Consumer guide to mandatory payment lifetime mortgages

Summary

The Equity Release Council sets product and advice standards for its members. We're making some changes to those standards to reflect the development of the market.

As consumer needs evolve, so the products offered to meet those needs must also evolve. The later life lending sector has always been innovative in its pursuit of the best customer outcomes. The most recent innovation is the new mandatory payment lifetime mortgage which is a lifetime mortgage under which interest payments are required for a specified term.

Whilst such products offer customers greater flexibility, they also come with potential consequences. Failure to make the mandatory payments could, in extreme circumstances, result in repossession.

The changes we're making will ensure our standards remain up to date and cater both for these new products and more typical lifetime mortgages. By making these changes we can ensure customers continue to benefit from the highest levels of protection and assist advisers in providing best advice, regardless of the product.

Context

Over time, the needs of consumers inevitably change, and the products provided to those consumers need to change too.

Increasingly, younger customers are seeking alternative solutions to their lending needs, with more 50 to 54 year old people responding to equity release advertisements. Equally, many over-55s are finding that they can't borrow as much as they need from traditional equity release products. Whilst the mainstream mortgage market has a range of options for such customers, many are unable to meet the strict affordability-in-retirement requirements. In each of these cases, there is a need for alternative solutions.

Later life lending is a field in which innovation and development have become the norm. As customer needs evolve, this is a sector committed to developing new and innovative solutions. With changes over recent years including the introduction of:

- **Downsizing protection** – allowing penalty-free repayment of a loan when the customer downsizes
- **Inheritance guarantees** – permitting customers to carve out a percentage of the property value to be protected for future generations
- **Greater availability of fixed early repayment charges** – giving customers the choice of fixed or variable early repayment charge options

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- **The right to make voluntary payments on new lifetime mortgages** – permitting a percentage of the loan to be repaid penalty free each year (depending on lender criteria).

Each of these changes has increased the flexibility available to consumers.

Product landscape

The range of solutions potentially available to borrowers in middle-to-later life is now wider than before, with the following solutions all potentially suitable:

- **Conventional capital and interest mortgages** – traditional mortgages, where regular payments are made throughout an agreed term, with no outstanding balance at the end of that term, provided payments have been maintained. There is no prescribed age limit for such products, with affordability being the most important factor.
- **Term interest only (TIO) mortgages** – like a capital and interest mortgage, these have a fixed and specified term, but in this case, only the interest is paid during that term, with the full capital balance due at the end. This might be repaid from a maturing savings policy or from a pensionpot maturing, for instance.
- **Retirement interest only (RIO) mortgages** – again, only the interest is paid, but unlike a TIO product, there is no specified term. The capital is repaid when the house is sold or the borrower (or last borrower in the case of a couple) either dies or leaves the property to move into permanent residential care.
- **Lifetime mortgages** – these are age-restricted products under which repayment of the capital isn't due until the property is sold or the borrower (or last borrower in the case of a couple) either dies or leaves the property to move into permanent residential care. Unlike with a RIO, on a typical lifetime mortgage, interest payments are either entirely optional, or can be set so that the borrower can choose to stop paying at any time. Any interest not paid will be added to the loan and will then, in turn, attract further interest (known as rolled-up interest).
- **Home reversion plans** – these aren't mortgage products at all but are instead an entirely different arrangement under which part of the property is sold to a provider, but the customer retains the right to live in the property until they (or the second customer in the case of a couple) dies or leaves the property to move into permanent residential care.

The first three fall under the regulatory definition of mortgage products while the last two are equity release products. This might not seem like an important distinction, but advisers may specialise in one or the other and each requires different regulatory permissions and qualifications. It is these final two categories that are covered by the Equity Release Council standards.

New products

The products coming to market are known as mandatory payment lifetime mortgages and the name reveals some important information. Firstly, they are lifetime mortgage products. This means they fall under the definition of equity release and can only be recommended by advisers with the appropriate regulatory permissions and qualifications. Secondly, unlike other lifetime mortgages, they require payment of interest to be made for a specified term. This may be all or part of the interest, depending on the product.

In very simple terms, they sit between the TIO / RIO products, and the typical lifetime mortgage products, where interest payments are purely optional. With these new products, interest has to be paid for a specified term, but after that term expires, the product converts to typical lifetime mortgage structure, with interest rolling-up unless the consumer elects to make voluntary payments.

This offers a couple of potential advantages relative to the other products:

- Unlike with a TIO, the capital doesn't have to be repaid at the end of the payment term – instead, the plan continues but interest is rolled up.
- Whereas a RIO requires the borrower to pay (and be able to demonstrate affordability for) the interest for the life of the plan, with the mandatory payment lifetime mortgage, affordability only needs to be demonstrated for the life of the agreed payment term.

It should also be clear the new mandatory payment products have potentially significant consequences for the customer in the event that payments aren't made. Failure to meet the contractual payments would be a breach of the contract on the customer's part and could – in extreme circumstances- result in repossession. This risk extends only for the agreed payment term, after which payments become optional.

The following case studies provide a couple of examples of customers for whom the new products might offer an appropriate solution. Of course, even if your circumstances look similar, you shouldn't take this as a recommendation and all equity release products can only be taken out with the support of a qualified adviser.

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Jamie is 60 and Rose 58. Both are still working full time but intend to stop work when Jamie reaches State Pension age in seven years. They remarried later in life having both been divorced and find themselves with a much larger mortgage than they'd expected at this time of life.

They've got a good level of income but can't afford a repayment mortgage over just seven years, especially if interest rates rise. They have no clear repayment vehicle so conventional interest only mortgages are closed to them, and they require a higher loan to value than would be available at their age from a typical lifetime mortgage.

A mandatory payment lifetime mortgage might allow them to remain in their property, to service the interest until Jamie retires and then to convert to roll-up. If they've got extra money, they may also be able to pay down some of the capital over the next few years.

Maya is 55. She recently repaid part of her interest only mortgage with her savings but having never really saved enough and been forced to dip into her savings through the pandemic, she's still got a shortfall of around £67,000.

A conventional lifetime mortgage would leave her around £15,000 short, based on her current property value. By using a mandatory payment lifetime mortgage and committing to payments until she reaches State Pension age, she is able to access a higher loan to value, sufficient to repay her mortgage.

Changes to the Equity Release Council standards

The Equity Release Council is a voluntary body which aims to ensure that its members are highly professional and act with integrity and transparency in offering high-quality products and services to customers.

A key part of our work is in setting standards both for products and advice. Through these standards, our members can guarantee their customers that they offer products and services which conform to the best practices of the sector, ensuring customers are fully informed and properly protected.

As the products available evolve, so must our standards. As a result, and after extensive research and consultation, we have introduced new standards to apply to this new generation of lifetime mortgage products.

The new product standards will only apply to these new products. The text highlighted in red, below, shows how they differ from the core product standards, which will continue to apply to typical lifetime mortgages:

"*The consumer must have the right to remain in their property for life or until they need to move into long-term care, provided the property remains their main residence and they abide by the terms and conditions of their contract, including making mandatory payments as agreed."*

This provides additional clarity by explicitly separating the mandatory payments from the usual terms and conditions associated with any lifetime mortgage. It is only where payments are missed during the mandatory payment period that the customer would be deemed to default on the contract.

Additional clarity is also added to the rule concerning voluntary payments:

"For lifetime mortgages, customers must have the right to make voluntary penalty-free repayments, at least once the mandatory payment period has ended, subject to lender criteria."

Whilst some providers may choose to allow voluntary payments over and above the mandatory payments, this amendment allows for greater flexibility.

Finally, the rule concerning the No Negative Equity Guarantee is amended as:

"The product must have a No Negative Equity Guarantee (NNEG) so that, whenever the amount owing to the provider member is to be repaid from the proceeds of sale of the secured property, the amount owing must not exceed the net proceeds of sale (after deduction of selling agents' fees, legal fees, disbursements, arrears plus arrears interest, and reasonable costs). Provided the property is sold for the best price reasonably obtainable, the provider member shall accept the net proceeds of sale in full and final settlement of the amount owing".

It would be unreasonable for a provider to have to write off amounts in arrears in the event of the NNEG potentially applying. Again, this gives all parties additional clarity.

Updated advice standards

Just as the product standards are evolving, so the advice standards need to be updated to reflect the new product landscape.

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We're asking advisers to make sure they're taking down details of their customer's income and expenditure, to establish whether the customer might be in a position to benefit either from a mainstream mortgage product, or one of the new mandatory payment products, or whether a roll-up product is more appropriate.

Where it becomes apparent that a mandatory payment product is most suitable, we're also asking advisers to satisfy themselves that the product will be affordable for the required payment term.

Questions and answers

The following questions and answers cover some of the things we expect consumers to ask. Your own adviser can provide you with more information.

Q. How much of the interest do I need to pay?

A. This depends on the product. Different products have different requirements – in some cases you might be asked to pay the full interest, but for a limited time, in other cases it may be possible to pay part of the interest for the agreed term. Your adviser will help you find the right solution for your needs.

Q. What happens if I miss payments?

A. With these products, you are committing to making interest payments for a specified term. If you miss payments, this would be a breach of the terms of the contract and in extreme circumstances this could result in repossession.

Q. How do I know which product is right for me?

A. Your adviser will work through your circumstances and recommend the most appropriate product solution for your needs. These products are only available with financial advice, so it is important to find an adviser who can help you work out the best course of action.

Q. What should my adviser cover with me?

A. Your adviser should discuss your circumstances in detail. This means looking at what you want to achieve, and both your current and future financial position. An important part of this is to consider your level of income and outgoings, to work out how much, if any, of the interest on a product you might be able to afford each month – and for how long. Your adviser will help you establish whether it is right to release money from your property and, if so, how much you need, and which is the best product for your needs.

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Q. How do the new Equity Release Council standards protect me?

A. The new standards will continue to provide protection and peace of mind to customers of this new type of lifetime mortgage. Any mandatory payment lifetime mortgage which complies with our standards will continue to offer our core protections, provided the customer maintains payments during the mandatory payment period. Advisers recommending products in line with our advice requirements will fully assess affordability and recommend the most appropriate products from the wider range of options in the market or refer customers where they lack the necessary permissions.