailable, for some. Firms will also see a wider group of consumers in financial difficulty, who will find it harder to pay their debts. Some of these consumers will be in vulnerable circumstances or may be experiencing financial difficulty for the first time. Firms need to remain alert to the changing situation of their customers and target their efforts in response.

We are particularly concerned that consumers in this portfolio who are facing financial stress may be more susceptible to the purchase of unsuitable equity release products. We expect firms in this portfolio to consider how the cost of living crisis is likely to impact consumers and take the necessary steps to support consumers and mitigate harm. As highlighted below it is important that your firm meets the standards set out in our Principles/Rules/Guidance and, in particular, that appropriate attention/resource is given to the treatment of those customers in vulnerable circumstances.

We consider that our Tailored Support Guidance (TSG) for mortgages, consumer credit and overdrafts which was issued to address exceptional circumstances arising out of coronavirus, is also relevant for borrowers in financial difficulties due to other circumstances such as the rising cost of living. Based on our rules, and Principles 6 and 7, it provides further guidance on our expectations of firms when supporting borrowers and providing tailored forbearance and debt help to those in financial difficulty. In addition, our Vulnerable Customer Guidance (VCG) sets out our view of what firms should do to comply with their obligations under our principles and ensure they treat customers in vulnerable circumstances fairly.

The cost-of-living crisis may affect firms' ability to respond to, recover and learn from operational disruptions. Like other firms, you should ensure you have robust governance arrangements and effective tools in place to identify, manage, monitor and report the risks you may be exposed to such as an increase in the need for advice and sudden increases in the volume of consumer contacts. You should consider different scenarios that may test your operations, to ensure that your internal processes and control mechanisms are adequate. As a regulator, we will continue to work with you and the financial services sector to monitor, manage and mitigate any harms to consumers due to the rising cost of living.

Our recently published Dear CEO letter outlines these points in greater detail.

FCA Business Plan and Strategy

In Our Strategy 2022 to 2025, we set out our vision and ambitions for the next three years. We also set out the consistent topline outcomes we expect from financial services and the key strategic areas we'll be focusing on. We have grouped our commitments into three areas:

- **reducing and preventing serious harm** – our focus is on protecting consumers from the harm that authorised firms can cause, including tackling fraud and poor treatment.
- **setting and testing higher standards** – we're focusing on the impact that authorised firms' actions have on consumers and markets. We expect all firms we regulate to adopt the same high standards, and have an open and cooperative approach.
- **promoting competition and positive change** – we want to use competition as a force for better consumer and market outcomes. We will support UK growth and innovation that serves our society, underpinned by widely recognised and respected high standards.

Our Business Plan explains our programme of work for this year to achieve this three-year strategy. It outlines the key work we will do over the next 12 months to deliver these outcomes and how we will measure progress.

We published this Business Plan when the external environment is changing rapidly. The longer-term impact of Covid continues to be uncertain. Low levels of financial resilience and rising costs mean many people are at risk of serious financial problems. And this is happening against a backdrop of rising inflation and interest rates and major geopolitical uncertainty. The impact of these factors will be felt by consumers and firms over the coming year and beyond.

By focusing more on end outcomes, and working across sectors and markets, we are better able to respond to new issues and macroeconomic challenges. Our new, more adaptive approach to allocating resources and monitoring our performance will make us more agile and help us respond more quickly to market needs.

The Business Plan details the work we will carry out this year under each of the 13 commitments from the Strategy where we will focus our work. We have grouped our commitments into three areas:

Our view of the portfolio

The work we do under these areas of focus will help create the conditions for financial services to deliver our expected outcomes. Collectively, we aim to improve firms' conduct and understanding of our expectations so that financial markets work well and are able to deliver good outcomes for consumers, market participants and the economy.

We need to use our resources efficiently and effectively to deliver across our commitments. We have weighed up the different outcomes we want to achieve and the issues we need to tackle by looking at factors including the likely scale, severity and probability of harm occurring, likely future harm given external events, our ability to address issues and our judgement about urgency.

Taking this into account, we continue to see challenges for the sector, particularly around customer vulnerability, product design and governance and its relationship with intermediaries, particularly where this may be subject to conflicts of interest, for example to providers that offer the highest procuration fees or where there is an adviser – provider relationship.

We remain focused on ensuring firms understand the importance of a customer centric culture to their business model and strategy.

Our view of the key drivers of harm

Our view of the risks of harm to consumers remain largely unchanged from those identified in our October 2020 letter. In this assessment we have considered the impact of the pandemic, and the implications of the rising cost of living, recognising that these have created significant challenges for firms and consumers that could not have been anticipated. Given the unprecedented impact of the pandemic, we expect firms to be aware of the difficult circumstances that some customers find themselves in and to consider very carefully the individual needs of their customers and show flexibility in their treatment of them.

Below we outline what we consider to be the key harms for consumers. In the next section we outline our expectations of firms, alongside our planned supervisory strategy.

1. **Customer Treatment**

- Firms fail to recognise and address the needs and challenges facing customers in vulnerable circumstances and fail to ensure that they obtain the same fair outcomes as other consumers.
- Poor product design and governance could lead to consumers in the later life lending market purchasing products they don't fully understand, and which do not meet their demands and needs.
- Firms' policies and procedures, as well as a lack of ongoing due diligence in regard to the relationship with intermediaries, particularly where these are part of the same group or have exclusive arrangements, may lead to products being offered outside their target market.
- Firms' post sales procedures (Repayment and Redemption) processes and controls may lead to distress and inconvenience or financial difficulties, for example at settlement, with unnecessary delays exacerbating situations.
- Consumers do not receive clear information about, or resolution to, their dispute/complaint, and feel confused or inconvenienced by repeatedly having to contact firms for answers.

2. **Operational issues, including resilience**

- Firms fail to have adequate systems and controls, processes and policies in place – and the appropriate governance and oversight - to mitigate the risk of operational events. These include systems failures that result in incorrect notifications or demands for payments being issued to customers causing distress/financial loss.
- Where firms rely on Intermediaries, they should have clear policies, and be able to evidence their use, in relation to the due diligence carried out at the outset of any relationship. This due diligence should be reviewed on an ongoing basis to ensure firms minimise the risk to themselves and consumers in terms of operational resilience, exposure to financial crime and business continuity.

3. **Firms' Prudential Resources - relevant for non-dual regulated firms**

- Firms prudentially-regulated by the FCA play an important role in supporting the functioning of the economy. During this time of stress, we expect firms to meet this responsibility by planning ahead and ensuring the sound management of their financial resources. This means taking appropriate steps to conserve capital, and to plan for how to meet potential demands on liquidity
- Liquid resources are critical for firms' survival and to help ensure that they meet their obligations as they fall due. Firms should monitor their financial health as part of appropriate systems and controls, e.g., through cash-flow forecasts and always maintain adequate financial resources. The role of liquidity monitoring is more relevant given the strain coronavirus has put on firms' financial resources, with a heightened risk of firm failure.
- Failure to adequately manage resources may mean a firm fails to meet its obligations as they fall due, leading to it exiting the market in a disorderly fashion. This could leave consumers without clear information about the status of their mortgage, including who to contact and when, thereby impacting their ability to make ongoing payments, where applicable, resolve issues or make settlement.

Our expectations and areas of focus

Our supervisory work is therefore prioritised to focus on the following:

Fair treatment of consumers

We expect firms to place sufficient emphasis on the fair treatment of all consumers, and as reflected in the 6 consumer outcomes they should seek to achieve. We often see poor treatment of consumers being linked to weak operational oversight, ineffective systems and controls and lack of meaningful management information. Unfair treatment is often reflected in consumer complaints, and we expect firms to provide clear resolutions and information to consumers along with clearly defined next steps.

We expect lifetime mortgage providers to manage these risks and to consider that increasing consumer debt and poor treatment has the potential to increase the prevalence of consumer harm.

Consumer duty

We are proposing to introduce a new 'Consumer Duty', that would set a higher standard of care that firms should provide to consumers in retail financial markets. The Consumer Duty would require firms to act to deliver good outcomes for customers (including those in vulnerable circumstances). This reflects the positive and proactive expectation we have of firm conduct, and our desire for firms to think more about consumer outcomes and place consumers' interests at the heart of their activities.

Amongst other things, it would require firms to focus on supporting their customers to make good financial decisions (including those in vulnerable circumstances) and avoiding foreseeable harm and checking whether their customers are getting good outcomes. This includes providing information consumers can understand, products and services that are fit for purpose and offer fair value and helpful customer service. A firm would for example, not be acting in accordance with the Consumer Duty where it seeks to exploit customers' lack of knowledge, understanding or behavioural biases.

We have seen examples of exploitation and misleading information. These practices are counterproductive and detrimental to a healthy financial services system and are the types of poor practices the Consumer Duty seeks to prevent.

Our second consultation with specific rules and guidance on the proposed new Consumer Duty is now closed and pending the outcome of this consultation, we expect any new rules and guidance to be published by the end of July 2022.

More information on the initial consultation can be found here and details of the second consultation can be found here.

Additionally, we have identified the following 7 areas where we expect lifetime mortgage providers to pay particular attention to the needs of consumers. We will act where we identify firms causing, or who we consider likely to cause, significant harm to consumers.

1. Treating customers in vulnerable circumstances fairly

Our Guidance on the fair treatment of vulnerable customers is clear that to comply with our Principles for Businesses firms should embed the fair treatment of customers in vulnerable circumstances in their business models, culture, policies and processes. The firms' senior leaders should create and maintain a culture that enables and supports staff to take responsibility for reducing the potential for harm to vulnerable customers. Firms should be able to evidence to us how they are monitoring outcomes for customers in vulnerable circumstances and what changes they are making as a result of their monitoring to improve outcomes for these customers.

2. Product design and governance

We expect lifetime mortgage providers to ensure that their products are designed to meet the needs of an identified target market and that they continue to perform as expected. Firms' product governance frameworks should help them identify and manage the ongoing risk of poor consumer outcomes.

Providers should have effective monitoring frameworks in place to help ensure the products continue to be sold appropriately and to the identified target market and are delivering in line with expectations.

3. Fees and pricing structure

Lifetime mortgage products can have a significantly different pricing structure to standard mortgage products. For example, in relation to interest roll-up and the calculation of early repayment charges.

MCOB 12 provides that firms must ensure that any regulated mortgage contract they enter into does not impose, and cannot be used to impose, excessive charges upon a customer. Payment shortfall fees must also be objectively justifiable as equal to or lower than a reasonable calculation of the cost of the additional administration required as a result of the shortfall. Where we see evidence of potentially excessive fees being charged, we will ask these firms to explain how these have been calculated.

Additionally, firms should keep in mind our proposed new Consumer Duty and consider what steps they may need to take when the new rules and guidance are published later this year. In particular, thought should be given to the outcome around price and value to ensure that products and services are fit for purpose and represent fair value.

4. Relationships between lenders and intermediaries

Sales of lifetime mortgage products are predominantly made through mortgage intermediaries. Our work with advisers and intermediaries in this and other portfolios has highlighted the risk that placement of business may be subject to conflicts of interest, for example to providers that offer the highest procuration fees or where there is an adviser – provider relationship. We will intervene where we consider that there is a potential distortion to the market or that firms' systems and controls are not operating effectively to help ensure positive outcomes for customers.

5. Responsible lending

Our monitoring of the Lifetime Mortgage sector has highlighted a trend of lifetime products being increasingly sold to younger customers and with larger median loan values. We expect Lifetime Mortgage providers to have effective monitoring frameworks in place to ensure these products are sold to the identified target market and are delivering positive customer outcomes. Firms should give themselves comfort that they have sufficient sight, for example in the form of management information, to identify where this is not happening. Firms should be able to demonstrate that their customers are treated fairly, particularly given the ongoing impact of coronavirus, the impact of cost-of-living increases and any associated increase in financial vulnerability across the country.

We are also concerned that poor product design and governance could lead to consumers purchasing later life products they don't fully understand, and which do not meet their demands and needs. We expect all firms operating in the later life lending market to treat customers fairly, particularly older borrowers, and to pay particular attention to signs of vulnerability. Although the majority of customers taking lifetime products do not make repayments, it is paramount that, where applicable, lenders ensure they apply appropriate affordability criteria, as inadequate affordability checks could leave older borrowers finding it more difficult to meet their financial obligations as they move into retirement. It is equally important that where a customer is making interest payments, that the lender deals with any change in circumstance, such as financial stress due to the cost of living impacting their disposable income, appropriately.

6. Post-sale systems and controls

Post-sale events, such as drawdowns and redemptions, can be relatively complex processes and can happen at a sensitive time for consumers or those acting on their behalf. We expect providers to assure themselves that any customer-facing systems and controls are consistently delivering appropriate customer outcomes throughout the term of a product. We will consider post-sales systems and controls as part of our product design and governance work.

For both product design and governance, and post-sales systems and controls, operational and financial pressures have increased due to the impact of coronavirus. This has the potential to translate into harm for consumers. For all firms, appropriate governance and effective systems and controls are key in balancing the needs of their customers, alongside those of investors or owners, in their product and lending decisions. We expect firms to consider the impact of coronavirus and how this has affected the end consumer when making changes to their products.

7. Financial Resilience

We use several data sources to monitor indicators of potential financial distress and any consequential risk of harm. You should familiarise yourself with Our framework: assessing adequate financial resources published in June 2020. We will engage with firms where we consider regulatory obligations have been breached. This includes where we learn that firms are at risk of exhausting cash reserves or face liquidity challenges and may need to exit the market. If your routine monitoring highlights financial concerns, that we would reasonably expect to be notified of, you should report these to us.

Additional areas of consideration

In addition to the above key risks of harm, we would also highlight the following areas that firms should give due consideration to.

Environmental, social and governance (ESG)

Financial services and markets have a central role in the transition to a low carbon economy and a more sustainable future. The Government has committed to achieving a net zero economy by 2050. We will support the financial sector in driving positive change, including the transition to net zero.

Firms have an important part to play in helping the economy adapt to a more sustainable long-term future. We've seen encouraging steps taken by some lenders, for example, providing green mortgages. But ultimately, a firm's own governance and culture will be critical drivers and enablers of its performance on environmental and climate matters. Since wider environmental and social matters are increasingly central to economic and financial decision making, our work too must encompass ESG considerations beyond climate change.

Firms processing and storing large amounts of data in their data centres that are part of a group listed in the UK should also take note of FCA policy statements confirming new climate-related disclosure requirements for premium and standard listed companies **(PS20/17 and PS21/23).**

Diversity and inclusion is a key component of ESG – both in its own right, and as an enabler of creative solutions to other environmental and social challenges. As set out in DP21/2, having staff and Board members from diverse background and experiences contributes to this. Diversity and inclusion in regulated firms is a priority for us, and DP21/2 (which closed on 30 September 2021) and the accompanying Literature Review started the conversation on what more can be done to improve diversity and inclusion in financial services and set out the links we see between D&I and conduct risks. We shall be consulting on rules and guidance to promote diversity and inclusion in the financial services sector in 2022.

Building from our work so far, we have developed a refreshed ESG strategy. It sets out our target outcomes and the actions we expect to take to deliver these in the coming months.

Senior Managers and Certificate Regime (SM&CR)

The regime replaced the category of Approved Persons with that of senior managers and charges them with a range of new responsibilities. As well as looking at senior managers, SM&CR also requires firms to identify individuals in the next tier down of management and those performing certain specific roles (certification functions). At least once a year, firms must evaluate and certify these named individuals' fitness for the roles they perform.

The deadline for completing this was 31 March 2021. You should have collected evidence to demonstrate that all certified staff are suitable to carry out their roles so you can issue their certificate. All other staff impacted by the conduct rules must have been trained in the rules as they apply to their roles. This information should have been uploaded to the Directory Persons on the new FCA Directory via Connect.

Regulatory reporting

Principle 11 includes a requirement for firms to disclose to the FCA anything relating to the firm of which the FCA would reasonably expect notice. We expect all firms in this portfolio to be aware of the requirements and guidance in SUP 15, and to submit notifications as required. This should be when an issue or event is identified, and firms should not wait until resolution to notify us. An example of where we expect to be notified is when a firm's business model is subject to change that would have a significant impact on the firm's risk profile, resources or consumers.

Contact

If you have any questions, please contact your normal supervisory contact on 0300 500 0597. This is the primary point of contact for your firm's interactions with the FCA. You can also email us at firm.queries@fca.org.uk. However, there may be times when your firm faces urgent issues of strategic importance. If this happens, please contact Andrew Kay on 0131 301 2052, or at Andrew.Kay@fca.org.uk. If not available, then please contact one of my managers, Craig Mason, on 0131 301 2060 or at Craig.Mason@fca.org.uk.

Yours faithfully,

David Raw

Co-Director, Consumer & Retail Policy Division

Supervision, Policy & Competition Division