HARPENDEN BUILDING SOCIETY

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INDUSTRY INSIGHTS

The FCA, Savings and the Impact on Mortgages

One of the long-term priorities of the FCA is to 'ensure fair pricing in financial services.' In July 2018, the FCA released a discussion paper titled DP18/6, as they were concerned that competition was not working well enough in the cash savings market. This led to the release of a Consultation Paper titled CP20/1 in January 2019, which sets out proposals to make the market simpler and improve competition.

While this might not currently be on everyone's radar, there are significant implications which could affect not only savers but homebuyers, brokers and lenders.

THE FCA'S CONCERNS

The FCA are consulting on proposals to improve competition in the savings market and to make it simpler and easier for consumers to understand how things work. At the heart of this consultation is the distinction between promotional rates, for acquiring new customers, and standard rates for customers on older products who have moved from a promotional rate.

The FCA's Cash Savings Market Study concluded that competition works well for customers when they take out a new product in the easy access cash savings market.

However, there are concerns that outcomes are not as favourable for long standing customers.

THE PROPOSED SOLUTION

The FCA's objectives are to provide protection for long standing customers on the lowest interest rates by providing firms with incentives to increase their rates while also maintaining competition for new customers. The consultation is on two proposals:

1) That providers introduce a 'Single Easy Access Rate' (SEAR)

2) That providers publish the data on their SEAR for easy comparison

The proposal is to allow introductory rates for up to 12 months. After this, customers benefit from competition by paying a single interest rate immediately after the promotional period on all easy access accounts and easy access cash ISAs. This rate will be published and comparable.

The FCA has estimated, as part of the cost/benefit analysis, that there would be a one-off cost of £94m to the industry with an ongoing cost of £35m. The FCA also estimates that consumers would benefit by approximately £261m a year. This would result in lower interest rates for the most competitive part of the market, but rates for the least competitive part would increase. In essence, lower promotional rates and higher longstanding rates.

Source:
The FCA, *https://www.fca.org.uk/publications/consultation-papers/cp20-1-introducing-single-easy-access-rate-cash-savings*

WHERE COULD THIS LEAD?

I think that three areas will need to be explored in greater detail. The first is that by introducing legislation around a SEAR could affect a provider's ability to innovate and offer product choice in savings. By only allowing two SEARs (one for easy access accounts and easy access cash ISAs) a provider would be unable to offer differential pricing by channel (online versus branch for example), tiered accounts and the length of a customer's relationship. This has the potential to limit product development.

The second area is that changes could add costs to mortgage providers and increase the risk of liquidity problems. The result might be an increase in mortgage interest rates. At a time when home buyers are already struggling with affordability, this is a potential problem.

The final area, which will be interesting to observe, is whether the FCA will view promotional and long-term rates in mortgages in the same way. Is there a requirement to reduce differential pricing? Could we be about to see the FCA examining the promotion of mortgages in the same way? Could fixed term rates be regulated along with the standard variable rate?

It's important to stress that no decisions have yet been made and consultation is continuing. However, this is an area which all of us should be keeping a close eye on when the decisions are made and announced later this year.

STRATEGIC CONSIDERATIONS

This has the potential for being a profound change for the banking industry. Banks and building societies need to bring in deposits to fund their mortgage lending and an increase in the costs of deposits can affect a lender's liquidity. The FCA's analysis briefly mentions that the SEAR could make liquidity management more difficult for banks which normally hold large savings balances. In addition, the SEAR could make easy access deposits more volatile, and the FCA could not reasonably estimate a cost for these two impacts. For building societies, The FCA believes that the introduction of the SEAR would reduce a mutual's ability to manage its liquidity.

Clearly, the consultation is designed to explore these issues in more detail and every organisation will have an opportunity to shape and scope the future. No-one would argue against the desire to help consumers make informed choices but significant changes like this add uncertainty and more risk to long-term pricing decisions.

Martin

By Martin Langlands, Chief Risk Officer, Harpenden Building Society

We individually assess and approach applications.

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