Re: Follow up to the Treasury Committee

Further to my appearance in front of your Committee on 31 October 2017, I indicated that I would write to you to provide information on a number of issues which I have set out below.

I will write to you separately concerning the Royal Bank of Scotland’s Global Restructuring Group, the free float requirement for listed companies and also on the regulatory perimeter.

Sandbox

Ms McGovern asked about the cost of the regulatory sandbox. It has been operational for 18 months and the average yearly staff cost totals £482,708 which represents around 0.1% of the FCA’s annual budget. There are no fees for applying to the sandbox, but firms must pay the normal authorisation fee that relates to the specific permission they require while testing.

Motor finance

In relation to motor finance, I referred to the work we set out in our Business Plan which is a proactive consideration of key aspects of the broader motor finance market. We are assessing whether the products available cause harm to consumers and if the market is functioning as well as it could.

The work we are undertaking seeks to answer some important questions on whether firms are taking the right steps to ensure that they lend responsibly. In particular, by appropriately assessing whether potential customers can afford the product. We also want to understand whether there are conflicts of interest arising from commission arrangements between lenders and dealers, and if the information provided to potential customers by firms is sufficiently clear and transparent, so that they can understand the risks involved and make informed decisions.
At this stage, our approach includes both desk-based and on-site supervisory work with FCA-authorised lenders and some of the largest motor retail groups that act as credit brokers in the finance sales process. We are also analysing millions of anonymised credit reference agency records to support our work on responsible lending, and reviewing the information provided to customers during the motor finance sales process to assess if it is sufficiently clear and transparent. We are working closely with nine of the largest motor finance lenders to understand how they are managing the risk that asset valuations could fall and adequately pricing risk.

We will decide what further interventions may be necessary as our work progresses and will publish an update early next year. In addition to this thematic work, we continue to actively supervise individual motor finance firms on the basis of intelligence received.

**Mortgages**

Mr Elphicke asked about the action the FCA is taking on mortgage market competition and reversion rates.

In the mortgage market, price competition is mainly focused on rates for an initial deal period. At the end of the deal, or earlier, since it is possible to arrange a product switch ahead of the deal period ending, consumers typically re-mortgage onto another deal. Customers who do not take action will move onto their lender's reversion rate, often a 'standard variable rate'. Although the majority of consumers take out a new deal within a few months of rolling onto the reversion rate, there are a significant proportion of consumers who have been on the reversion rate for several years. This can lead to a much wider spread in the prices being paid between customers with similar credit risk characteristics, with those customers on their lender's reversion rate typically paying higher rates.

We are currently undertaking two pieces of work that are relevant to the issue of reversion rates. As part of our Mortgage Market Study we are looking at the extent to which consumers could potentially benefit from switching products and what barriers are preventing them from doing so. This includes an assessment of the potential savings consumers could make if they were to switch from the reversion rate they are currently paying to a new deal for which they are eligible. The committee asked about "mortgage prisoners" and we are considering whether consumers currently on a reversion rate are potentially unable to switch to a new deal from which they would benefit. We are looking to publish our interim findings in early 2018 and will then consider whether there are remedies which can be implemented to promote competition.

We have also launched a strategic review of retail banking business models which seeks to understand retail banking business models in greater depth. Mortgages play a key part in retail banking business models and this piece of work will assess in greater depth the costs and incentives faced by different suppliers and the interactions with other product areas within the retail banks. This includes the provision of funding from personal current accounts and cash savings products.

We want to better understand what is driving differences in mortgage profitability, how this has evolved over time, and how the future changes in the market will affect this. As one of the potential drivers of profitability we will look to understand the differences in pricing and profitability of different firms' mortgage books and the role of reversion rates within that.
The committee also asked whether we would consider putting a moratorium or consider ordering a moratorium on penalties. While a mortgage is clearly a long term commitment, the UK market has evolved so that consumers typically take on a succession of shorter term 'deals', usually lasting for two, three or five years. These deals can allow consumers to control their repayments by opting for interest rates that are fixed or capped, that track external measures (such as the Bank of England official rate), or that vary at the lender's discretion. Early repayment charges are typically used by mortgage lenders to help manage the financing of these deals.

For example, a lender may be borrowing money over a term to lend on to consumers and if the consumer repays early the lender still has to meet this funding cost even though market rates and new lending rates may have moved on. Similarly, the initial deal period may be priced at a discount that the lender expects to recoup after the discount period has finished. A consumer choosing to repay early will mean the lender incurs a loss, which without an early repayment charge would likely mean other consumers having to pay for this loss through higher interest rates.

Early repayment charges are not found on Standard Variable Rate products. They also tend only to apply for the duration of the deal period, although this was not always the case in the past. As a result consumers are able to avoid the charge, obtaining the same effect as a moratorium, by delaying repayment (or re-mortgaging) until the deal ends. Where there is such a charge our rules require that it is disclosed, in cash terms at the pre-sale stage, it is cost-reflective and must not seek to profit from the consumer choosing to repay. The charge should also be calculated as a reasonable pre-estimate of the actual cost on a product or portfolio basis.

Taken together, these rules require that such charges are not penal in nature. Customers should be free to repay early or to move to another provider; the lender is entitled to charge only to the extent such charges increases its cost.

In light of that, we are not minded to change these rules by adding any further moratorium. The Mortgage Market Study work, described above, will look at whether other measures are needed to ensure consumers can take advantage of competition in the mortgage market.

**Diversity and Inclusion**

We welcomed the opportunity to discuss diversity with the committee, but also recognise that the time we could devote to the topic was limited and therefore we wanted to provide you with additional information regarding the work we are doing in this area.

At the FCA we believe that we must employ the very best diverse talent and expertise and develop an inclusive culture in which the range of voices and views can be heard.

Currently the percentage of women at Board level is 45%, in our Executive Committee is 44% and within our senior leadership as a whole is 36% (which has decreased in the last financial year). The Board has agreed to set the public commitment to reach 45% of our Senior Leadership Team (SLT) identifying as female by 2020 and 50% by 2025.
In terms of ethnic diversity within the FCA, we are seeking to reach 8% of our SLT being Black Asian and Minority Ethnic (BAME) by 2020 and 13% by 2025. The current position of 2% is clearly an area of focus for us.

Whilst we are disappointed that the level of women and BAME colleagues in our SLT decreased in the last financial year, we are taking a series of renewed steps to ensure that we meet our targets. All SLT members now have an objective to promote a diverse and inclusive culture and performance in this area is linked to variable pay.

In addition, we have instituted an FCA-wide Positive Action Framework to address any potential unconscious bias that may be taking place in our recruitment, work allocation and progression efforts. Every Division within the FCA is being held accountable for its embedding of this framework. We have already taken steps to ensure diverse shortlists during the recruitment process, use recruitment agencies that specialise in sourcing diverse talent, apply a gender decoder for all job descriptions to remove gender-biased language and embedded unconscious bias messages into our recruitment training. An unconscious bias e-learning module is also mandatory for all staff to complete.

As a matter of course, we undertake analysis and challenge during key stages such as appraisal, pay, bonus, and manager development course decisions. We have also introduced a number of mentoring schemes including a BAME Reverse Mentoring Scheme and are participants in external mentoring schemes such as the 30% Club and the Race for Opportunity.

We are taking an increasingly public role in highlighting and implementing our Public Sector Equality Duty. There is greater focus each year on how we can have regard for diversity and inclusion in our wider work, including access to financial services and vulnerable consumers or in talking publicly about the value of the diversity of thought and perspective in ensuring regulated firms take good conduct decisions.

We published our gender pay gap statistics on 30 October 2017. Our mean pay gap is 19.28% and median is 20.91% in favour of males, as at 31 March 2017. The factors driving the gender pay gap are the under-representation of women in more senior technical and managerial roles, and a higher proportion of women in administrative roles.

I hope that you find this information helpful.

Andrew Bailey
Chief Executive