FinCoNet
INTERNATIONAL FINANCIAL CONSUMER PROTECTION ORGANISATION

Briefing Note

Mortgage Distribution – sales incentives, consumer outcomes and supervisory approaches

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Disclaimer

This briefing note is based on information and responses gathered between May and August 2022. Information cited in this report has been updated to the furthest extent possible during the drafting process. Nonetheless, subsequent changes in circumstances and practices may render some information out-of-date.

The opinions expressed and arguments employed herein do not necessarily reflect the official views of FinCoNet member organisations.

About FinCoNet

In November 2013, FinCoNet was formally established as a new international organisation of financial consumer protection supervisory authorities. FinCoNet is recognised by the Financial Stability Board and the G20. The goal of FinCoNet is to promote sound market conduct and enhance financial consumer protection through efficient and effective financial market conduct supervision, with a focus on banking and credit. FinCoNet members see the Organisation as a valuable forum for sharing information on supervisory tools and best practices for consumer protection regulators in financial services. By sharing best practices and by promoting fair and transparent market practices, FinCoNet aims to strengthen consumer confidence and reduce systemic consumer risk.

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Glossary

Term	Meaning
Bundling	Practice where a firm offers a consumer a product or service in addition to the credit agreement. The credit agreement is available to the client separately, but the terms or conditions may differ when offered bundled with the ancillary services.
Consumer	Individual acting for personal, domestic or household or residential investment purposes, not business or professional purposes.
Consumer credit	Credit provided to individuals for personal, domestic or household, or residential investment purposes, not business or professional purposes. This includes both secured credit (such as mortgage loans and personal loans) and unsecured credit (such as personal loans, lines of credit, credit cards, overdraft facilities and payday lending).
Credit intermediaries	Individuals or firms (other than an issuer or a mortgage lender) who arrange or offer to arrange the provision of credit for a consumer. This includes brokers.
Direct distribution	Distribution (including through a digital channel) of a product directly from the issuer to the consumer.
Distributor	A person or entity who offers and/or sells the product to consumers. This includes credit intermediaries and business units of financial product providers that are not involved in designing the product but are responsible for bringing the product to the market.
Financial product governance	The procedures and controls in place to design, approve, market and manage retail financial products through their life cycle to ensure that they meet, at any time, the interests and objectives of consumers and the relevant regulatory requirements.
Firm	Financial services firm (including a financial, credit or banking institution).
In-direct distribution	Distribution (including through a digital channel) of a product through a third party to the consumer.
Issuer	Firm that issues the financial product.
Jurisdiction	The territory over which the respondent's authority is exercised.
Referrers	Individuals or firms who refer consumers to an issuer or a third party for mortgage distribution. For example, real-estate agents, lawyers, accountants, or comparison websites that pass on customer details to the issuer.
Reporting	Refers to the legal requirements on the submission of information from firms to their supervisors.
Sales incentive	A reward provided for selling a particular product or service or for selling a particular amount of products and/or service.
Target market	Group of consumers for whom the product is designed.
Tying	Practice where a firm offers a product or service in a package with the credit agreement where the credit agreement is not made available to the client separately.

Executive summary

Entering a mortgage is a significant financial decision for any consumer. The offer and sale of mortgages that meet the consumers' objectives and needs is important to ensure appropriate consumer outcomes over the life of the loan. At an economy wide level, appropriate consumer outcomes regarding mortgages help underpin the stability of the financial system. Market conduct supervisors are responsible for identifying poor market conduct and driving improvements to consumer outcomes.

This Briefing Note, informed by a survey of market conduct authorities, explores risks to consumer outcomes associated with mortgage distribution practices. These include sales incentives, bundling and/or tying practices, and distribution through digital channels. Supervisory approaches on each of these topics are discussed, including case studies and research.

Rules and principles govern the sale of mortgages through both direct and in-direct channels. Legal and regulatory requirements designed to protect the consumer vary across jurisdictions and include conduct rules, licensing requirements, cooling-off periods, and disclosures. Common principles required of lenders and distributors include honesty in dealing, transparency in disclosure and professional conduct.

Supervisor awareness of the impacts of lender incentive structures has improved in recent years. Without appropriate rules governing sales incentives, salespeople may be motivated to engage in the inappropriate sales of mortgages to consumers, resulting in the potential for poor consumer outcomes and increased market risks.

Bundling the sale of financial products with a mortgage can be convenient for the consumer, reduce transaction costs, and support the consumer's interests when initiating the loan, for instance by offering insurance on the property. Products bundled with a mortgage are most commonly insurance such as life insurance, credit products such as credit card accounts and bank accounts such as offset accounts. Many jurisdictions rely on product governance provisions or specific rules relating to bundled products to ensure appropriate consumer outcomes. The sale of tied products, not otherwise available to the consumer, are prohibited in most jurisdictions.

It is essential that consumers are aware of the product attributes and costs associated with mortgages and bundled products.

Distribution through digital channels is essential to keep pace with consumer expectations, provide efficiencies, improve customer experience, and prevent biased credit decision making. Risks associated with digital distribution include possible impairment of financial inclusion, or opaque decision making. Technology neutral rules are common.

Looking ahead, supervisors can improve effectiveness in the identification of risks to consumer outcomes associated with mortgage distribution. The collection and analysis of data on consumer outcomes can be used to identify consumer risks. This information can be used to improve product governance, for instance identifying when products are being sold to consumer groups outside of the target market or where target markets are not appropriately defined.

1. Introduction

1.1 Background

In this Briefing Note, FinCoNet SC6 explores risks to appropriate distribution of mortgage products to consumers through both direct and in-direct channels and how legal and regulatory frameworks and conduct supervision tools are designed to address those risks. The Briefing Note considers consumer outcomes associated with direct and in-direct distribution, situations in which sales incentives are permitted, distribution through digital channels, and the use of bundling and tying practices when mortgage products are distributed.

This paper complements FinCoNet's previous publications relating to sales incentives provided in the distribution of financial products with respect to responsible lending obligations. In 2016 FinCoNet published Sales Incentives and Responsible Lending followed by a consultation paper on the Impact of Sales Incentives on the Sale of Consumer Credit Products. The outcome of this work, Guidance to Supervisors on the setting of Standards in the field of Sales Incentives and Responsible Lending, was published in December 2016.

This work also builds on FinCoNet's previous report by SC6 on Financial Product Governance and Culture, which identified risks including incentive schemes which produce poor consumer outcomes and examined product governance frameworks that are designed to address those risks.

FinCoNet SC6 continues its focus on conduct supervision designed to provide for appropriate consumer outcomes relating to mortgage distribution.

1.2 Purpose of the Briefing Note

The purpose of this Briefing Note is to examine mortgage distribution, including the use of sales incentives and risks of poor consumer outcomes associated with various forms of mortgage distribution.

The Briefing Note shares supervisory approaches from respondent jurisdictions including research and data on the topics covered in a survey of FinCoNet members.

1.3 Methodology

SC6 distributed a survey in May 2022 to gather information on risks to appropriate distribution of mortgage products and how supervisors were using conduct supervision tools (such as product governance) to address those risks.

SC6 received 17 responses to the survey from members of FinCoNet. A list of responding jurisdictions is at Annex A, and a copy of the survey can be found at Annex B.

Please note that in this report we have referred to "respondents" rather than jurisdictions in the figures. Not all respondents answered each question.

1.4 Overview of the survey

SC6 produced a survey on mortgage distribution and incentives which was divided into four parts, each reflected in the Briefing Note. The four topics are the following:

- Direct and in-direct distribution channels legal frameworks,
- Sales incentives and the impact on consumer outcomes,
- Bundled or tied products sold with mortgages, and
- Mortgage distribution through digital channels.

The Briefing Note is informed by the survey responses received from 17 jurisdictions.

2. Mortgage distribution channels

2.1 Consumer risks and benefits comparing direct and in-direct distribution

Mortgage distribution is carried out through a combination of both direct and in-direct channels in most responding jurisdictions. Regulators and supervisors observed differing risks to consumers associated with mortgage distribution channels and the way they are addressed through legal and regulatory frameworks and conduct supervision.

Respondents reported that they have little data to analyse consumer outcomes associated with mortgage distribution channels.

Affordability risks are mitigated through serviceability assessments and prudential measures irrespective of distribution channel. Brazil and Italy noted that direct mortgage providers are more likely to have more historic data about their consumers financial situation and are therefore better able to assess their creditworthiness accurately. This can enable them to make risk-based decisions to lend a larger amount as they can assess the consumers' capacity to repay the loan more quickly on a sustainable basis, spending less on interest.

Loans with a higher **Loan to Value** (LTV) ratio provide the benefit of greater access to funds for the consumer to purchase a home with a smaller down payment. However, higher LTVs incur higher costs and can pose a greater risk for the consumer if the property decreases in value due to the lower amount of equity. In Canada there are additional costs for the consumer where the LTVs ratio is above 80% due to requirements to purchase private mortgage default insurance. In Australia, a customer with a mortgage loan with a LTV ratio over 80% is typically charged mortgage lenders insurance to protect the lender in the event of default making the product more expensive for the consumer. Consumers may also be exposed to higher risks where they have a lower proportion of savings available in the event of a change in circumstances.

Four jurisdictions noted that LTV ratios do not differ based on the distribution channels. Ontario noted a difference on the demand side as more borrowers turn to in-direct channels to obtain finance where they cannot qualify for a conventional mortgage. As a result of access to alternative sources of finance, there is a higher proportion of higher LTV ratio loans sold through in-direct channels.

Most jurisdictions did not identify differences in consumer outcomes based on **higher interest rates** associated with direct or in-direct distribution channels. Brazil noted interest rates may be higher for mortgages sold through intermediaries due to an incapacity to consider all the variables effectively when pricing the loan, especially when calculating creditworthiness of consumers that lack credit history or traditional bank accounts.

Ireland and Brazil noted that in-direct distributors may increase competition between lenders, which can in turn assist the consumer to access lower interest rates. Ontario noted that consumers that use brokers are likely to pay more over the life of the loan because broker services are often accessed for the purposes of borrowing a higher proportion of the property value.

Canada reported that in-direct mortgage distributors are usually paid based on volume and interest rate which incentivises larger mortgages at higher interest rates.

Paying higher fees increases the cost of the loan and the risk of indebtedness. A minority of jurisdictions noted that consumers are likely to incur additional charges through the in-direct channel (Ontario, Brazil, Netherlands).

In Brazil the risk of paying higher fees is mitigated, as banking agent's commissions are capped to a fixed percentage, and the banking agent must abide by the contracting Supervised Entities fees. However, the risk of higher fees is more likely where there are referrers due to commissions paid (not regulated by the BCB).

2.2 Legal and regulatory frameworks

Regulatory regimes generally incorporate both rules-based and principles-based approaches to address consumer risk. Rules-based regulation is a prescriptive framework that includes rules and requirements by which a regulated sector is required to abide. Principles-based regulation uses a set of principles or core values that is expected to be adopted and incorporated into conduct and policy by sector participants to achieve measurable outcomes.

All jurisdictions reported that mortgages are distributed through direct channels that are governed by a legal framework. Most reported that mortgages are also available through in-direct distribution channels, including credit intermediaries (88%).

In most jurisdictions there are specific laws and regulations that relate to direct or in-direct distribution however this is not always the case (see Box 1 for examples). In the Netherlands the same law applies irrespective of whether the distribution occurs through direct or in-direct channels. Instead, laws apply based on whether distribution is through a mortgage advisor or is execution only.

Distribution through referrers operate in a smaller proportion of respondent jurisdictions (65%). Alternative distribution channels are available in Canada where private mortgages are available. Half of the respondent jurisdictions reported that they have supervisory scope relating to in-direct distribution using referrers.

Rules reported by respondents include:

- conduct rules on behaviour and prohibited acts;
- standardized licensing requirements (including minimum education requirements);
- product suitability assessments;
- credit-worthiness assessments;
- cooling-off periods;
- disclosures; and
- complaints frameworks.

Principles of oversight and regulation reported commonly by respondents include:

- honesty in dealings;
- transparency in mortgage transactions;
- clarity of information and adequate risk disclosures; and
- fair, responsible, and professional conduct.

Box 1. Examples of rules, requirements, and principles governing mortgage distribution

The **Australian** framework requires lenders to meet minimum licensing standards, responsible lending obligations and product design and distribution obligations. Where mortgages are sold by a broker, there are obligations requiring the mortgage broker to act in the best interests of consumers when providing credit assistance.

In Ontario, **Canada**, from 2024 there will be tiered licensing requirements for the distribution of conventional mortgages and private or complex mortgages. Professional conduct standards and principles are incorporated into regulatory compliance requirements including dealing with honesty, competency, and transparency, ensuring product suitability, and the management and disclosure of conflicts of interest.

Ireland's Minimum Competency Code 2017 establishes minimum professional standards for financial services staff providing advice to consumers. The Consumer Protection Code sets out principles of conduct when offering financial products or services including suitability, affordability, and sustainability considerations.

In the **Netherlands** there are licensing requirements and education requirements for credit providers. There is also a consumer "Knowledge and Experience Test" for consumers who use an execution-only brokerage without receiving advice. There are product suitability requirements and a prohibition of acting against the best interests of the consumer.

In **Peru**, clear, accurate, and relevant disclosures are required. Financial firms must develop responsible business practices at all stages of the product lifecycle (from product design and distribution to post-sale monitoring and support) incorporating principles of disclosure, transparency and fair treatment to consumers. In addition, financial institutions must define their target market and identify acceptable consumer profiles to that market. The establishment of complaints handling mechanisms is a requirement.

In **Portugal**, rules govern all phases of the mortgage contractual relationship, including the pre-contractual phase, contractual phase, term of the contract and default, if applicable. It also regulates pre-contractual information, creditworthiness assessment, duty of assistance and information during the contract. The regulatory framework also sets out requirements concerning the definition of remuneration policies by credit institutions. The principle of exclusiveness applies in the Portuguese legal framework of credit institutions and financial companies. Only credit institutions and financial companies are authorised to lend on a professional basis. The Portuguese legislator has also regulated credit intermediation activity.

2.3 Conduct supervision and oversight

Regulators and supervisors have tools designed to improve financial consumer protection and promote consumer focused product design and sales practices.

Market conduct supervisory tools relating to mortgage loans include:

- **On-site inspections** – financial supervisors consider whether entities comply with the regulations and the application of best practices in the distribution of mortgages through direct and in-direct channels.

- **Off-site supervision or thematic reviews** – supervisors carry out permanent or specific reviews to determine alert signals through statistical tools, introducing greater selectivity in the criteria and a more agile procedure.
- **Consumer complaint mechanisms** – analysis to identify financial products and distribution channels that may be resulting in poor outcomes for consumers.

A variety of tools are used to oversee requirements of lenders that are designed to promote appropriate targeting of sales, informed consumer decision making and to allow regulators/supervisors to identify financial products and distribution channels that may result in poor consumer outcomes.

Specific requirements or guidelines used to address consumer risks associated with mortgage distribution, include:

- **Product governance** – outlined in section 2.4
- **Disclosure** – supervisors review whether entities clearly and accurately disclose their interest rates, fees, terms and conditions. Disclosure may be required to be presented in a specific form, containing personalised information and at a specific time prior to contracting to allow consumers to compare products.
- **Contract clause requirements** – Contracting clauses that contracts must contain (rights and obligations of the parties). Unfair or abusive clauses and practices are prohibited.
- **Best interests** – Requirements to recommend only suitable mortgages or some form of consumer's best interest standard can also ensure only mortgages that are appropriate for consumers based on their specific needs, risk tolerance and circumstances are offered.
- **Creditworthiness** assessments.
- **Fairness** – Requirements that consumers be treated fairly (see Box 2 for examples).
- **Fee approval** - supervisors establish an approval procedure that entities must follow before their application to consumers.

Box 2. Guidance on the fair treatment of consumers

Some jurisdictions have requirements or guidelines designed to make the fair treatment of consumers a core component of the corporate culture of supervised entities, protecting consumers from the inherent risks associated with using their financial products. The requirements are also intended to bolster consumer confidence in the financial system.

Examples include the AMF's Sound Commercial Practices Guideline (**Quebec**) that sets out expectations that supervised financial institutions establish practices to protect consumer interests, including guidance on governance and culture, design and marketing of products, disclosure and product advertising.

A further example is the requirement in **Ontario**, Canada, that credit unions adopt a code of market conduct. The code is designed to prevent credit unions from delivering poor or unfair outcomes for members that will harm their interests and must address mis-selling of products to members. Licensed mortgage brokerages are required to ensure that any mortgage is suitable and appropriate to the consumer's needs.

Market conduct supervision tools are being used to address specific consumer risks relating to mortgage loans. Many of these issues relate to disclosure:

- Interest rate, renewal terms, and fees – Clear, accurate, and relevant information must be disclosed, such as interest rate, renewal terms and permitted fees for additional or complementary services. In the current environment of rising rates, renewal terms could be restrictive, or in the case of variable-rate mortgages, the adjustments could render the debt unserviceable. Additionally, credit providers must disclose formulas and examples about interest calculations in clear language so consumers can replicate those calculations for their specific cases.
- Mechanisms to disclose fees in a standardized format to allow comparisons between issuers, readily available prior to in person and digital sales.
- Disclosure during the contract stage – Entities must deliver to consumers, as a part of the contract, a document that includes the amount of credit, interest rate, fees, insurance information, and payment schedule. Also, there should be clear disclosure on full or partial prepayment costs for consumers. Ideally, consumers should be able to make advanced payments free of charge, with the consequent reduction of interest and fees; and -in case of partial prepayments- they should be able to choose if they prefer to reduce future monthly payments or the remaining duration of the loan.
- Entities must inform consumers before a unilateral modification of interest rates, fees, expenses, and other contractual aspects.
- Requirements for consumers to have easily accessible channels to terminate a contract.

Box 3 describes examples of these issues in two jurisdictions.

Box 3. Current mortgage distribution market issues: Italy and Brazil

Italy noted opportunities to improve disclosure through in-direct channels to improve consumer outcomes, observing that disclosure by in-direct channels may not be complete, accurate or consistent, whereas information provided by the issuer may be more accurate.

Brazil noted that artificial intelligence (AI) may be a useful tool to address risks of poor disclosure practices and to customise information on pricing, terms and conditions based on the consumer's profile. AI may also be used to streamline the application process to reduce assessment timeframes. Brazil also recognized that AI posed risks, e.g. data breaches due to collection and storage of a large amount of data, as well as privacy, ethical, and legal concerns.

2.4 Product governance supervisory and regulatory tools

Product governance is frequently used to ensure mortgage products are designed and distributed to a target market to address consumer risk and deliver appropriate consumer outcomes. The majority of respondents indicated that they use product governance requirements (94%). This majority has increased since the FinCoNet paper on *Financial Product Governance and Culture*[1] that reported 89% of respondents having product governance rules in place for banking products.

Of the respondents that have product governance requirements in place, most indicated that a definition of the target market is required based on a description of the consumer (88%) and/or on the product features (69%). Most reported that their product governance regime imposes obligations on third party distributors (i.e., brokers) (81%), for instance that the product is directed to the target market.

Three quarters of respondents reported having product testing and monitoring requirements. Many reported requirements that issuers and/or distributors collect information relating to consumer outcomes (62%). The majority of jurisdictions carry out periodic reviews of the target market, product testing and monitoring (81%). Examples of product governance tools can be found in Box 4.

Box 4. Product governance tools used to supervise mortgage distribution

In the **Netherlands**, requests for cash-out mortgages in return for equity is increasing. The target group of consumers for this complex product is retirees, as it allows consumers to redeem the accumulated capital in the value of the house. As the Authority for Financial Markets (AFM) observed that the risks and long-term impact associated with cash-out mortgages were difficult to understand, it conducted an in-depth investigation on the implementation of product governance for this product.

The AFM concluded that the product governance was not accurately executed. Firms performed insufficient analysis on the exact definition of the target market. The potential impact of changing market conditions, such as a fall in house prices, had been inadequately researched. In addition, the provision of information to consumers was not always correct and clear. Firms have been summoned to implement improvements to product governance on the distribution of cash-out refinance mortgages. The AFM also required firms to check the product governance of other financial products.

In 2018, the FCAC in **Canada** conducted a review of domestic bank retail sales practices. The FCAC found that governance frameworks did not manage sales practices effectively and set the expectation that retail banks take measures to reduce the risks associated with mis-selling and that compliance with market conduct obligations should be improved.[2]

In **Peru**, as a result of on-site inspections and information requests in a cross-section review of the financial system, SBS identified governance issues in mortgage product design, including undue charges of interest rates and fees and unjustified charging for associated insurance premiums (e.g., mortgage hazard insurance for apartments under construction), barriers on prepayments and lack of information to consumers about changes in the terms and conditions of these products. To address these issues, SBS required corrective measures from the firms involved, including product design adjustments, improvement in

[1] FinCoNet, *Financial Product Governance and Culture*, finconet.org/Financial-Product-Governance-Culture.pdf, 2021.

[2] Financial Consumer Agency of Canada (FCAC), Domestic Bank Retail Sales Practices Review, Domestic Bank Retail Sales Practices Review - Canada.ca, 2018.

communication processes during the product's life, and redress actions towards customers affected by those undue charges. SBS monitored the implementation of these corrective measures, until such practices disappeared from the financial system.

2.5 Proposed reforms

Several jurisdictions plan to or are implementing changes to the regulation and supervision of mortgage distribution to improve consumer outcomes (41%). These include:

- The European Mortgage Credit Directive is currently under review, which may affect the relevant regulation throughout the European Union. Requirements for creditors and credit intermediaries are under consideration including the impact of digitalisation and artificial intelligence on the distribution of mortgage credit.
- In the United Kingdom, the Financial Conduct Authority (FCA) has introduced a new consumer duty to set a higher standard of consumer protection in retail financial markets. This is not specific to mortgage distribution but may apply to retail financial markets as a whole.
- In Canada:
  - As of June 30, 2022, a new Financial Consumer Protection Framework was put in place for banks. Under the framework a bank must ensure that its remuneration of any person does not interfere with the person’s ability to comply with policies and procedures. Guidelines have been issued by the Financial Consumer Agency of Canada (FCAC) to assist banks to comply with their new obligations. Such guidelines enable banks to assess appropriateness of products and services to consumers before offering or selling a bank product or service.
  - In Ontario, Canada, a new licensing class was recently implemented, with enhanced proficiency requirements for mortgage brokers and agents who deal with private mortgages (defined as mortgages that are not issued by financial institutions or lenders not approved by the National Housing Authority, which are generally mortgages that have lower risk profiles). The Financial Services Regulatory Authority is considering guidance for mortgage brokers to set out expectations on how they should ensure that any mortgages presented to borrowers are suitable.

3. Sales incentives

Sales incentives are an arrangement under which a firm rewards sales staff, credit intermediaries or referrers. Incentive scheme design can influence how products are sold, who they are sold to and the design of the product.

Sales incentives are based on the performance of an individual, group or organisation and can include financial or non-financial reward. Financial incentives can include a bonus for reaching a target, commission, variable portion of a salary, a permanent increase in base salary, or payment in stocks or stock options. Non-financial incentives can include promotion and career development opportunities, vouchers and gifts, extra holidays, company cars, or alternatively performance management. The possibility of humiliation from superiors or peers, or the risk of dismissal from the job may also be relevant in steering the conduct of salespersons.

This chapter provides an overview of consumer risks associated with the inappropriate use of sales incentives used in the distribution of mortgage products. The legal and regulatory frameworks governing sales incentives are considered, comparing direct and in-direct channels. Further, the supervision of sales incentives, including the information gathered by supervisors is explored.

3.1 Consumer risks associated with misaligned sales incentives schemes

Incentive schemes designed to influence the decisions of sales staff can result in poor outcomes for consumers. Where not properly managed, sales staff or managers may experience a **conflict of interests**, where their own interests or the interest of the organisation may not align with the consumers' needs.[3] Sales incentives scheme design needs to balance the associated risks for the consumer ensuring effective systems and controls to adequately manage the risk of mis-selling.

Where remuneration schemes take into account the total value of the loan granted, this can result in incentivising sales practices that may not be in the best interests of the consumer. This can result in loans with higher LTV ratios which in turn increases the possibility of the consumer later entering financial hardship. Furthermore, poorly designed sales incentives schemes may also lead to sales practices that do not adequately consider the product's suitability as compared to consumer's needs, such as offering variable-rate mortgages to clients who cannot adjust their monthly payments in case of a rise in interest rates; this may also result in **breaches of product governance** and distribution arrangements, and even may result in affordability issues in the future.

Where misaligned incentives become widespread, there can be a **destabilising influence on financial systems** as observed in the global financial crisis of 2007. In September 2010, the Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke remarked that '…the expanded use of [the originate-to-distribute banking model] to finance subprime mortgages through securitisation was mismanaged at several points, including

[3] FinCoNet Report on Sales Incentives and Responsible Lending, [Report on Sales Incentives and Responsible Lending (finconet.org)](), 2016, p 60.

the initial underwriting, which deteriorated markedly in part because of incentive schemes that effectively rewarded originators for the quantity rather than the quality of the mortgages extended."[4] This highlights the importance of balancing incentive scheme design with consumer-centric product design and appropriate product distribution controls.

Misaligned incentives resulting in poor consumer outcomes has the potential for **cross border implications**. This is a topic warranting coordinated supervisory attention, including the consideration of whether the supervision of sales incentives appropriately balances risks to both market conduct and appropriate consumer outcomes.

3.2 Legal and regulatory frameworks – sales incentives for direct and in-direct channels

The majority of respondents reported that they have rules relating to financial sales. There are rules that relate to financial and non-financial incentives, as set out in Table 1.

Table 1. Rules relating to sales incentives

	Financial incentives	**Financial incentives not permitted**	**Financial incentives – No answer**	**Non-financial incentives**	**Non-financial incentives not permitted**	**Non financial incentives – No answer**
Direct	12	2	3	8	1	8
In-direct – credit intermediaries	11	2	4	8	1	8
In-direct - referrers	7	1	9	5	1	11

Source: Responses to question 2.a. "Does your jurisdiction have any legal or regulatory provision relating to sales incentives for the distribution of mortgages? If sales incentives are permitted, are there rules relating to the nature of the incentive (financial or non-financial) received by the salesperson?" (n=17)

Legal and regulatory frameworks - direct channels

Legal frameworks relating to sales incentives used in the direct distribution of mortgages have common objectives to:

- balance the interests of the consumer against the interests of the financial product provider or the salesperson that may benefit from the sale, and
- prevent undue risk in lending.

The variety of approaches include:

- prohibition on the payment of commissions when selling complex financial products such as mortgages (Netherlands);
- prohibition on linking remuneration to the income of the financial institution or level of activity on consumer accounts (Mauritius);

[4] September 2010 Testimony of the Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke of the Financial Crisis Inquiry Commission, Washington, D.C.

- implementing a duty to act in the best interest of the consumer including liability for the acts of staff (Ireland);
- implementing a reasonable steps obligation on the firm to ensure that sales incentives do not give rise to a conflict of interests (UK);
- a requirement that the remuneration policy be written and accessible (Netherlands);
- requirements that remuneration policies be balanced between fixed and variable remuneration, and the variable remuneration be conditional on compliance criteria (Portugal);
- reliance on product governance principles to ensure appropriate product design and consumer outcomes (Australia); and
- request of periodic compliance assessment to monitor the correct set up of internal control mechanisms on sales incentive schemes (Italy).

Sales incentives must not impair decision making

In several jurisdictions financial and non-financial incentives are permitted where it will not result in the salesperson prioritising their own interests, or the interests of the organisation over consumers' interests (Italy, Ireland, Spain, Luxembourg and UK). In Italy, variable remuneration shall be designed in a way that prevents certain products to be promoted over others, for example, products that are more profitable for the company or the salesperson to the detriment of the consumer. There must be a balance of incentives with fixed remuneration and there must be mechanisms that allow the reduction (or cancellation) of sales incentives in the case of misconduct that has caused damage to consumers.

Allow incentives where there is prevention of undue risk in lending

Lending institutions must define the remuneration policy and salary scheme of its employees. In Mauritius, banks are required to have a Nomination and Remuneration Committee which recommends an incentive package to enhance staff performance, ensuring that staff are not incentivised to take excessive risk.

In Peru, financial institutions are required to constitute a Board Committee on Remunerations, whose objectives are to propose the remuneration and compensation system to the Board in line with the institution's business strategy, risk appetite, and financial soundness; evaluate potential conflicts of interest; and define goals and indicators. Additionally, financial institutions should prepare an annual evaluation report on the employee remuneration and compensation system, which must include the measurement criteria, evaluation, periodicity, and form of payment (including variable remuneration), as well as the correspondence between the indicators used to measure performance with the risk appetite defined by the entity. The internal audit unit must prepare this report, which must be available to SBS on request.

Brazil takes a principles-based approach, requiring sales incentives be considered an indicator of the adequacy of the management of the organisational culture which should promote a balanced relationship with consumers and users.

Disclosure of incentives

In Canada, there are no restrictions on the type of sales incentives offered in relation to mortgage sales (direct or in-direct), however they must be disclosed. The AMF expects that incentives do not affect the fair treatment of consumers.[5]

Legal and regulatory frameworks – in-direct channels

Legal provisions relating to the use of sales incentives through in-direct sales channels are generally intended to ensure the consumers interests are prioritised and the salesperson's decision making is not impaired (see Box 5 for an example from the EU). The way that this objective is achieved varies, including:

- prohibiting the payment of incentives by the mortgage issuer to the intermediary and only allowing payment direct from the consumer (Netherlands);
- allowing incentives where they do not likely give rise to a conflict with the duties owed to the consumer and a prohibition on the linking of incentives to sales volumes or targets (UK);
- allowing commissions where they do not impair the intermediary's duty to act in the consumer's best interests (Ireland);
- allowing remuneration by creditors but ensuring remuneration is not based exclusively on quantitative measures, but also on qualitative measures such as compliance with rules and procedures (Portugal);
- requiring brokers to act in the best interests of consumers, including a conflict priority rule (Australia).

Box 5. Mortgage Credit Directive (EU)

In EU countries, national provisions implementing the Mortgage Credit Directive (Directive (EU) 2014/17 – MCD) mandate that credit intermediaries and mortgage lenders act in an honest, fair, transparent and professional way, respecting the rights and interests of natural person borrowers, not only when designing but also when granting, advising on, intermediating and executing mortgages. The way creditors remunerate their staff and credit intermediaries, and the way credit intermediaries remunerate their staff and appointed representatives must comply with the MCD.

Issuer responsibility for in-direct distribution practices

The majority of respondents observed that the issuer can be held responsible for non-compliance with legal requirements relating to sales incentives both for poor sales practices of its staff and for poor conduct by in-direct distributors (94%).

Interestingly, in Spain, mortgage credit issuers must define the remuneration policy for the mortgage credit intermediaries according to the applicable legal provisions and follow the product oversight and governance rules applicable to product distribution. Otherwise,

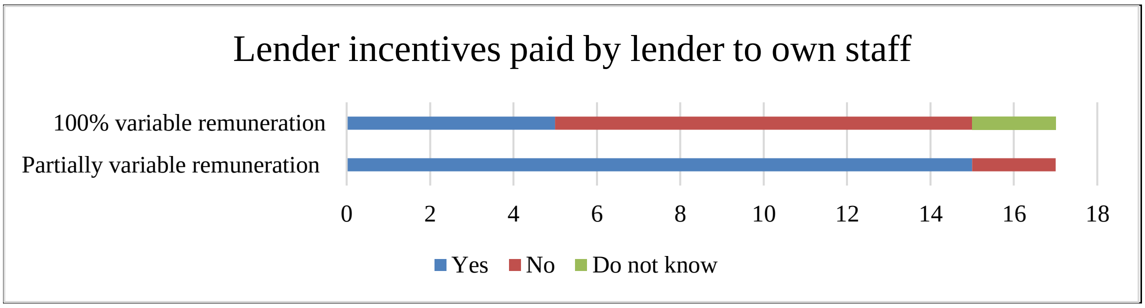
[5] AMF, Sound Commercial Practices Guideline (lautorite.qc.ca), June 2013, pg 6.

mortgage credit issuers cannot be held responsible for non-compliance with legal requirements by mortgage credit intermediaries and mortgage credit intermediaries' staff.

3.3 Sales incentives permitted – direct channels

For direct channels, in most jurisdictions lenders are not allowed to pay their staff a 100% variable remuneration, however in most cases, they are permitted to pay their staff a variable wage in part. Where there are no restrictions on the structure of remuneration, other consumer protection requirements are put in place, such as remuneration policy requirements.

Figure 1. Lender incentives permitted to be paid by lender to own staff



Source: Question 2.d.: "In relation to direct sales (for example, by staff of lenders), please select the types of mortgage sales incentives legally permitted in your jurisdiction: Part variable remuneration (salary based partly on the achievement of sales volumes revenue or targets) or 100% variable remuneration (salary based solely on the achievement of sales volumes, revenue or targets)" (n=16) Note: No nil response.

Where respondents reported that variable remuneration of staff is permitted, the amount can typically be determined by:

- Risk-adjusted return on capital, economic profit, internal economic risk capital;
- Operational or efficiency indicators (profits, revenues productivity, costs and volume metrics);
- Market measures (share price and total shareholder's return);
- Performance metrics (firm wide, division/department, individual performance);
- Sales performance remuneration for staff where the consumer buys additional bundled or tied products (not applicable in Luxembourg);
- Institutional objectives and business strategy; and/or
- Discouraging poor market practice(s) that give rise to consumer detriment.

Dutch law states that financial firms must have publicly accessible and written remuneration policy for both direct and in-direct distribution channels. The remuneration policy must include the criteria on which the variable remuneration is based and include both financial and non-financial criteria.

In Italy, an adequate balance is required between the fixed and variable component of the remuneration and remuneration shall consider the rights and interests of the consumer. To discourage poor market practices, many financial institutions design their variable remuneration schemes taking into account customer satisfaction indicators, the number of complaints traceable back to the conduct of sales staff and other indicators of poor sales practices.

Box 6 provides an example from the European Banking Authority on disclosing remuneration policies.

Box 6. European Banking Authority case study

In 2021 the European Banking Authority published a report assessing the effectiveness of its Guidelines on the remuneration of sales staff (**EBA Guidelines**). Prior to the guidelines being implemented, the EBA identified that poor remuneration policies and practices were a key driver of miss-selling of banking products and services.

The EBA Guidelines aim to provide a framework for financial institutions to implement remuneration policies and practices that will improve links between incentives and the fair treatment of consumers, reduce the risks of mis-selling and resultant conduct costs for firms.[6]

The report found that financial institutions applying the EBA Guidelines focus more on prudential requirements and commercial interests than on meeting the interests of consumers.[7] Governance structures, the design, approval and monitoring of the remuneration policies and practices are often handled by the same function, thereby increasing an inaction bias when reviewing the remuneration policies and practices.

The EBA also noted good practices including:

- having an integrated remuneration policy for all staff, covering all applicable regulatory requirements and differentiating according to the type of staff where appropriate;
- applying a mix of qualitative and quantitative criteria when determining the variable remuneration of sales staff;
- making internal assessments about the appropriate balance of variable remuneration to fixed remuneration in dependency of the products that the sales staff are predominantly selling and the type of customer for whom these products are intended;
- not considering sales performance as the determining criteria for the promotion of staff;

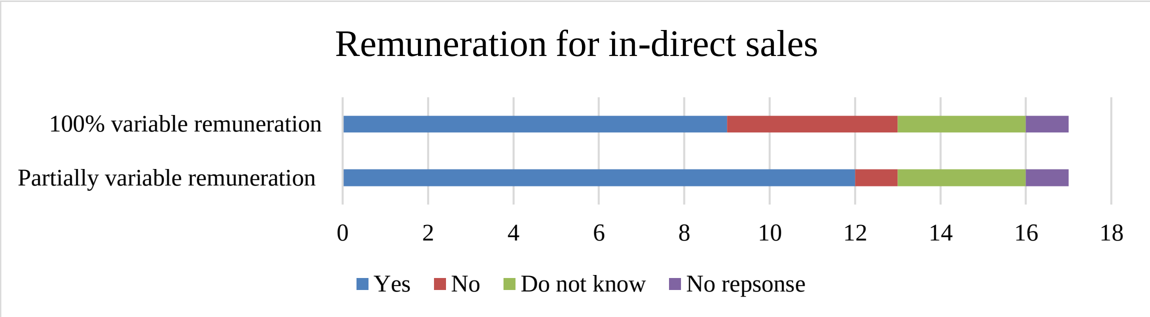
implementing measures that explicitly disincentivise sales staff from acting in a way that may cause consumer detriment.

[6] EBA Guidelines on remuneration policies for sales staff, Guidelines on remuneration policies for sales staff | European Banking Authority (europa.eu), EBA-GL-2016-06, 2016.

[7] EBA Report on the application of the Guideline on the remuneration of sales staff, EBA report highlights shortcomings in the application of its Guidelines on the remuneration of sales staff | European Banking Authority (europa.eu), 9 December 2021.

3.4 Sales incentives permitted – in-direct channels

Figure 2. Sales incentives permitted to be paid by lender to own staff



Source: Question 2.g: "In relation to in-direct sales (for example, by credit-intermediaries), please select the types of mortgage sales incentives legally permitted in your jurisdiction: Part variable remuneration (salary based partly on the achievement of sales volumes revenue or targets) or 100% variable remuneration (salary based solely on the achievement of sales volumes, revenue or targets)" (n=15).

Compared to direct sales, 100% variable remuneration is more often permitted in relation to in-direct sales (e.g., through credit intermediaries). Partially variable remuneration is less commonly permitted in in-direct sales, compared to direct sales. Across both direct and in-direct sales, supervisors seem to have greater awareness of sales incentives compared to other credit products and compared to previous surveys (see Box 7).

Box 8 provides an example of setting and disclosing remuneration policies in Spain.

Box 7. Supervisor awareness of sales incentives paid in relation to mortgage products

Awareness of sales incentives paid in relation to mortgage products appears to be greater than incentives paid in relation to other credit products. Further, supervisor awareness of incentives paid directly and in-directly may have improved over time. In 2016 FinCoNet conducted a similar survey in respect of sales incentives in relation to the sale of all credit products.[8]

In the 2016 report, in relation to sales incentives paid for direct distribution of credit products, at least one third of the responses were 'do not know' or no response was provided (for 100% variable remuneration, 50% responded 'do not know' or did not provide a response; in relation to variable remuneration, 33% responded 'do not know' or did not

[8] FinCoNet Sales Incentives Consumer Credit, FinCoNet-Sales-Incentives-Consumer-Credit-Products.pdf, 2016, page 30.

respond). In contrast in 2022, all supervisors were able to provide an informed response in relation to mortgage products.[9]

In comparison to the 2016 survey, supervisor awareness of in-direct incentives paid in relation to mortgages also higher. In the 2016 report more than half of supervisors 'did not know' or did not provide a response to questions about sales incentives paid in relation to in-direct distribution (54% in relation to 100% variable remuneration and 58% in relation to variable remuneration). The response in relation to mortgage products in 2022 reflected a greater understanding of lender practices in relation to mortgage products (24% responded 'do not know' or did not respond).

Box 8. Remuneration policies are often required to be established and applied

In **Spain**, legislation establishes certain safeguards in relation to the remuneration of mortgage credit issuers to their staff responsible for the assessment of creditworthiness and the granting of mortgage loans. Specifically, the design and application of the remuneration policy by mortgage loan issuers must comply with the following principles, taking into account the complexity of their activities:

- The remuneration policy is the ultimate responsibility of the board of director.
- The policy must be consistent with sound and effective risk management and must not provide incentives to take risks that exceed the level of risk tolerated by the lender.
- It must be consistent with the business strategy, objectives, values and long-term interests of the lender and incorporate measures to avoid conflicts of interest, in particular by providing that remuneration is not dependent on the number or proportion of applications accepted.
- Internal procedures for the implementation of the remuneration policy should be in writing and made available to the competent authority upon request.

The remuneration policy and its implementation procedures shall also be applicable to both the remuneration of mortgage credit intermediaries by mortgage credit issuers and to the remuneration by mortgage credit intermediaries to their designated representatives.

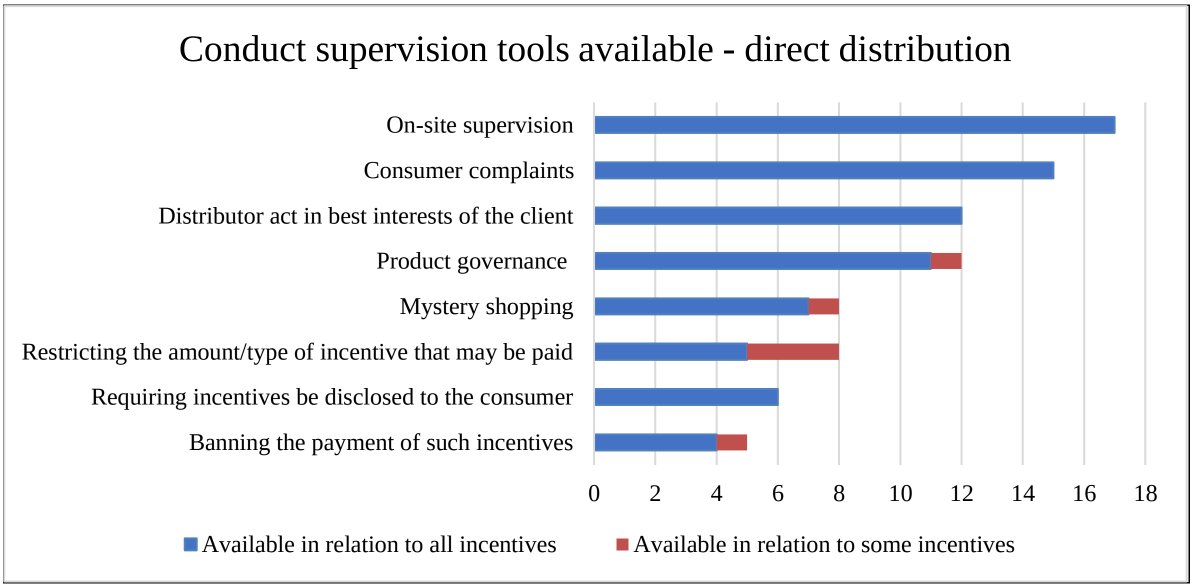
3.5 Oversight, supervision and regulatory tools

To support supervision of sales incentives, two respondents reported that they have annual collections of data (FSRA (Ontario) and AMF (Canada)). In addition, other respondents reported that they collect documents on practices and remuneration policies. While most respondents reported no regular collection activity, many can seek information in response to dedicated information collections.

[9] FinCoNet Sales Incentives Consumer Credit, FinCoNet-Sales-Incentives-Consumer-Credit-Products.pdf, 2016, page 31.

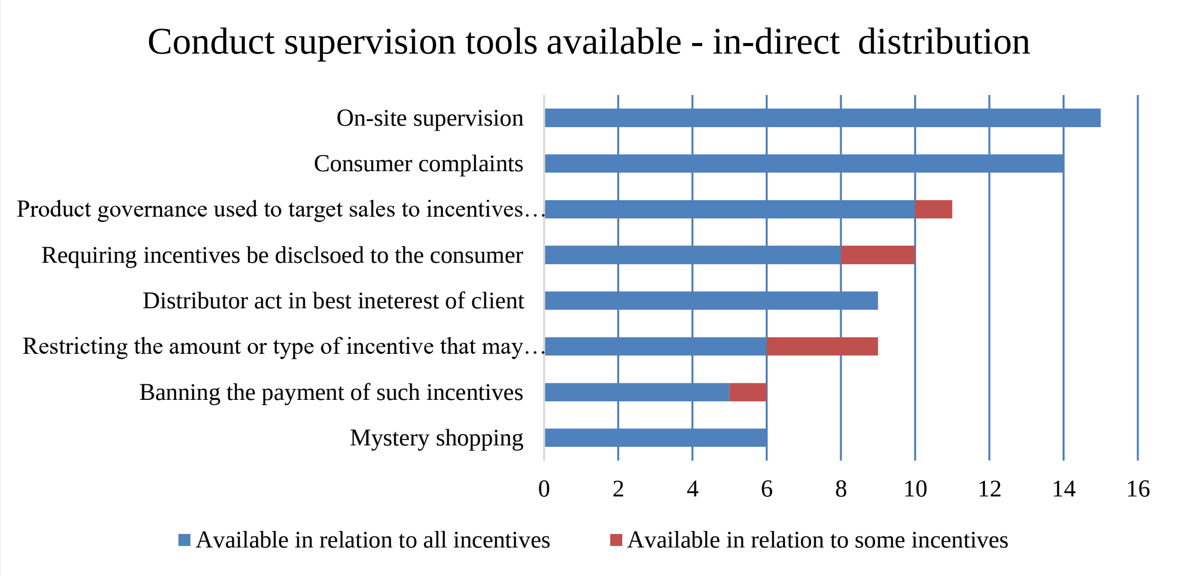
The AMF in Quebec reported that information is collected to measure compliance with the Sound Business Practices Guideline, including quantitative collection on how the following factors influence the payment of incentives/commissions quantitative data on incentives: sales volumes, the number of contract cancelations, the number of complains, cross-selling volumes, customer retention, customer satisfaction and the result of sales quality monitoring. In addition, data is collected on the average percentage weight of the sales volume criterion within the incentive calculation by activity/distribution channel, product and the amount paid as an incentive to employees responsible for the sale of products, and intermediaries (tied agents, brokers, other).

Figure 3. Regulatory requirements and conduct supervision tools relating to sales incentives – direct distribution channels



Source: Question 2.j: "What are the legal/regulatory measures and conduct supervision tools available relating to the use of sales incentives for direct sales (for example, by staff or lenders)?"

Figure 4. Regulatory requirements and conduct supervision tools relating to sales incentives – in-direct distribution channels



Source: Question 2.1: "What are the legal/regulatory measures and conduct supervision tools available relating to the use of sales incentives for in-direct sales (for example, intermediaries, brokers, referrers etc)?"

In addition to the supervisory tools in the figures above (Figure 3 and Figure 4), some respondents reported additional tools such as requesting documentation related to remuneration policies of tied intermediaries (Portugal), request of periodic reviews of remuneration policies (Canada) and dedicated surveys (Italy).

4. Bundling and tying practices

4.1 Consumer risks and benefits

Consumers may receive a variety of product offers regarding their mortgage loans including the option or requirement to purchase additional products. Box 9 describes recent publications on these issues.

There are benefits identified from bundling the sale of the mortgage with additional products:

- Consumers may benefit from reductions in the cost of the mortgage and bundled products (Italy, Spain, Canada, Ireland, France, Ontario, Portugal, Netherlands);
- Enhancement of consumer experience by providing bundled products through one-stop-shop (Mauritius, Ireland);
- Complementarity and interdependence with other banking products, for instance a mortgage and a life insurance, multi-risk insurance or other insurances (such as, insurance in case of unemployment in certain circumstances), which may be a guarantee for the creditors and in turn a mechanism of protection for consumers in that insurance policies may protect them from detrimental situations that may restrict their ability to repay the existing loans (Spain, Brazil, Peru, Italy, Portugal).

The main risks identified regarding bundling practices are the following:

- Lack of information provided to the consumer related to the features of ancillary products (Italy, Peru, France, Spain);
- Higher overall cost borne by the consumer when comparing the cost of each product sold separately (Italy, Peru, Spain, Luxemburg, United Kingdom, Ireland, France, Mauritius, Ontario);
- Acquisition by consumers of products that are not suitable for them or do not meet their interests or objectives (Spain, Australia, Canada, France, Ontario, Quebec);
- Reduction of comparability among the different banking products in packages and possible increased complexity (Peru, Portugal);
- Imposition of insurance products offered by a particular insurance company, preventing the consumer from buying those products from another insurance company that may offer better conditions (Ireland, Mauritius, Peru).

Where a product is bundled, it is essential that the issuer informs the consumer of the possibility not to take up the additional product, to prevent the consumer from mistakenly thinking that if they don’t accept the bundled products offered, they will not be entitled to the loan.

Tying practices can significantly reduce consumers’ freedom of choice, increase costs, undermine the possibility of consumers switching between firms and therefore reducing competition. Where tying a product to a mortgage is permitted consumers can be obliged to buy financial products and services that they may not need or want.

Box 9. Publications on bundling products with mortgages

There are few studies, or data available, on the sales of bundled or tied products and the distribution of mortgage products.

In March 2020, **Banca d'Italia** together with Istituto per la Vigilanza Sulle Assicurazioni (IVASS) published a joint communication to the market relating to the offer of non-financial products jointly with a loan.[10] The communication stated that this kind of offer requires the adoption of appropriate conduct and customer awareness of characteristics, obligations and advantages deriving from the combination of the products offered.

In mid-2022, **Banco de Portugal** published a report on cross-selling practices, in particular bundling practices, and fees charged to retail bank customers in Portugal.[11] The report describes and analyses the commercial practices adopted by institutions when selling mortgage credits and other consumer credit products, the cost of the main services provided to customers in the retail banking markets, as well as the applicable legal and regulatory framework.

4.2 Legal and regulatory frameworks

In the survey, FinCoNet members were asked if their legal/regulatory framework permitted the sale of either bundled or tied products (financial or non-financial) through direct or in-direct channels. All respondents reported that the sale of either bundled or tied products was allowed through direct channels, however 19% of jurisdictions prohibit the sale of bundled and tied products through in-direct channels.

Around a third of respondents indicated that while bundling products with mortgages is legal, tying products is prohibited (35%). In Ontario, Canada, tied selling is prohibited for in-direct channels and credit union lenders.

Across EU Member States, tied selling is prohibited for both direct and in-direct channels, as the EU Mortgage Credit Directive Article 12 prohibits tying practices.

In a minority of jurisdictions, insurance is a condition of acquiring a mortgage loan. In these cases, the insurance does not have to be supplied by the credit provider. In other instances, the bundled insurance policies offered by the credit provider may come from insurance companies belonging to the same economic group as the credit provider. These insurances can include mortgage life insurance, death and permanent invalidity insurance, and insurance for physical damage to the property. Mortgage life insurance policies could be simple (decreasing) or level-term, which will pay the beneficiaries any remainder from the agreed sum that exceeds the mortgage debt at the time of the borrower's death.

In some jurisdictions and in limited situations, products can be required to be purchased alongside a mortgage. In Spain, Banco de España may issue regulations authorising specific

[10] Banca d'Italia and IVASS (Istituto per la Vigilanza Sulle Assicurazioni): https://www.bancaditalia.it/compiti/vigilanza/normativa/orientamenti-vigilanza/Com-BI-IVASS-Polizze-17.3.20.pdf (Italian only), 2020.

[11] Banco de Portugal, Report on cross-selling practices, relatorio_bdp_-_artigo_7.o_da_lei_57-2020.pdf (bportugal.pt) (Portuguese only), 2022.

tying practices when the lender can demonstrate that the tied products, which are not presented separately, bring a clear benefit to borrowers.

In Brazil, it is the consumer's right to be able to purchase the desired product or service only. If a financial institution requires that when a customer opens a mortgage, they also have an additional bank account with the credit provider, that bank account must be provided free of charge.

In Portugal, credit institutions may require clients to contract the relevant insurance for the credit agreement, but they shall accept any insurer of the client's choice. Lenders may also require customers to have a current account, but they are obliged to accept an account in any financial institution of the client's choice.

In Peru, the consumer has the right to reject purchasing any bundled mortgage life insurance and other bundled insurance policies if they buy an equivalent policy from another insurance provider and endorse it to include the credit provider as beneficiary; additionally, the credit provider cannot charge additional costs in case of endorsement of credit/mortgage life insurance. The credit provider has to disclose this right to the consumer at the time of purchase of the mortgage loan.

The sale of products (financial or non-financial) bundled with a mortgage is more common, however some jurisdictions have consumer benefit thresholds. For example, in Ireland a regulated entity is prohibited from bundling except where it can be shown that there is a cost saving for the consumer.

In Portugal, credit institutions are prohibited from selling some products in association with the credit agreement, considering the risk they may bring to consumers. This is the case of savings or investment products that do not secure the principal during the lifetime of the credit agreement.

Responses indicate that the most commonly bundled products are insurance policies as they are often considered to be complementary to the mortgage and are not necessarily sold by the mortgage provider. These include credit insurance, life insurance and home insurance (82%). Additional credit products (including credit cards, personal loans, credit for renovation) (31%), bank accounts such as offset accounts (29%) and investment products (18%) are also bundled with mortgages.

In most jurisdictions the product issuer is responsible for the distribution of its product and ensuring that mortgage brokers, referrers and credit intermediary follow laws and regulations relating to the sale of bundled or tied products. These responsibilities usually lie within product governance and remuneration policies.

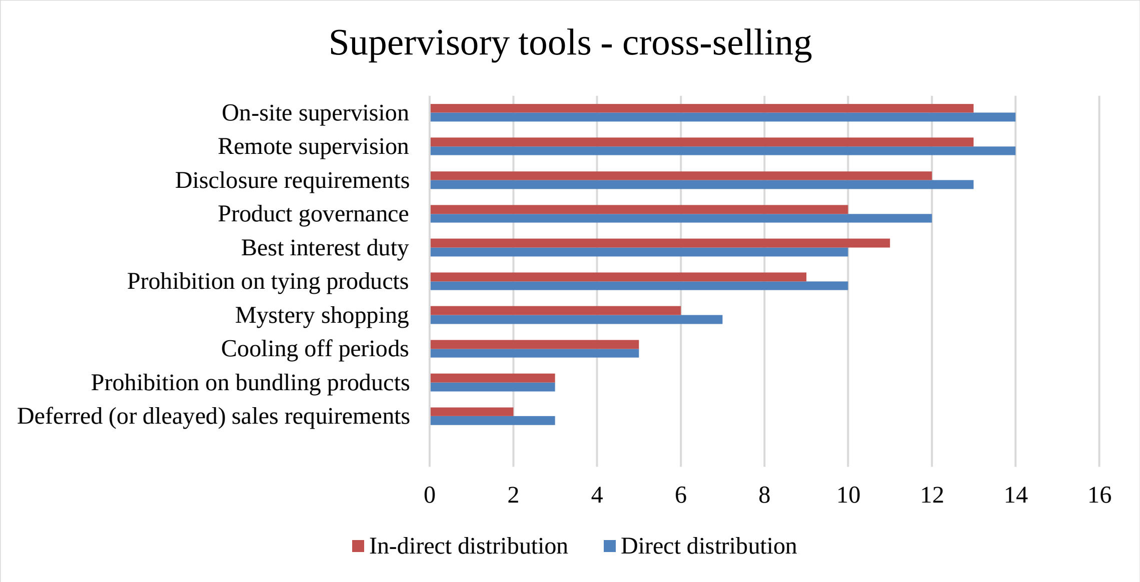
In the Netherlands, supervisory authorities can intervene to require the product issuer set up rules to make sure mortgage brokers, referrers and the intermediary are operating within specific laws and regulations.

Some respondents, such as Bank of Italy, reported that the product issuer could be held responsible when consumers do not receive clear information relating the existence and costs of tied products.

4.3 Supervisory and regulatory tools

To address the inappropriate sale of bundled or tied products through direct channels of mortgage distribution, most of the respondents use on-site and remote supervision (82%) as well as disclosure requirements (76%). The most widely available supervisory and regulatory tools used to oversee in-direct mortgage distribution are on-site supervision, remote supervision (76%) and the use of product governance rules (71%).

Figure 5. Tools used to address inappropriate bundled or tied products (direct and in-direct channels)



Source: Question 3d. "Which legal/regulatory measures and supervisory tools are used to address the inappropriate sale of bundled or tied products when mortgages are sold?" (n=17)

Respondents rely on different information to supervise the sale of bundled or tied products such as complaints information and regulatory data. The BCB in Brazil reported obtaining additional information relating to administrative fines, actions filed against supervised entities and alternative dispute resolution mechanisms from the National Consumer Defense Information System (Sindec).

Further to the tools mentioned above, respondents reported using inspections, monitoring, thematic reviews (see Box 10), moral suasion, and enforcement action to address legal breaches, including the application of administrative and criminal sanctions. Portugal reported that it oversees credit agreements provided by creditors.

Box 10. FCAC thematic study to understand HELOC consumer risks

In 2017, the FCAC in **Canada** published a report[12] following an industry review of Home Equity Lines of Credit (HELOC), revolving lines of credit using the equity in a residential property as collateral often bundled with a mortgage. In the report, FCAC identified four potential consumer issues: over-borrowing, debt persistence, wealth erosion and uninformed decision-making. The report identified some contributors to these issues such as the complexity of re-advanceable mortgage products and HELOCs, a lack of consumer

[12] Financial Consumer Agency of Canada, Home equity lines of credit: Market trends and consumer issues, https://www.canada.ca/en/financial-consumer-agency/programs/research/home-equity-lines-credit-trends-issues.html, 2017.

awareness and understanding of HELOCs, and the limited availability of information to help consumers understand how these products work.

As a follow up, FCAC conducted a survey of consumers to assess their knowledge, awareness and opinions regarding the key terms, conditions, fees, and risks associated with HELOCs and re-advanceable mortgages.[13] FCAC found that although HELOCs were widely sold, many consumers appeared to lack awareness of the terms and conditions. This lack of knowledge may have made it difficult for consumers who acquired or used HELOCs to ensure they were making the most appropriate financial decision for themselves.

[13] Financial Consumer Agency of Canada, Home equity lines of credit: Consumer knowledge and behaviour, https://www.canada.ca/en/financial-consumer-agency/programs/research/home-equity-lines-credit-consumer-knowledge-behaviour.html, 2016.

5. Digital distribution channels

5.1 Consumer risks and benefits

Digital transformation of mortgage sales is essential to keep pace with evolving consumer expectations and improve customer experience, while lowering operational costs and mitigating risks.

Distribution of mortgage products through digital channels may however present risks for consumers, such as the increased possibility that information provided in the pre-contractual stage is unclear (this has been reported by 35% of respondents). Furthermore, two jurisdictions observed that digital channels entail the risk of loss or misuse of consumer's confidential data.

Distribution through digital channels could also impair financial inclusion of vulnerable consumers who may not have access to digital services; furthermore, the use of AI for lending decisions may produce biased results (e.g., in assessing the creditworthiness of consumers, the use of AI might be detrimental for certain consumers).

Mortgage distribution through digital channels may also occur in the context of increased recourse to aggressive cross-selling practices.

Digital channels may produce benefits for consumers as well as for the mortgage market. For instance, digital channels enable faster and more efficient processes (e.g., the simulation and approval of a loan may take place within a few hours, and the underlying document can be processed in less than a day); furthermore, the possibility to access mortgage credit from home represents a great facilitation in the post pandemic context and aligns with emerging consumer preferences. Moreover, digital processes may lead to overall more competitive pricing (lower fees and interest rate) and reduce the risk of administrative errors.

In certain cases, especially relating to the creditworthiness assessment, technology solutions may be designed – or re-designed – to prevent biased decisions and reduce the risk that consumers are recommended products that are not in their best interest.

5.2 Legal and regulatory frameworks

All respondents reported that mortgage distribution through digital channels is permitted. Legal frameworks and supervisory tools are usually designed to be technologically neutral, so that there is protection of the consumer irrespective of the distribution channel, including when assessing whether a mortgage product is suitable for a prospective customer, based on their specific interests and needs. 35% of respondents have specific regulatory requirements or supervisory tools dedicated to this kind of distribution.

Box 11 highlights examples of specific requirements focused on mortgage distribution through digital channels.

In response to a question on whether supervisory tools (including product governance) are used to address potential consumer risks associated with distributing mortgages through digital channels, 76% of respondents reported the possession of such tools.

Box 11. Regulatory requirements for mortgage distribution through digital channels

Ontario, Canada: A duty for banks to establish policies and procedures to ensure that any mortgage they offer or sell through a digital channel is appropriate for consumers having regard to their circumstances, including their financial needs;

The Netherlands: A "knowledge and experience test", addressed to the consumer before entering the contract, aimed to assess the consumer's awareness and knowledge about the functioning of a mortgage. The result of the test is not binding by law. Depending on the internal policy of the lender, a consumer can retake the test after having first failed it.

Peru: Secondary market conduct regulation provisions intended to guarantee security mechanisms for user identification and product acceptance through authentication factors (e.g., biometrics) or a combination of factors. Further, to manage updates, notifications of changes in terms and conditions and periodic information using digital channels approved in the contract clauses. Accept contract termination requests from the client by, at minimum, the same digital channels used to purchase the product.

Quebec, Canada: A distinction between mortgage products sold by direct and in-direct distributors. Direct mortgage lending through digital channels is subject to the same rules as traditional distribution channels; however, in-direct distributors are subject to additional obligations aimed to achieve a consumer outcome similar to an in-person distribution experience.

Portugal: Banco de Portugal established best practices to enhance information transparency on digital channels (Circular Letter no CC/2020/00000044) following the EBA opinion on transparency in disclosure to consumers of banking services through digital means. Through this Circular Letter, the Banco de Portugal provides general recommendations that must be observed throughout the marketing process (e.g., highlighting the need for institutions to ensure that the font size used on the screens of the marketing platform allows for readability). It also foresees specific recommendations, which are applicable, in certain phases of the marketing process (general pre-contractual stage, personalized pre-contractual stage, contract conclusion stage and post-sale stage) and which strive for the institutions to guarantee, for example, that the information on the banking product or service being marketed is presented separately from information about an additional or ancillary product or service and the compulsory scroll down of mandatory information documents.

5.3. Changes in distribution practices associated with COVID-19

Seven respondents reported an increase in the use of digital platforms during COVID-19, whereas the remaining ten reported not having any information on the issue.

The main change in distribution practices reported relates to the interaction between mortgage distributors and financial consumers. As COVID-19 lockdowns entailed the sudden implementation of physical-distancing policies and closing of services, rendering face-to-face meetings impossible for a while, institutions had to rapidly adjust to serving consumers almost entirely digitally. As such, distributors quickly found new ways of connecting with consumers by prioritising the use of electronic communication channels and embracing platforms like Zoom/Teams/Google Meet to stay in touch with customers.

Such digital procedures will be valuable in the longer-term provided previous barriers to digital adoption such as customer preferences and regulatory approvals are upended permanently post-COVID-19.

Although these interaction practices may seem commonplace, only five countries reported changes to their legal framework relating to mortgage distribution through digital channels regarding interaction with financial consumers in response to COVID-19. In Portugal it became possible to enter into mortgage agreements via video conference using a new digital platform that allows documents to be circulated in a safe environment.

Some measures implemented were temporary. For example, in Italy, the digital subscription of banking and financial contract via email was permitted only during the most acute stage of the pandemic (measures expired in July 2021).

5.4. Issuer responsibility for digital distribution

The various components of complex mortgage delivery systems are governed by an equally complex set of laws and regulations, which determines the degree of responsibility for digital distribution regarding the in-direct distributors and financial institutions alike.

One key difference lies in the way in-direct representatives can be held accountable. 71% of respondents stated that the responsibility for poor sales practices through digital distribution channels rests with the issuer.

Consequently, the sole responsibility (both via direct and in-direct distributors) entails the obligation for the product issuer to set up clear rules to make sure that mortgage brokers, referrers and the intermediaries obey all laws and regulations for various reasons, ranging from:

- The product issuer could be held responsible if standard information concerning credit agreements – such as interest rate or any figures relating to the cost of the credit – are not made available through the digital channel (Italy, Brazil).
- Inadequate and ineffective IT security systems and controls put in place by the product issuer may render the product issuer liable to sanctions when relied on by in-direct distributors (Mauritius).

Jurisdictions where in-direct distributors can be held responsible for poor sales practices (including through digital channels), include:

- France where the issuer is responsible only for the product that is being sold via direct distribution or due to the intermediary acting on its behalf. When the intermediary does not act on behalf the product issuer, it shall have its own liability coverage.
- Canada where even if the broker relies on technology and algorithms to identify suitable mortgage recommendations for borrowers, the broker and its principal are accountable for ensuring suitability of the recommendations (FRSA).
- Spain, where the issuer is subject to product governance rules, and accordingly should take all reasonable steps to ensure that distributors act in compliance with the objectives of the issuer’s product oversight and governance arrangements. This, however, does not make the issuer liable if the intermediary does not meet the mortgage distribution obligations to which it is subject.

6. Key Findings

The following **key findings** emerge from this Briefing Note:

Mortgage distribution and legal frameworks

- All respondents indicated that a legal framework applies to all or some channels of mortgage distribution within its jurisdiction. Most have in place rules, principles and policies governing mortgage sales through direct and in-direct distribution channels.
- Conduct rules, standardised licensing requirements, cooling-off periods and disclosures are rules reported by jurisdictions. Principles of oversight commonly reported across all jurisdictions include honesty in dealings, fair treatment of customers, transparency and disclosure, and professional conduct.
- Many jurisdictions require that a mortgage distributor, whether through a direct or in-direct channel, assess the suitability of a certain mortgage product for the potential borrower and that the suitability assessment include determining the borrower's capacity to repay the loan.
- In most respondent jurisdictions, there are product governance obligations for issuers and distributors of mortgages. The aim of product governance requirements is to ensure mortgage loans are provided with the intention of aligning consumer interests with consumer outcomes. Most respondents indicated that in their jurisdictions there are requirements that the target market is defined based on a description of the consumer and/or product features. In most jurisdictions product governance requirements place obligations on third party distributors.
- Most jurisdictions do not identify differences in consumer outcomes when comparing direct and in-direct channels relating to higher loan to value ratios, spending a higher proportion of wage on the property or interest rate.
- Supervisors had little data available to consider whether consumer outcomes vary between direct and in-direct channels.

Sales incentives

- Supervisors appear to have a growing awareness of sales incentives paid in relation to direct and in-direct distribution, the influence sales incentives have on outcomes for consumers and the need for effective controls to adequately manage the risk of mis-selling. The majority of respondents' jurisdictions have rules relating to sales incentives and the nature of incentives a salesperson can receive. A variety of approaches are used across jurisdictions with the common objective to balance the interests of the consumer with the interests of the mortgage provider or salesperson and to prevent undue risk in lending.
- Regarding direct distribution, in several jurisdictions, financial and non-financial incentives are permitted where it will not impair decision making to the detriment of consumers. In most jurisdictions, lenders are permitted to pay their staff a variable wage but only in part.

- Supervisors and regulators generally use a range of tools to supervise/regulate sales incentives, for both direct and in-direct distribution, which may include data collection, mystery shopping, consumer complaints, on-site supervision, enforcement of product governance requirements, banning's, imposing best interest obligations, restrictions, and disclosure requirements.

Bundled or tied products

- Tying practices, that is offering or selling a product or service with a credit agreement where the credit agreement is not made available to the client separately, are prohibited in many jurisdictions.
- Selling bundled products is a common practice when acquiring a mortgage, particularly insurance products that protect the consumers interests. In most jurisdictions product issuers are responsible for the distribution of their products. Product governance and remuneration policies are relied on to ensure that bundled products are designed and sold appropriately.
- In some jurisdictions there are laws and regulations that relate specifically to bundled and tied products. It is essential that consumers are aware of the product attributes and costs associated with bundled products, as well as their right regarding purchasing those products separately.

Distribution through digital channels

- In most jurisdictions, distribution through digital channels is dealt with through technology-neutral legislative provisions and so there are not unique provisions relating to the digital distribution of mortgage products or the supervision of distribution through specific channels.
- Some respondents reported having tools designed to address potential risks to consumers associated with digitally distributed products but did not report that they are specific to mortgages.
- In response to COVID-19, five jurisdictions put in place measures to address the increase in demand for digital distribution of financial products and the increase of risks for consumers, such as data security risks. Not all measures have been retained.

Conclusion

Ensuring that consumer interests are prioritised when a mortgage is sold, irrespective of the sales channels used, is important to ensure fair treatment of consumers, appropriate consumer outcomes are achieved, and financial systems are secure. This paper provides shared learning on how jurisdictions address consumer risks associated with mortgage distribution, including the use of sales incentives giving rise to competing interests through the sales process.

Supervisors of mortgage distribution use both on-site and off-site supervision to oversee the principles and requirements designed to address consumer risk and drive appropriate consumer outcomes. Principles applied include honesty in dealings, transparency and fairness. Regulators and supervisors oversee requirements including disclosure, product suitability assessments, credit-worthiness assessments, and complaints frameworks. The value of having a variety of tools to address market conduct risks and to promote better consumer outcomes is affirmed through examples of supervision and enforcement.

Looking ahead

Supervisors should consider improving data capability to support better consumer outcomes. Many supervisors reported that they have little or no data available to measure consumer outcomes based on distribution channel. Where promptly available, information can be used to drive improvements, including to product governance measures such as defining narrower target markets that fit best with the mortgage products offered. Further consumer outcomes data puts the supervisory authority in a better position to identify lender processes, poor sales practices and products design issues that warrant further assessment through on site or off-site supervision, thematic reviews, or enforcement.

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Annex A. List of responding jurisdictions

Jurisdiction	Organisation
Australia	Australian Securities and Investments Commission (ASIC)
Brazil	Banco Cenral do Brasil
Canada	Financial Consumer Agency Canada (FCAC)
France	Banque de France
Ireland	Central Bank of Ireland
Italy	Banca d'Italia
Japan	Japan Financial Services Agency
Luxembourg	Commission de Surveillance du Secteur Financier (CSSF)
Mauritius	Bank of Mauritius
Netherlands	Autoriteit Financiële Markten (AFM)
Nigeria	Central Bank of Nigeria
Ontario	Financial Services Regulatory Authority of Ontario (FSRA)
Peru	Superintendence of Banking, Insurance and Private Pension Fund Administrators (SBS)
Portugal	Banco de Portugal
Quebec	Autorité des Marchés Financiers (AMF)
Spain	Banco de España
United Kingdom	Financial Conduct Authority (FCA)

Annex B. Survey on Financial Product Governance and Culture

Section 1. Mortgage distribution via direct and in-direct channels - consumer risks, benefits and outcomes

1.a How are mortgages distributed in your jurisdiction? Select as many as are relevant

☐ Direct - from the issuer to the consumer

☐ In-direct - credit intermediaries, including brokers

☐ In-direct - referrers

☐ Other

If there are other mortgage distribution channels, please describe:

1.b Comparing mortgage distribution channels, please outline whether mortgage sales through these distribution channels are within the supervisory scope of your supervisory authority.

	Yes	No
Direct sales	☐	☐
In-direct sales – credit intermediaries, including brokers	☐	☐
In-direct - referrers	☐	☐

1.c Does your jurisdiction have in place any rules or principles governing mortgage sales?

	Yes, rules	Yes, principles	No	Under consideration/ In progress
Direct sales	☐	☐	☐	☐
In-direct sales – credit intermediaries, including brokers	☐	☐	☐	☐
In-direct - referrers	☐	☐	☐	☐

1.d If you answered yes to Q1.c, please outline the legal framework or the principles applicable.

1.e Comparing direct and in-direct mortgage distribution channels, please describe differences in consumer outcomes:

Consumer outcome	Direct distribution (describe risks and benefits)	In-direct distribution (describe risks and benefits)
Higher loan to valuation ratios		
Spending higher proportion of wage on the property		
Taking out more interest only loans		
Paying higher interest rate		
Pay higher fees		
Purchasing tied or bundled products		
Receiving information on pricing, terms and conditions during the pre-contractual phase		
Other		

1.f Please provide a summary of any existing studies, or data available, on any differences in consumer outcomes relating to mortgages distribution channels (i.e. direct and in-direct). Please describe briefly and provide a link to existing relevant documents.

1.g Are there product governance requirements in your jurisdiction that place the following obligations on issuers and distributors of mortgage products?

	Yes	No
Definition of the target market based on description of the consumer	☐	☐
Definition of the target market based on description of the product features	☐	☐
Oversight of product approval procedures	☐	☐
Product testing and monitoring	☐	☐
Obligations on third party distributors (ie brokers)	☐	☐
Obligations on referrers	☐	☐
Collection of information about consumer outcomes by the product issuer	☐	☐
Collection of information about consumer outcomes by the product distributor	☐	☐
Periodic reviews of the target market	☐	☐
Reporting to the supervisor/regulator	☐	☐

1.h If there are product governance obligations for issuers and distributors of mortgages in addition to those listed in 1.g, please describe (e.g. requirement on intermediaries to explain suitability of product to consumers).

1.i Case studies: Please provide brief examples of supervisory action taken using product governance requirements relating to mortgage distribution via direct or in-direct distribution.

1.j Are there planned changes to regulation in relation to consumer outcomes associated with mortgage distribution in your jurisdiction?

☐ Yes
☐ No

1.k If yes, please explain the proposed changes.

Section 2. Mortgage distribution – legal or regulatory requirements relating to sales incentives

2.a Does your jurisdiction have any legal or regulatory provisions relating to sales incentives for the distribution of mortgages? If sales incentives are permitted, are there rules relating to the nature of the incentive (financial or non-financial) received by the sales person? For example, financial incentives could include staff bonus payments or commissions and non-financial incentives could include tickets to events.

	Financial incentives	Financial incentives not permitted	Non-financial incentives	Non-financial incentives not permitted
Direct	☐	☐	☐	☐
In-direct – Credit intermediates	☐	☐	☐	☐
In-direct – Referrers	☐	☐	☐	☐

2.b For each distribution channel, please describe the sales incentives permitted by your legal/regulatory framework.

Direct	
In-direct - Credit intermediaries	
In-direct - Referrers	
Other (please describe)	

2.c For each distribution channel, please describe the information/data on sales incentives collected by your supervisory/regulatory authority.

	Does your supervisory/ regulatory authority collect any statistics on sale incentives?	What are the sources of information on incentives used by the supervisor/regulator?
Direct		
In-direct - Credit intermediaries		
In-direct - Referrers		

2.d In relation to direct sales (for example, by staff of lenders), please select the types of mortgage sale incentives legally permitted in your jurisdiction.

Lender incentives to own staff	Yes	No	Do not know
Part variable remuneration (salary based partly on the achievement of sales volumes, revenue or targets)	☐	☐	☐
100% variable remuneration (salary based solely on the achievement of sales volumes, revenue or targets)	☐	☐	☐

2.e If you answered yes to Q2.d, does your legal or regulatory framework allow variable remuneration of staff of lenders (direct sales) to be determined by any of the following criteria?

Lender incentives to own staff	Yes	No	Do not know
Risk-adjusted return on capital, economic profit, internal economic risk capital	☐	☐	☐
Operating efficiency indicators (profits, revenues, productivity, costs and volume metrics)	☐	☐	☐
Market measures (share price and total shareholder's return)	☐	☐	☐
Firm wide performance	☐	☐	☐
Division / department performance	☐	☐	☐
Individual performance	☐	☐	☐
Sales performance commissions for staff where the consumer buys additional bundled or tied products	☐	☐	☐
Discouraging poor market practice(s) that give rise to consumer detriment	☐	☐	☐

2.f. Referring to Q2.e, please specify any other criteria allowed to be used to determine variable remuneration of staff of lenders (direct sales).

2.g In relation to in-direct sales (for example, by credit-intermediaries), please select the types of mortgage sale incentives legally permitted in your jurisdiction.

Remuneration for in-direct sales	Yes	No	Do not know
Partly variable remuneration (salary based partly on the achievement of sales volumes, revenue or targets)	☐	☐	☐
100% variable remuneration (salary based solely on the achievement of sales volumes, revenue or targets)	☐	☐	☐

2.h If you answered yes to Q2.g, does your legal or regulatory framework allow variable remuneration for credit intermediaries (in-direct sales) to be determined by any of the following criteria:

Remuneration for in-direct sales	Yes	No	Do not know
Risk-adjusted return on capital, economic profit, internal economic risk capital	☐	☐	☐

Operating efficiency indicators (profits, revenues, productivity, costs and volume metrics)	☐	☐	☐
Market measures (share price and total shareholder's return)	☐	☐	☐
Firm wide performance	☐	☐	☐
Division / department performance	☐	☐	☐
Individual performance	☐	☐	☐
Discouraging poor market practice(s) that give rise to consumer detriment	☐	☐	☐

2.i Referring to Q2.h, please specify any <u>other</u> criteria used to determine variable remuneration for in-direct sales.

2.j What are the legal/regulatory measures and conduct supervision tools available relating to the use of sales incentives for direct sales (for example, by staff of lenders)?

	Yes (in relation to all incentives)	Yes (in relation to some incentives)	No	Do not know
Requiring disclosure to the consumer	☐	☐	☐	☐
Restricting the amount or type of the incentives that may be paid	☐	☐	☐	☐
Imposing an obligation that the lender and or the staff member must act in the best interests of the client	☐	☐	☐	☐
Banning the payment of such incentives	☐	☐	☐	☐
Product governance used to target sales to consumers that will benefit from the product	☐	☐	☐	☐
On-site supervision	☐	☐	☐	☐
Consumer complaints	☐	☐	☐	☐
Mystery shopping	☐	☐	☐	☐

2.k Referring to Q2j, please specify any <u>other</u> legal/regulatory and conduct supervision tools available relating to the use of sales incentives for direct sales:

2.l What are the legal/regulatory measures and conduct supervision tools available to supervise the use of sales incentives for in-direct sales (for example, intermediaries, brokers, referrers etc)?

	Yes (in relation to all incentives)	Yes (in relation to some incentives)	No	Do not know
Requiring that they be disclosed to the consumer	☐	☐	☐	☐
Restricting the amount or type of the incentives that may be paid	☐	☐	☐	☐

Imposing an obligation that the distributor must act in the best interests of the client	☐	☐	☐	☐
Banning the payment of such incentives	☐	☐	☐	☐
Product governance used to target sales to consumers that will benefit from the product	☐	☐	☐	☐
On-site supervision	☐	☐	☐	☐
Consumer complaints	☐	☐	☐	☐
Mystery shopping	☐	☐	☐	☐

2.m Referring to Q2.l, please specify any <u>other</u> legal/regulatory and conduct supervision tools available relating to the use of sales incentives for in-direct sales.

2.n Please provide a summary of any existing studies, or data available, on the use of sales incentives in the distribution of mortgages and the effect on consumer outcomes. Please <u>briefly</u> describe and provide a link to existing relevant documents.

2.o Case studies: Can the product issuer be held responsible for non-compliance with legal/regulatory requirements relating to sales incentives in the following situations? If so, please provide examples:

Poor sales practices of its staff	
Poor sales practices by in-direct distributors	

Section 3. Mortgage distribution – bundled or tied products

3.a Does your legal/regulatory framework permit the sale of bundled or tied products (financial or non-financial) when distributing mortgage products through the direct or in-direct channels?

	Yes	No
Direct	☐	☐
In-direct	☐	☐

3.b If you answered yes to Q3.a, please provide examples of the products (financial or non-financial) that are legally permitted to be sold as a bundled or tied product.

3.c Please describe any known risks or benefits to appropriate consumer outcomes associated with the sale of bundled or tied products.

3.d Which legal/regulatory measures and supervisory tools are used to address the inappropriate sale of bundled or tied products when mortgages are sold?

	Direct mortgage distribution	In-direct mortgage distribution
Prohibition on bundling products	☐	☐
Prohibition on tying products	☐	☐
Cooling off periods	☐	☐
Product governance	☐	☐
Deferred (or delayed) sales requirements	☐	☐

Disclosure requirements	☐	☐
Best interest duty	☐	☐
On-site supervision	☐	☐
Remote supervision	☐	☐
Mystery shopping	☐	☐

3e. Referring to Q3.d, please specify any other legal/regulatory and supervisory tools used to address the inappropriate sale of bundled or tied products.

3.f Please provide a summary of any existing studies, or data available, on the sales of bundled or tied products and the distribution of mortgage products, including the effect on consumer outcomes. Please describe briefly and provide a link to existing relevant documents.

3.g Case study: Can the product issuer be held responsible for non-compliance with legal/regulatory requirements relating to sales incentives relating to the sale of bundled or tied products? If so, please provide an example.

Section 4. Mortgage distribution through digital channels

4.a Does your legal/regulatory framework permit mortgage products be distributed through digital channels in your jurisdiction?

	Yes	No
Direct	☐	☐
In-direct	☐	☐

4.b If you answered yes to 4.a, are there legal/regulatory requirements specifically relating to the distribution of mortgage products through digital channels?

	Yes	No
Direct	☐	☐
In-direct	☐	☐

4.c If you answered yes to 4.b, please outline the main legal/regulatory requirements.

4.d Has mortgage distribution through digital sales changed in your jurisdiction over the COVID-19 period (since March 2020)?

Yes, it has increased	No, it has remained the same	Yes, it has decreased	Don't know
☐	☐	☐	☐

4.e Has there been any changes to your legal/regulatory framework relating to mortgage distribution through digital channels in response to COVID-19?

4.f Please describe any observed or potential risks or benefits to consumer outcomes associated with digital distribution of mortgage products.

4.g In your jurisdiction, are there supervisory tools (including product governance) used to address potential risks to consumers associated with the distribution of mortgages through digital channels?

Yes	No
☐	☐

4.h If yes, please describe.

4.i Please provide a summary of any existing studies, or data available, on the distribution of mortgage products through digital channels and the impact on consumer outcomes. Please describe briefly and provide a link to existing relevant documents.

4.j Case study: Can the product issuer be held responsible for poor sales practices through digital distribution channels? If so, please provide an example.

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