

REGULATING HOME REVERSION PLANS SUMMARY OF CONSULTATION RESPONSES

Context

1. The Pensions Green Paper stated that the Government would be looking at options to create a level playing field for the regulation of equity release and home reversion plans to protect consumers and make the market work better. During the first half of 2003, we held discussions with stakeholders. Whilst they provided no evidence of consumer detriment at present, stakeholders were concerned about the projected expansion of the market and the potential for consumer detriment in the future.

2. In the light of these concerns, the Chief Secretary announced that we would carry out an open consultation on whether home reversion equity release plans should be regulated by the FSA. The Treasury issued a public consultation paper in November 2003, as well as conducting further discussions with stakeholders. The purpose of the consultation was to arrive at a more in depth analysis of the costs and benefits of regulation.

3. The consultation closed on 13 February. There were 53 responses, of which 46 supported regulation, and 7 were opposed. This document summarises the responses to the consultation.

Q1 – What is your estimate of the number of firms that are or will be in the reversion market? How many plans are or will be provided? What might be the value of those plans? What new products might be in the pipeline?

4. There are various estimates of the numbers of firms in the reversion market. SHIP (Safe Home Income Plans) has five members that provide reversion plans. However, one respondent suggested there were about fifty companies that offer home reversion plans, mostly small firms or individuals, but also thought there were many more introducers. Another firm suggested that including small

companies and private individuals, the number of investors ran into the hundreds.

5. As to the market, SHIP has reported that the value of transactions conducted by its members has reduced from £227 million in 2000, to £129 million in 2003. Various reasons for this have been cited including low long-term interest rates, house price inflation, and the UK tax treatment of investment in residential property. One respondent suggested that the decision of GE Life to cease direct selling of a range of products, and of NPI to withdraw from the market as a result of AMP, its parent company's, decision to rationalise its operations in the UK, directly affected sales of reversion plans.

6. Two firms that are not SHIP members reported the value of their business. One, a private family firm currently owns 30 properties (purchasing 15 in the past year alone). Another firm, acting on behalf of Stock Exchange quoted property companies and privately owned family interests had since 1989 acted in 235 cases with an open market value of £36.5 million.

Q2 (part 1) – Readers are invited to make available any evidence they may have of how reversion plan providers may treat consumers unfairly or unreasonably.

General

7. There were opposing views on reversion plans themselves. Some, particularly those that opposed regulation, thought that they were relatively simple arrangements, although they were complex and expensive for the provider to set up. Those opposed to regulation thought that the use of independent solicitors and valuations meant that the potential for consumer detriment was small.

8. However those supporting regulation thought that the actual decision to take out a reversion plan was complex because people needed to look at the full range of options to increase their income or

reduce outgoings and also to consider the impact that using equity release could have on their and their heirs' future positions.

9. The consultation has revealed some concerns about consumer detriment in the home reversion market at present, although there is no hard evidence of widespread mis-selling at present. However the market is currently a relatively small one. Many respondents were concerned about the potential for consumer detriment in the future should the market grow. Some respondents cited recent consumer complaints in the following areas.

Suitability

10. Consumers may be vulnerable to being sold a reversion plan where such a plan is unsuitable to their needs. Consumers may take out reversions without the provider making reference to the consumer's tax and benefit position.

- One respondent cited a couple who were not much better off following sale of their home under a reversion plan because they lost some of their benefit entitlements as a result.
- One respondent noted that taking out the wrong reversion plan could result in a tax bill of over one-third of the ongoing income from the product.

Information asymmetry

11. Some respondents noted that the potentially complex impact of a reversion plan on an elderly consumer's wider financial position suggests that there can be a substantial information asymmetry between the reversion provider and the consumer.

12. The value of the reversion also depends crucially on both the valuation of the property, and the proportion of that valuation paid to the consumer, the latter likely to be based on a potentially complex actuarial calculation. There is likely to be significant information asymmetry between provider and consumer in both these aspects. Respondents provided examples of consumers complaining about receiving a low valuation of the property where there had not been an independent valuation.

Transparency – market operation

13. Respondents also raised concerns about transparency and the operation of the market.

- One respondent gave an example of a broker claiming Age Concern recommended it when this was not the case.
- There were concerns about the way these properties were marketed. One respondent cited examples of properties advertised with photographs and details of location on the internet which means that the property and the elderly owners may be identified and therefore be at risk of crime.

Q2 (part 2) To what extent would FSA regulation tackle this detriment? To what extent would FSA regulation tackle the issues highlighted in paragraphs 18 – 24?

14. A number of respondents suggested that regulation could deal with the above areas of consumer detriment:

- *No independent valuation:* FSA regulation could ensure that valuations were independent of the reversion provider;
- *Taking out a reversion without reference to the consumer's tax and benefit position:* FSA regulation could require that advisers were trained and able to advise on wider financial planning issues, including the tax and benefit implications. Tax and benefit implications are likely to feature in the syllabus for the exams that advisers will need to pass before they can advise on lifetime mortgages;
- *Redress and compensation:* FSA regulation could also ensure that it is easier for consumers to seek redress in the event of mis-selling through the FOS.

15. The FSA would neither set house prices, nor determine the proportion of the valuation that would go to the consumer. This would be for individual providers on the basis of their attitude to risk and the competitive market.

Q3 – What effect will mortgage regulation have on the wider equity release market and specifically on reversion plans? Are there comparable situations that could be used as a model to predict how this might affect the equity release market?

16. Most respondents were concerned about the impact that the regulation of lifetime mortgages could have on the equity release market and reversion plans. They thought that all equity release products fulfil essentially the same function and the structural differences between the products are not a valid reason to deny protection to all consumers across the piece. The points made included:

- The regulation of lifetime mortgages will create a two-tier system. For example, the protection offered on lifetime mortgages will be different from the protection offered on home reversion plans. Intermediaries selling lifetime mortgages will need to offer comparisons with home reversions, whereas intermediaries offering home reversions only will not be obliged to make any comparison with lifetime mortgages;
- It would cause confusion to consumers who wish to make a fair comparison between products offering broadly similar benefits. This could lead to intermediaries favouring one product over the other for purely regulatory reasons and this would be unhelpful to the development of the market;
- Lifetime mortgages might be recommended by some financial intermediaries ahead of reversions, purely on the grounds that they are regulated and are in some way 'safer' or 'more

appropriate' than reversions, thus resulting in clients buying a less suitable product;

- Ill constructed or poorly presented reversions may be promoted by salesmen and advisers because they are unregulated;

17. On the other hand, the minority of respondents that opposed regulation suggested that:

- Formal regulation will only marginally increase public confidence in home reversion plans. But it could result in a reduction of choice and competition as smaller providers will be unable either financially or practically to comply with regulatory requirements;
- It is not right to assume that firms that move into the reversion market, away from the lifetime mortgage market, are doing so because they are unscrupulous. There is very little scope for mis-selling or under-pricing due to the way reversions are transacted. The reason for wishing to operate outside regulation is most likely to be that of cost and the added burden of administration.

Q4 – How effective are the current voluntary arrangements? Do they meet consumers' needs? Do they provide effective redress? What could be done to improve their effectiveness and their coverage? Will the proposed voluntary arrangements help?

18. Most respondents thought that the current arrangements set up by Safe Home Income Plans (SHIP) had done much to build confidence in the equity release market. SHIP has been instrumental in the recovery of the equity release market following the scandals of the late 1980s. But many believed that all equity release schemes should be subject to the same consumer protection. There were also

concerns about voluntary arrangements in principle and SHIP in particular. The points made included:

- Voluntary arrangements can only be effective as formal regulation when 100% of the market participants agree to abide by the rules. The home reversion industry is largely comprised of small practitioners. There will inevitably be practitioners that decline to abide by the code and it is in this area that there is the highest risk of consumer detriment;
- Voluntary regulation can never deliver the safeguards and levels of consumer protection afforded by statutory regulation;
- Whilst SHIP covers an estimated 90% of product providers it does not apply to intermediaries, monitor firms compliance, nor have a compensation scheme;
- In order for the new self-regulatory framework to succeed, significant effort would have to be put into its implementation, endorsement and promotion by all relevant bodies so the code becomes recognised as the effective requirement for entry into the reversion market.

Q5 – Could readers provide examples of the different types of arrangements in the market place, together with views as to whether or not they should be included in any definition of a home reversion plan. Would it be possible to craft a definition that does not capture other sale and purchase arrangements that it would not be appropriate to regulate? Would it be possible to craft a definition that prevented firms from creating similar products that lay outside the boundary of legislation? Are there alternative property financing arrangements other than reversions that might be at risk of being caught by any definition?

19. A number of respondents considered that it should be possible to draft a definition that would only cover reversion plans, just as it was possible to draft a definition of lifetime mortgages.

Q6 – What are your views on the assumptions used in the regulatory impact assessment?

20. A number of respondents commented on the RIA. Some thought that the assumptions were reasonable others questioned the cost estimates believing them to be too high. Some wondered whether it was appropriate to apply the experience of the cost of regulating mortgage providers and intermediaries to reversions. The reversion product is in some ways simpler than a mortgage, as it is a single transaction involving a defined cash payment and no interest accrual. The record-keeping requirement should reflect this.

HMT conclusion

21. The consultation has provided many arguments in favour of regulation. The target market for home reversion plans tends to be elderly people who have paid off their mortgage. The implications of mis-selling for a consumer are likely to be great as the home reversion transaction involves the consumer's largest asset, and elderly consumers may be vulnerable.

22. Reversion plans are a type of equity release scheme and an alternative to lifetime mortgages. Lifetime mortgages are regulated by the FSA and classified as high-risk products. There is therefore a strong case for subjecting home reversion plans to similar regulation.

23. The costs and benefits of a home reversion plan for the individual consumer are complex and can be difficult for the consumer to assess. A home reversion may have implications for an individual's tax, benefits, inheritance and long-term financial planning.

24. It is vital that people make the right choice and the consequences of mis-selling can be significant.

25. FSA regulation will therefore provide consumers with the protections they need and help ensure they receive appropriate advice. We will bring forward legislation to regulate home reversions as soon as the Parliamentary timetable allows.

HM Treasury
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