Financial Conduct Authority: Call for Inputs on competition in the mortgage sector

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Consultation response from the

Centre for Competition Policy

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This consultation response has been drafted by the named academic members of the Centre, who retain responsibility for its content.

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CCP Consultation Response

This response is largely based on observations from a large-scale survey carried out by Centre for Competition Policy (CCP) and the empirical findings of Waddams Price and Zhu (*forthcoming*)[1] using data generated from this survey. A summary of findings from the study together with some details of the survey dataset is provided first, followed by specific response to relevant questions set out in the Call for Inputs.

In Waddams Price and Zhu (forthcoming) we explore the effect on searching and switching across eight markets, including mortgages, of three 'primary' factors which we would expect to drive activity: the expected saving, the anticipated time required to find a better deal and the anticipated time required to change suppliers. The empirical models applied in the study control for other underlying factors and allow for the effects of the primary factors mentioned above to vary across individuals. We find that potential gains and anticipated switching time are associated with changes in consumer activity, but there are differences between markets, demographic groups and individuals. Our findings are derived from those respondents who could provide the necessary information, and so apply to the more informed (and more active) section of consumers. The survey is ten years old, and changes in technology have changed possibilities (and some behaviour) since then, though we believe the conclusions remain qualitatively valid.

Key findings from the paper are:

- The middle-aged are least active, and the young and old most active.
- The effects of the main drivers of activity are exaggerated among older people: gains provide a greater incentive to action, and switching time is a greater deterrent.
- The effect of previous experience of switching has a smaller effect on older respondents, probably because they have more experience.
- Lower income respondents are more likely to switch (but not significantly more likely to search) than those with higher incomes, perhaps because their marginal value of savings is higher.
- However, lower income respondents are less likely to search and switch in response to increases in potential gains, and they are more deterred from searching (but not from switching alone) by a longer switching time.
- The experience of switching in other markets is less influential for lower income respondents.
- While there is no significant difference in the underlying level of searching and switching amongst respondents with lower educational achievements, they are more responsive both to higher expected gains in encouraging searching and switching, and to anticipated switching time in deterring searching.

[1] Waddams Price, C. and Zhu, M. (forthcoming) Empirical Evidence of Consumer Response in Regulated Markets, *Journal of Competition Law and Economics,* forthcoming (Jan 2016), 12-1. An earlier version of this paper is available at Waddams Price, C., Webster, C. & Zhu, M. (2013), '*Searching and Switching: Empirical Estimates of Consumer Behaviour in Regulated Markets*', http://competitionpolicy.ac.uk/documents/8158338/8235394/CCP+Working+Paper+13-11.pdf/96adc02f-dd01-4d07-b5b0-f5e5404d07a1; a policy brief for the research paper is at http://competitionpolicy.ac.uk/documents/8158338/8235394/CCP+Policy+Brief+13-11.pdf/42ccc0d0-c7a2-4606-a4bb-352490e299ba

- The experience of switching in other markets affects behaviour differently across the eight markets analysed, demonstrating that variations in behaviour are due to market as well as consumer characteristics.

- There are persistent differences between markets in the underlying propensity to switch.

Detailed response to relevant questions for the mortgage market:

Q5(c). The nature and relevance of different barriers to re-mortgaging. The extent to which the (perceived or real) costs of switching prevent consumers from accessing better deals.

Although our study is not confined to the mortgage market, a comparison across different markets highlights the importance of *switching experience* in other markets, which is particularly influential in encouraging search and switching in the mortgage market.

In contrast, an additional pound of *expected gain* is less likely to motivate search or switching activity in the mortgage market than in the mobile phone provider market. Expected switching time seems to provide less of a deterrent to searching and switching between mortgages than in fixed phone provision and current bank accounts. These effects are identified after different levels of switching across markets (and changes in other variables) have been taken into account.

These findings suggest that increasing (well founded) consumer confidence in potential gains is likely to be an effective strategy across markets. However it is important to note that in addition to significant heterogeneity across different markets, our results also indicate significant difference across individuals in responding to the primary factors. For example the model predicts that (across markets) gains have to be as high as £100 per month (when the sample mean is about £12 per month) to entice the majority of consumers (around 80%) to search and switch. This means the task of effectively increasing consumer confidence in potential gains may be challenging.

Q2. The extent to which consumers choose mortgages that are less suitable than other products available to them, and whether certain mistakes are more prevalent amongst some consumer groups.

Although our findings are not based on any specific type of mortgage products, we do find interesting patterns regarding whether demographic factors influence consumers' decision to look for and switch to a better deal *in general* across all markets studied.

Once other factors are controlled for, we find consumers who might be considered "vulnerable" (on a low income, the elderly or with low educational achievement) are neither less active nor less responsive to changes in expected gains and switching time than average. Indeed all show signs of responding more to these stimulants than other groups in the population. For instance, additional gains provide a greater incentive to action, and switching time a greater deterrent to searching among older respondents; this is also true for respondents with lower educational achievement; those with lower income are more (negatively) responsive to the length of the process, though less responsive to expected gains.

When we look further into our survey data, we find that average gains are markedly lower for older respondents, and for lower income consumers. These groups may participate much less in the mortgage market. We also observe that both switching and searching rates decline with age and there is a clear inverse relationship between activity and income. Therefore, interpreting the results and developing appropriate policies (for example to encourage the less active to become more so) depends on how far these different expectations by different types of consumers reflect variations in potential gains available in the market. For instance, a low income consumer may have a smaller mortgage which implies a smaller gain from switching to a better deal in absolute terms, though having lower consumption/bill is unlikely to account for all of the difference in expectations.

Q3. The different providers of information and advice typically considered by (different types of) consumers, and how they are used.
Q4. Whether existing information and advice channels cater for the needs of different types of consumers. If not, which types of consumers face particular challenges.

Although not explicitly analysed in the study, we can observe from our survey data that respondents, at the time of survey, on average, trusted more the information/advice available from suppliers and friends and family than from other sources. In the mortgage market, it seems that “intermediaries, experts and brokers” are an important source of information, more so than in any other sector.

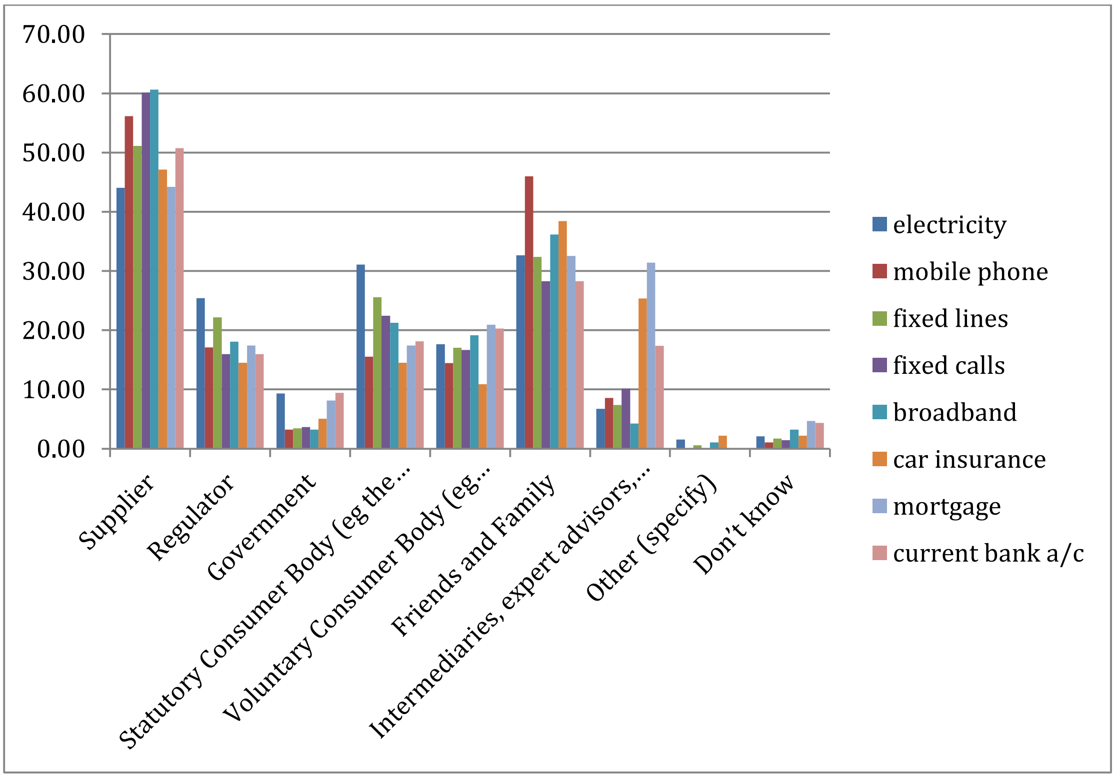

Fig 1. Different sources of information people trust in each market (expressed as % of respondents in each market)

We do not see a striking difference in terms of whether people of different groups might trust different information sources. For instance, in terms of age groups, it seems that the 65-74 age group trust suppliers (accounting for more than 35 % of the respondents in this group) and intermediaries (accounting for just below 35% of the respondents in this group) most. This pattern does not appear to be very different among respondents in the younger age groups, for instance, those aged 35-44.

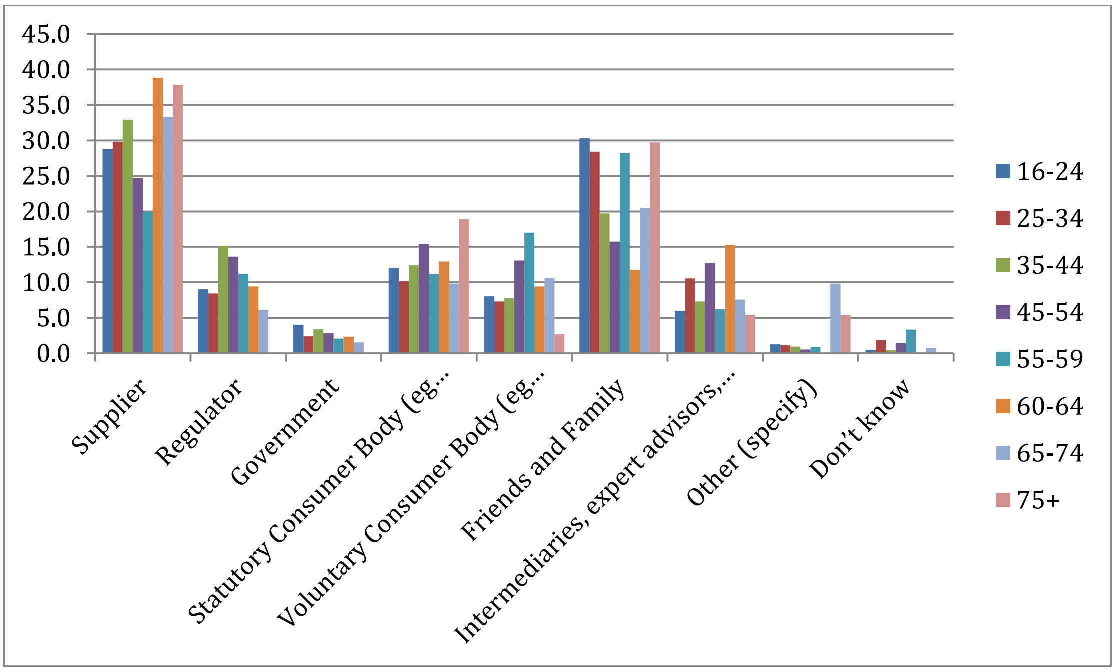

Fig 2. Different sources of information people trust in each age group (expressed as % of respondents in each age group)

The data on which these findings and conclusions are based are almost a decade old at the time of writing, and services available on the internet, and their usage, have developed significantly in that time, almost certainly reducing the cost of searching, and perhaps lowering the cost of switching to a lesser extent. However there is increasing concern about a digital divide, in particular that lower income and older consumers may have less access to or be less comfortable using such innovations, so the differences between consumers of different age/income groups may be more significant now than those reported here.