Equity Release Council response to
Financial Conduct Authority CP17/32: Quarterly Consultation Paper No.18

Introduction

The Equity Release Council is the industry body for the equity release sector. The Council represents over 650 members, including providers, qualified financial advisers, solicitors, surveyors, intermediaries and other industry professionals.

Every member is committed to The Council's Statement of Principles and its Rules and Guidance, which aim to ensure consumer protections and safeguards. In addition, the Equity Release Council works to boost consumer knowledge and increase awareness of equity release as a solution to financial challenges facing people over the age of 55 across the UK.

We welcome this opportunity to comment on Chapter 9 of CP17/32 and the proposals around the facilitation of retirement interest-only mortgages.

Response

Q9.1 Do you agree with our proposed approach to retirement interest only mortgages?

We support efforts to provide innovative and flexible options that are in the best interests of older consumers and welcome the fact the FCA is actively considering the issue of interest-only mortgages reaching maturity, as many consumers will require solutions to repay the outstanding balance. There are, however, various aspects of the proposal on which we seek clarification.

Consumer

Intended consumer

Older consumers may wish to take out a retirement interest-only mortgage for broadly three reasons: (i) to address a particular issue such as their interest-only mortgage reaching maturity; (ii) to build retirement income; (iii) for tax planning purposes, thus reducing their inheritance tax burden.

The first category (consumers with interest-only mortgages) may be in a very different position, both financially and asset-wise, from the other two. Therefore, any retirement interest-only mortgage would need to be suitable for a range of customer circumstances, both now and in the future.

We would welcome the FCA's view on who the retirement interest-only mortgage is primarily intended for; if it was intended that to be eligible for a retirement interest-only mortgage, the consumer must first have a current interest-only mortgage at the time of transfer, then this new product and its definition would have a limited lifespan and therefore be an expensive development for firms. However, as 9.1 refers to both interest-only mortgages reaching maturity and customers who are seeking to release equity from their homes without the cost of interest roll-up, we assume that the intention is for retirement interest-only mortgages to be available to consumers who neither currently have, nor previously had, an interest-only mortgage.

We would also welcome the FCA's view on whether a customer must be of a certain minimum or maximum age and/or be semi or fully retired to be eligible to apply for a retirement interest-only mortgage.

Consumer vulnerability

The FCA itself has said that, while older consumers aren't necessarily vulnerable, they are more likely to be so than other groups, for reasons including the loss of a loved one, changes to physical or mental health, or limited provisions for retirement, which lead to changed circumstances or reduced financial resilience.[1]

As indicated above, many consumers with interest-only mortgages will be distressed due to being in a very difficult financial position and with no means to pay off their mortgage. The fact that they may be under such stress underlines the importance of accessing both legal and financial advice to get an objective view on the options available to them. Vulnerable customers are mentioned in MCOB 4.2.1 (d) as a group who are given regulated advice in every case.

It is important that the rules also take into account potential mental capacity challenges as consumers age, but also the potential for undue influence from family members – for example, the pressure to forego care to protect a future inheritance. Council Members are consistently working to address the challenges presented to customers with – or considering – lifetime mortgages to ensure they have the capacity to make a decision without undue influence from other people, and these efforts should be replicated in rules around retirement interest-only mortgages.

Consumers must be continually protected, particularly at or after key life events, to ensure that they are not disadvantaged at the most vulnerable points of their retirement.

Consumer advice

[1] Speech by Linda Woodall, delivered at the Ageing Population Occasional Paper launch event, 16/10/2017 https://www.fca.org.uk/news/speeches/ageing-population-financial-services

We believe that access to sound, independent and regulated consumer advice is paramount. Older customers not only face a range of complex retirement options, but they may also do so at a time when they may be financially vulnerable as well as experiencing declining physical and mental health.

Advice should be balanced and fair, outlining the differences between products and the associated financial and tax implications over the longer term. Paragraph 9.3 correctly points out that there are different risks associated with retirement interest-only mortgages and lifetime mortgages, but then doesn't offer a fair comparison between the benefits and risks. Consumers need to be made fully aware of the details below the top-line figure – a product that is cheaper at the point of purchase may not be the most cost-effective or suitable in the long-term.

At 9.3, the Quarterly Consultation highlights the risk of rapid equity erosion on roll-up mortgages, but not the fact that a retirement interest-only mortgage with no alternative default option carries the risk of repossession if interest payments aren't sustainable. Customers who are in a difficult financial situation should not be given the impression that a retirement interest-only mortgage is necessarily a less risky option when this may not be the case. – consumers should be given the opportunity to consider the benefits and risks of <u>all</u> available products. If advice is not compulsory, then consumers may not have the opportunity to weigh up all options and choose the most suitable product for them.

Inertia

Previous work by the FCA on the ageing population has highlighted the tendency of customers to remain with their existing provider rather than shop around for a better deal[2]. The Retirement Outcomes Review interim report suggested that, before the pension freedoms, between 40-68% of customers who purchased an annuity stuck with their existing provider – with customers not taking advice more likely to stick with their provider. The FCA expressed concern in the Retirement Outcomes Review interim report (section 4.17-4.18) that, as financial decisions became more complex with the arrival of the pensions freedoms, customers may be even less likely to shop around different providers.

Such a pattern of customer behaviour is likely to be repeated with retirement interest-only mortgages, not least because it would appear the most straightforward option. Not only could this result in less desirable consumer outcomes, particularly in the longer term, it is open to question whether the market for retirement interest-only mortgages would be truly competitive.

Consumer protections

We would welcome the FCA's views on the consumer protections that it intends would be provided with a retirement interest-only mortgage. For instance, will there be a requirement

[2] FCA Retirement Outcomes Review Interim report, published July 2017

that customers should seek regulated advice and/or they should have access to independent legal advice etc?

<u>Retirement interest-only mortgages - details</u>

We would welcome clarification on how it is envisaged that interest rates would be determined. Is the intention that the product would be offered at a fixed rate of interest or at standard variable rate? In the case of the latter, should interest rates rise, this would have a significant impact on customers' ability to afford the ongoing interest payments – a key requirement of the proposals, as set out in 9.1.

The removal of the requirement to assess the ability to purchase a cheaper property may lead to scenarios where the product becomes unsuitable or inappropriate later in life, but the borrower has no viable exit strategy. This again increases the risk of repossession.

Product definitions

There is an overlap between the definitions of lifetime mortgage and retirement interest-only mortgage in Annex A (see Glossary I c ii, iii.)

We would welcome the FCA's comments on whether this change might limit innovation in the later life lending market. For example, it is not clear from the proposed change how a product that is part lifetime mortgage and part interest only would be treated. Clarification on this matter would encourage innovation in that space.

<u>Retirement interest-only mortgages – application process</u>

Application process and product transfer

We would welcome the views of the FCA on what the process would be for entering into a retirement interest-only mortgage. In the case of a current customer having an interest-only mortgage nearing the end of its term, is the intention that the consumer is then automatically enrolled on to a retirement interest-only mortgage? If so, would the rate of interest on the currently interest-only mortgage simply be transferred on to the new product?

Consumers who have taken out an interest-only mortgage are contractually liable to repay the capital sum borrowed: if they reach the end of their term having made no capital repayments, and have no credible repayment strategy, they could risk facing action for repossession. Would lenders effectively be able to oblige customers to transfer to a retirement interest-only mortgage or face repossession? Could lenders then determine that such product transfer must also be at a higher rate of interest, thus affecting the customer's affordability?

In a truly open and competitive market a consumer could shop around for a better deal. However, as we have discussed earlier, research has shown that consumers are more likely to stick with their existing provider. Further, a customer's financial position may mean they have little option other than to take out a retirement interest-only mortgage at an uncompetitive rate of interest.

Our view is that, to mitigate the risk of poor customer outcomes, it should be made clear that a retirement interest-only mortgage must be treated as a new loan for all customers. We believe a retirement interest-only mortgage is fundamentally a different product offering for a customer who is currently servicing a mainstream mortgage given there is no specific end date etc. Hence, the FCA should make clear that there can be no automatic roll over of an existing mainstream mortgage loan into a retirement interest-only mortgage, and that firms cannot use the exemption to the affordability requirements which are allowed within MCOB 11.6.3.

Advice

Retirement options are complex, and older consumers may be vulnerable, particularly if facing financial challenges. Sound and timely advice is paramount to ensure the best possible consumer outcomes. (Regulated advice is of course an absolute requirement for products offered by Equity Release Council members).

As part of this, financial advisers need to be appropriately qualified, knowledgeable and experienced to ensure they are best able to advise, or can direct consumers to specialists who can support them to make the right choices. Due to the complex nature of retirement options, we are concerned that if it were permissible to take out a retirement interest-only mortgages on an execution-only basis under the rules of MCOB 4.8A, this could result in an outcome that is ultimately detrimental to the consumer.

Equity release advisers are required to have specific qualifications which ensure that they understand the later-life lending market – those offering advice on retirement interest-only mortgages will not be required to be similarly qualified, if advice is taken at all.

Consumers will benefit from speaking to advisers who can explain the differences between products such as retirement interest-only mortgages and lifetime mortgages, and the implications of both types of products over the longer term – not just those which may be cheaper at the point of purchase.

Whilst the proposed amendments to MCOB Sourcebook at the initial disclosure stage are intended to sign post consumers to lifetime mortgages, greater consideration needs to be given to ensure consumers are made fully aware of benefits and risks of the different products. For example, lifetime mortgages offered by Equity Release Council have specific consumer protections, such as the no-negative equity guarantee. These protections provide important security and peace of mind. Many lifetime mortgages are also flexible, in that they allow the customer to pay off the interest in the early years of the contract, but allow the option of rolling it up at a later date should the customer's financial circumstances changes.

While it is laudable to try to keep costs down for consumers, savings on the cost of advice could lead to consumers taking out products that do not serve them well in the long-term.

We are of the view that advice will result in better consumer outcomes and welcome an environment where, at the very least, consumers are actively encouraged to take advice so they are fully aware of the range of options available. Consumers should also be made aware of the funding mechanisms available to access advice, such as the Pensions Advice Allowance.

The FCA needs to clarify its view on the proposed advice structure for retirement interest-only mortgages. If the intention is for some customers to be able to proceed on an execution-only basis, there must be provision for a review of finances and circumstances at a later stage. We believe that periods of review attached to retirement interest-only mortgages would be beneficial to both industry and consumers.

Affordability

Whilst paragraph 9.1 confirms that Customers must still be able to afford the ongoing interest payments, lenders must undertake thorough affordability checks as standard, but in particular to minimise the risks to potentially vulnerable consumers.

There are several factors which need to be taken into account when considering affordability. Consumer affordability can change over time – for example, consumers may take out a retirement interest-only mortgage when working, then see their income fall on retirement. This contrasts with a standard mortgage where earning potential is expected to increase and then level off over the mortgage term.

When one partner in a couple dies or goes into care this can affect income and outgoings. For example, through a reduced pension or the need to pay for care and associated costs. Occupational pensions will generally not pay out to cohabitees. Many married men take out single life annuities, even though they are married, because the payments are greater, but on their death, the widow can be left without an income.

Other factors which may impact on affordability include variable interest rates (which are currently at historical-lows but may increase in future), and the fact that pension freedoms may mean that the customer runs out of money over the course of their retirement.

Review

We would like to see periodic reviews with customers put in place. The purpose of these would be to evaluate a customer's current and future circumstances, to help consumers determine whether the product they have is the most appropriate for them, of if they would benefit from switching. Such an assessment would consider potential circumstances such as a partner dying or going into care, or a house requiring repair.

We would welcome further discussion between policymakers and stakeholders to determine the practical steps of establishing review periods, i.e. who the responsible owner would be (lender or adviser) and the level of Know Your Customer information that would be required for such a review to be truly effective. Our initial thought is that if advice is made compulsory, then a regulated adviser would most likely be best placed to carry out an impartial review of a consumer's situation. However, if advice is not made compulsory, then the lender would need to initiate a follow up conversation with the consumer.

Operations

Paragraph 9.2 refers to firms not wishing to complicate systems or staff arrangements which are set up for standard mortgage lending. However, it is highly likely that the development of a new product would necessitate additional costs. If there was no obligation for firms to provide additional training and/or qualifications for staff, then it is possible that products may be slightly cheaper for consumers. Nonetheless, such an approach appears to be placing the priorities of firms over consumers.

Conclusion

A regulated market is in everybody's interest – consumers, industry, government, and regulators. Any lifetime product, whether it is a retirement interest-only mortgage or a lifetime mortgage, should come with the necessary advice and safeguards to deliver better consumer outcomes.

Over the last 25 years, through The Council's standards and principles, the equity release market has developed into one offering safe, robust, consumer-focused products. Equity release is not the solution for everybody, but should be regarded as one of a range of options.

Many older consumers can become, or already are, vulnerable due to their age, health and financial position. The development of any retirement interest-only mortgage product must ensure consumers are protected and not placed at increased risk of mis-selling or repossession.

We consider this proposal to be far from ready for an implementation roll out and would welcome FCA workshops dedicated to detailed policy discussion on the various elements within the proposed retirement interest-only mortgage paper that we have identified. We would also like to see the development of 'What-if?' scenarios to test the feasibility of retirement interest-only mortgages, particularly in relation to future affordability as circumstances change. This will establish whether the proposed product structure will indeed help meet the policy challenge it is intended to resolve.

Q9.2 Do you agree with our approach to correcting the inadvertent partial disapplication of the age criterion in the lifetime mortgage definition?

We agree with the approach. Lifetime mortgages are sold to those aged 55 and over.

Submitted by the Equity Release Council
1 November 2017