

# **Regulating home reversion plans**

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## **Consultation Document**

November 2003



**HM TREASURY**



HM TREASURY

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Consultation Document

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## **REGULATING HOME REVERSION PLANS**

This document seeks views on whether home reversion plans should come within the scope of Financial Services Authority (FSA) regulation.

The Government would welcome feedback on the proposals explained here. It would be helpful if responses could cover the issues listed in Annex A. Other relevant input would also be welcome.

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This paper is available on the Treasury's public website [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk). For hard copies, please use the contact details above.

It would be helpful to receive your response by 13 February 2004. We cannot guarantee to consider your response if it arrives after that date. Please explain in your reply if you represent an organisation, and if so, its membership and coverage. For individual firms and brokers, it would be helpful to know the numbers of reversion plans (and other equity release schemes) that you sell and what proportion of the market you cover. In accordance with the code of practice on open government, comments will be made publicly available unless respondents specifically request otherwise. Any e-mail response sent from a corporate system may carry an automatically generated message stating that the content of the message should be treated as confidential. If you are replying by e-mail, please make it clear in the body of your response whether or not you wish your comments to be treated as confidential.

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## **1 - Introduction**

1. The Government's Pensions' Green Paper<sup>1</sup> 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.'
2. Treasury officials held a number of discussions with stakeholders in the first half of 2003. Whilst stakeholders provided no evidence of consumer detriment at present, they were concerned about the projected expansion of the home reversion market and the potential for consumer detriment in the future.
3. In the light of these concerns, on 5 June 2003, the Chief Secretary to the Treasury, Paul Boateng, announced that the Government would carry out an open consultation on whether home reversion equity release plans should be regulated by the Financial Services Authority (FSA). The purpose of this consultation is to arrive at a more in depth analysis of the costs and benefits of regulation.

## **2 - Background to the consultation**

### **i. What are equity release schemes**

4. Equity release schemes are financial products, or sale and purchase arrangements, that allow homeowners to release the value of their property above any amount owed on a mortgage. These schemes involve a provider giving the homeowner either a lump sum or income (or both) on the basis of the value of the home. Providers receive their returns when the home is sold. There are two basic types of scheme: lifetime mortgages (mortgage-backed equity release plans); and home reversion equity release plans.

### **ii. What is a lifetime mortgage?**

5. With a lifetime mortgage, the homeowner takes out a mortgage loan secured on the property. The loan can be used to fund an annuity and provide regular income, or provide a lump sum payment. There are also draw down products that provide a regular income but are not linked to investments. The amount of the loan is based on the age of the owners, their life expectancy and the value of the property. Ownership remains with the homeowner. The loan, with interest, is repaid when the property is sold either on the borrower's death or if the borrower moves into long-term care or possibly sheltered accommodation.

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<sup>1</sup> Simplicity, Security and Choice: Working and Saving for Retirement (Department for Work and Pensions - December 2002)

There are also some schemes where the borrower chooses to pay interest on the loan and the capital is repaid when the property is sold.

### **iii. What is a home reversion plan?**

6. Under a home reversion plan, a homeowner sells part or all, of the home in return for a lump sum payment (usually within a range of 30-65% of the property value) and the right to remain in the house until they die or move home. The lump sum depends on a number of factors including the age of the owners, an actuarial assessment of life expectancy, and the value of the property. As with lifetime mortgages, the lump sum may be drawn down or be used to purchase an annuity that is invested to provide additional income, or paid straight to the former owner to do with as they please. When the former owner dies or moves house the reversion provider can sell the property.

## **3 - The current equity release market**

7. Both types of equity release scheme are aimed at the same market: older consumers who have paid off their mortgages (or have substantial equity, notwithstanding a mortgage) and require additional income or a cash lump sum. This money may be used to supplement pensions, or meet expenses such as home repairs or maintenance, and long-term care.

8. Complete and accurate information on the size of the home reversion market itself, is difficult to obtain. The main trade body for those selling equity release plans, Safe Home Income Plans (SHIP), estimates that the total value of the equity release market was some £852 million in 2002 - up from £240 million in 1999. About a quarter of this, by value were reversion plans. However, in a press release in August 2003, the Council of Mortgage Lenders (CML) suggests that the total size of the lifetime mortgage market (excluding reversions) is £2.3 billion<sup>2</sup>. In work carried out in 2001<sup>3</sup>, the CML projected that the size of the whole equity release market could potentially rise to £50 billion by 2008 – though this is an indication of market potential rather than a firm forecast of the likely size of the market at that date.

9. In total, we have been able to trace forty-one firms currently in the equity release market. These comprise:

- providers;
- brokers (comprising specialist equity release intermediaries)
- reversion brokers (those that market reversionary properties to private investors).

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<sup>2</sup> Press Notice of 21 August 2003 – available from CML website - [www.cml.org.uk](http://www.cml.org.uk)

<sup>3</sup> The Market for Equity Release Schemes - CML Research – October 2001

There may be many more intermediaries and Independent Financial Advisers (IFAs) selling equity release products, including home reversions as part of their range of business. The following table summarises the position, based on the information currently available to us:

**Numbers of firms in the equity release market<sup>4</sup>**

	<b>Providers</b>	<b>Brokers</b>	<b>Reversion brokers</b>
Lifetime mortgages	23	5	-
Reversion plans	5	-	5
Both types of equity release scheme	2	-	1
<b>Total</b>	<b>30</b>	<b>5</b>	<b>6</b>

**4 - Legal and regulatory position**

10. The equity release market is, or will be, covered by a range of regulatory and self-regulatory arrangements.

**i) FSA regulation**

11. From 31 October 2004 the FSA will have the power to regulate the selling of first charge mortgages under the Financial Services and Markets Act (FSMA).

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<sup>4</sup> *As at 27 August 2003*, SHIP had 14 members. Eight provide lifetime mortgages only, four provide reversion schemes only and two others sell both types of equity release scheme. Of the non-SHIP providers, one firm provides a reversion plan, and a number of banks and building societies sell lifetime mortgages.

On 21 August 2003, the CML published lifetime mortgage figures based on returns from 21 lenders. The eight SHIP members that provide lifetime mortgages only are also CML members and are therefore included within the total of 21 lifetime providers. Two other firms (an insurer and a firm that specialises in providing services to the elderly – neither of which are CML members) have recently launched lifetime mortgage products in association with a main provider. For convenience, we have classified these as providers, so we estimate that there are currently 23 lifetime mortgage providers in the market at present.

*As at 27 August*, 5 brokers advertised on the internet selling either or both reversions and lifetime mortgages. The brokers are either FSA-regulated already, comply with the Mortgage Code (and therefore likely to be regulated by the FSA when mortgage regulation comes into force), or sell the lifetime mortgages or reversion plans of SHIP members.

*As at 27 August*, 6 reversion brokers advertised on the internet. These are aimed at the investor, rather than the consumer. They seek funds from private and corporate clients to invest in reversions. Three advertise specific properties for sale in the same way as estate agents do for the ordinary selling of properties - two appear to be members of the National Association of Estate Agents - and the other invites investment from the British ex-patriot community in other European countries. Finally, another firm advertises reversions with a view to releasing enough equity for the consumer to buy a property in Spain.

This will be applicable to all first charge mortgages, including lifetime mortgages, on property where at least 40% is used as, or in connection with, a dwelling by the borrower or a member of their immediate family.

12. The FSA also has limited powers to make rules related to the unregulated activities of regulated firms. Where firms sell both lifetime mortgages and home reversion plans, the FSA has made rules for these regulated firms to cover both products.

13. Also if a home reversion plan is used to purchase an annuity in order to provide income, the sale of the annuity is regulated by the FSA and subject to the Financial Ombudsman and Financial Services Compensation Scheme rules. However, the FSA regime will not extend to firms that only offer reversion plans and carry on no other regulated activities.

## **ii Consumer Credit Act**

14. The FSA regime will only apply to first charge mortgages. However, much mortgage lending that will not be covered by the FSA mortgage regime will fall to be regulated by the Office of Fair Trading (OFT) under the Consumer Credit Act (CCA). The CCA currently only applies to loans of less than £25,000. This means that second charge lifetime mortgages (where one lender provides a loan to release equity notwithstanding the fact that a borrower has another mortgage with another lender on the same property) below £25,000 will be covered by the CCA requirements. However, the DTI announced in November 2002 that the £25,000 financial limit would be abolished. It is therefore likely that, at some time in the future, second charge lifetime mortgages of any amount will be covered by the CCA.

## **iii) Code of practice**

15. SHIP has a voluntary code of practice whereby members agree to provide:

- fair, simple and complete presentation of their plans;
- a guarantee that a client's legal work will be performed by a solicitor of their choice;
- the right to remain in the property for life (as well as freedom to move to another property without financial penalties); and
- a no negative equity guarantee.

16. A number of SHIP members are already regulated by the FSA or comply with the Mortgage Code and are likely to be regulated by the FSA when mortgage regulation comes into force in 2004. In the event of a complaint about a SHIP member who is not regulated by the FSA or under the Mortgage Code, consumers have recourse to an independent arbitrator who will be appointed by the Chartered Institute of Arbitrators. We understand that the independent

arbitrator does not make binding awards. The code only applies to SHIP members, and therefore does not extend to any brokers against whom a claim may be made.

17. Two of the reversion brokers are members of the National Association of Estate Agents (NAEA). The NAEA has its own code of practice, mediation and arbitration scheme in the event of consumer complaints in respect of estate agency aspects of the transaction.

## 5 - Why is this an issue?

18. Both types of equity release scheme are aimed at the same market – older consumers who have (or nearly) paid off their mortgages and are looking to use some of the equity in their home to provide additional income or a lump sum. Consumer organisations and firms have expressed a number of concerns that might lead homeowners to end up in an inappropriate financial arrangement. These include:

- *mis-selling*: for example, being advised to take out one sort of equity release plan when the consumer would be better off trading down to a smaller property or taking out another type of equity release plan;
- *pricing*: the consumer being offered a reversion of an unfairly low value, due either to a low valuation of their property, or to a low proportion of that valuation being offered as a reversion;
- *regulatory boundary*: consumers may not understand the difference between the regulated and unregulated parts of the market, particularly as FSA regulation will require lifetime mortgage providers to consider both lifetime mortgages and reversions. Firms selling only reversions will not be caught by FSA regulation. Consumers also may be confused by the differences in redress arrangements.

## 6 - What FSA regulation of home reversion plans may mean

### i) Mis-selling

19. If the Government were to regulate reversion plans, it could bring them into the scope of FSA regulation in the same way as lifetime mortgages. It would then be for the FSA to determine the detailed regulatory regime, following consultation and cost benefit analysis. There would be additional costs for the firms that sell reversion plans. Firms would have to meet the FSA Threshold Conditions, including meeting fitness and propriety criteria. The FSA would need to consult on how it would regulate, on the basis of cost benefit analysis. But by analogy with lifetime mortgages, it might regulate the conduct of business of the

selling, marketing, advising on and arranging of reversion plans. This would help to address concerns about mis-selling.

20. However, consumers already have access to a good deal of information. For example, charities such as Age Concern, and trade bodies such as the CML and SHIP publish consumer fact sheets that set out the pros and cons between lifetime mortgages and reversion plans (and indeed whether equity release meets individual needs). In addition, the FSA will be publishing its own fact sheet shortly. It has been argued that some consumers already have the wherewithal to take their own decisions on the basis of full information.

## **ii) Pricing**

21. The pricing of the home reversion plan is an important area of consumer concern. A key factor is the valuation of the property. An under valuation means that the consumer would receive a lower cash payment when they sell the property to the reversion provider. Assuming that house prices continue to rise, by starting from a lower base, it also increases the reversion company's return when they sell the property on the consumer's death or if they move house. (The same may not be said for a lifetime mortgage where the lender's return depends on the interest charged on the lump sum lent to the consumer.)

22. However, the value of the reversion depends not only on the valuation of the property but other factors, such as the proportion of the valuation paid to the reversion customer. For example, the amount of cash paid ranges between 30% and 65% of the property value, depending on the consumer's age and life expectancy. FSA regulation in this area would not address all of the concerns on pricing.

23. In practice these factors are unlikely to be easy to regulate and so regulation might not address key parameters of the home reversion transaction. One option will be for the FSA to require a compulsory independent valuation of the house price that is at the heart of the deal. It would not address other risk factors in the transaction, such as the proportion of the valuation paid to the customer. Alternately, the FSA may, in making its rules, decide not to regulate this area at all.

## **iii) Regulatory boundary**

24. If they were to be brought into FSA regulation, home reversions would need to be defined in legislation. Whilst any legislation would be drafted to be as clear as possible, it would not necessarily resolve all concerns about regulatory boundaries. There is a danger that a definition could capture other forms of sale and purchase arrangements that we would otherwise not want to regulate. Alternatively, regulation could simply encourage firms to create new types of plan that are outside the regulatory regime.

## 7 - Issues for consideration

25. In carrying out a more in depth analysis of the costs and benefits of regulation, the Government would welcome views on the following:

### **i. The market**

26. The Government would be interested in receiving further information on the current and future structure and size of the reversion plan market.

***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?***

### **ii. Consumer detriment**

***Q2 – readers are invited to make available any evidence they may have of how reversion plan providers may treat consumers unfairly or unreasonably. To what extent would FSA regulation tackle this detriment? To what extent would FSA regulation tackle the issues highlighted in paragraphs 18 - 24?***

27. In informal discussions with the Government, stakeholders provided no evidence of consumer detriment in the home reversion market. If readers have examples of consumer detriment in the current reversion market, the Government would be interested in seeing them.

28. However, even if there is evidence of consumer detriment, the Government would need to be clear that FSA regulation was the most appropriate tool to use. It would be helpful to have views on the extent that FSA regulation would tackle the detriment.

### **iii. Impact of regulation on the market**

29. The Government would welcome views on the likely impact of FSA regulation of lifetime mortgages on the wider equity release market, including home reversions. The Government also seeks views as to whether there are any comparable situations that could be used as a model for how regulation of lifetime mortgages might affect the equity release market.

30. There may be relatively little impact on the market. However, some stakeholders have suggested that, if they are not regulated, the market could be distorted in favour of reversion plans because providers will not need to incur the costs of complying with the FSA regime, whereas lifetime mortgage providers will

have to meet those costs. Unscrupulous firms may be tempted to move into the home reversion market because it is not FSA regulated.

31. On the other hand, some reversion plan providers have suggested that regulation of lifetime mortgages would be a powerful marketing tool, so that consumers may favour these products.

***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?***

#### **iv. Current arrangements**

32. There are some protections already in place for those taking out reversion plans: the SHIP code of practice and the FSA regulation of annuities. However, whilst SHIP has a code of conduct, it does not apply to intermediaries. SHIP does not monitor firms' compliance, nor does it have arrangements for dispute resolution or a compensation scheme.

33. In the future, the FSA will have limited powers to make rules in respect of those firms that sell both lifetime mortgages and reversions. But neither the Financial Ombudsman nor Financial Services Compensation Schemes will cover reversion sales.

34. Clearly, there are firms that are not covered by any voluntary or statutory arrangements. But we understand that the industry is working to put in place voluntary arrangements that could bridge the regulatory gap between reversion plans and lifetime mortgages.

***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?***

#### **v. Scope of regulation**

35. If home reversions were to be brought into FSA regulation, they would need to be defined in legislation. There is a danger that a definition could capture other forms of sale and purchase arrangement that we would otherwise not decide to regulate. Alternatively regulation could simply encourage firms to create plans that are outside the regulatory regime. It would therefore be helpful to have examples of arrangements currently available in the market place.

36. It would also be helpful to have information on arrangements that are not reversion plans but which might nevertheless be caught by any legislative

definition. For example, we are aware of alternative property financing arrangements that may be used by banks to provide housing finance that complies with Sharia law and which might be caught.

***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?***

## **vi Costs**

37. If it was decided that the FSA should regulate home reversion plans, firms would face additional costs in both setting up systems as well as ongoing costs in complying with conduct of business rules. Even firms that are already regulated would face additional costs, for example, one-off costs to adjust their systems to take account of any FSA disclosure and compliance rules. Any new regime would, of course, be subject to FSA consultation and cost benefit analysis.

38. We have no clear information about the numbers of firms involved in selling reversion plans, but based on the costs of regulating lifetime mortgages, one-off costs for individual firms could be:

- pure reversion providers that are not already regulated by the FSA - £475,000;
- providers already regulated by the FSA for lifetime mortgages - £233,000;
- intermediaries and property firms that are currently unregulated by the FSA - £11,000; and
- intermediaries already regulated by the FSA for lifetime mortgages - £6,000.

## **8 - Regulatory impact assessment**

39. A draft regulatory impact assessment is attached as Annex B. The Government would welcome views on the assumptions made in the RIA. It would be helpful to receive views on both the costs and the benefits to businesses and consumers of the proposed regulation. The Government would particularly welcome views on the likely impact on competition and small firms.

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

## **9 - Other comments**

40. The Government would welcome any other comments on the issues discussed in this consultation paper.

***Q7 – do you have any other comments relevant to the issues discussed in this consultation paper?***

## **10 - Conclusion**

41. In this consultation, the Government seeks help in arriving at a more in depth analysis of the costs and benefits of the regulation of home reversion plans. In particular, the Government is seeking evidence of consumer detriment in the present market, as well as readers' views on the impact that the regulation of lifetime mortgages might have on the wider equity release market and on the provision of reversion plans. It would be helpful if readers could respond by 13 February 2004.

**HM TREASURY  
NOVEMBER 2003**

## ANNEX A

### Issues for input to the review

***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?***

***Q2 – readers are invited to make available any evidence they may have of how reversion plan providers may treat consumers unfairly or unreasonably. To what extent would FSA regulation tackle this detriment? To what extent would FSA regulation tackle the issues highlighted in paragraph 18 - 24?***

***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?***

***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?***

***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?***

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

***Q7 – do you have any other comments relevant to the issues discussed in this consultation paper?***

## **DRAFT REGULATORY IMPACT ASSESSMENT**

### **Regulating Home Reversion Plans**

#### **Issue**

Equity release schemes are financial products, or sale and purchase arrangements, that allow homeowners to 'release' the value of their property above any amount owed on a mortgage. They are aimed at older consumers in order to provide increased income or capital, for example, to cover long-term care, home improvements or repairs, or for holidays. These schemes involve a provider giving the homeowner either a lump sum or income (or both) on the basis of the value of the home. Providers receive their returns when the home is sold.

There are two basic types of scheme: lifetime mortgages (mortgage-backed equity release plans); and home reversion equity release plans. Under lifetime mortgages, a homeowner takes out a loan secured against a property. The loan is used to provide a regular income or provide a lump-sum payment. Ownership remains with the homeowner. The loan is repaid when the property is sold either upon death of the owner or if the borrower moves house. As with other regulated mortgage contracts, lifetime mortgages will be covered by the Financial Services Authority (FSA) regulatory regime that will come into force with effect from 31 October 2004.

Under home reversion equity release plans homeowners agree to sell all or part of their home in return for a lump sum payment and the right to remain in the house until they die or move home. At such a time the home reversion provider is free to sell the property. A key part of the transaction is therefore the underlying agreed house valuation. Under current legislation, home reversion plans will not be brought into FSA regulation.

The Government's Pensions' Green Paper<sup>1</sup> 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.' Treasury officials held a number of discussions with stakeholders in the first half of 2003.

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<sup>1</sup> Simplicity, Security and Choice: Working and Saving for Retirement (Department for Work and Pensions - December 2002)

In brief, stakeholders provided no evidence of consumer detriment at present. However, there were concerns over a projected rapid expansion of the market and the potential for consumer detriment - particularly once FSA regulation of lifetime mortgages comes into force. In view of this, the Chief Secretary to the Treasury, Paul Boateng, announced that the Government would carry out an open consultation on whether home reversion plans should be regulated by the FSA<sup>2</sup>. The purpose of this consultation is to arrive at a more in depth analysis of the costs and benefits of regulation.

On 5 June, the Government published a separate regulatory impact assessment covering all regulated mortgages<sup>3</sup>. That document took account of the costs and benefits of regulating mortgages, including lifetime mortgages. This regulatory impact assessment purely covers the regulation of home reversion plans.

In calculating the costs, this RIA assumes that the FSA will adopt a similar regime for reversions to that it is planning to introduce for lifetime mortgages **if** it is decided that reversion plans are to be regulated. Whilst, we cannot anticipate the exact regime that the FSA might apply, we assume that the regime would cover the regulation of firms, advice and advisers, the disclosure regime, financial promotions, and other conduct of business issues as well as providing access to the Financial Ombudsman Service (FOS).

## **The market**

Both types of equity release scheme are aimed at the same market: older consumers who have paid off their mortgages (or have substantial equity, notwithstanding a mortgage) and require additional income or a cash lump sum. This money may be used to supplement pensions, or meet expenses such as home repairs or maintenance, and long-term care.

Complete and accurate information on the size of the home reversion market itself is difficult to obtain. The main trade body for those selling equity release plans, Safe Home Income Plans (SHIP), estimates that the total value of the equity release market was some £852 million in 2002 - up from £240 million in 1999. About a quarter of this, by value were reversion plans. However, in a press release in August 2003, the Council of Mortgage Lenders (CML) suggests that the total size of the lifetime mortgage market (excluding reversions) is £2.3 billion<sup>4</sup>. In work carried out in 2001<sup>5</sup>, the CML projected that the size of the whole equity release market could potentially rise to £50 billion by 2008 – though this is an indication of market potential rather than a firm forecast of the likely size of the market at that date.

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<sup>2</sup> Hansard – 5 June 2003 (Column 34 – 35 WS)

<sup>3</sup> Available from HM Treasury website – [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

<sup>4</sup> Press Notice of 21 August 2003 – available from CML website - [www.cml.org.uk](http://www.cml.org.uk)

<sup>5</sup> The Market for Equity Release Schemes - CML Research – October 2001

More detail about the market is contained in the consultation document, but, in total, we have been able to trace forty-one firms currently in the equity release market. These comprise:

- providers;
- brokers (comprising specialist equity release intermediaries)
- reversion brokers (those that market reversionary properties to private investors).

## **Purpose and intended effect of the measure**

### *i) the objective*

The objective of this consultation is to carry out a more in depth analysis of the costs and benefits of regulating home reversion plans.

### *ii) the background*

The Government is giving the FSA responsibility for regulating mortgages (including lifetime mortgages) as from 31 October 2004. But under current legislation home reversion plans will not be brought into FSA regulation.

In informal discussions with the Government, stakeholders provided no evidence of consumer detriment in the home reversion market. However, there were concerns about a projected rapid expansion of the equity release market and the potential for consumer detriment of reversion plans remaining outside the FSA regime. The Government therefore decided to carry out a more in depth analysis of the costs and benefits of regulating reversion plans.

### *iii) overall risk assessment*

One aspect of the consultation is to seek evidence of the risks. But in preliminary discussions some stakeholders considered that the risks of *not subjecting reversion plans* to FSA regulation included:

- *mis-selling*: for example, consumers being advised to take out one sort of equity release plan when the consumer would be better off trading down to a smaller property or taking out another type of equity release plan;
- *pricing*: the consumer being offered a reversion of an unfairly low value, due either to a low valuation of their property, or to a low proportion of that valuation being offered as a reversion;
- *regulatory boundary*: consumers may not understand the difference between the regulated and unregulated parts of the market, particularly as FSA regulation will require lifetime mortgage providers to consider both lifetime mortgages and reversions. Firms selling only reversions will not

be caught by FSA regulation. Consumers also may be confused by the differences in redress arrangements.

But the risks of *subjecting reversion plans* to FSA regulation might include:

- the possible stifling of a growing and innovative market that is providing a good service and one where there is no evidence of consumer detriment;
- that the FSA could be focussing its regulatory regime where it may not be needed, particularly if there is no evidence of consumer detriment;
- additional compliance and conduct of business costs for firms;
- setting a precedent for the FSA to regulate other sale and purchase arrangements or non-financial services activities.

## **Options**

Option 1 – do nothing.

Option 2 – give the FSA responsibility for regulating reversion plans.

## **Risks of each option**

The risks of each option are set out above.

## **Analysing the benefits**

### Option 1

The main benefits of doing nothing appear to be:

- avoiding the barrier to entry of regulation;
- the current market has been growing for sometime without regulation or consumer detriment, and this could continue;
- the Government is already focussing its regulatory regime on where there is a proven need for regulation following past problems, and arguably there is no need to do more;
- consumers already have access to a good deal of information. For example, charities such as Age Concern, and trade bodies such as the CML and SHIP publish consumer fact sheets that set out the pros and cons between lifetime mortgages and reversion plans (and indeed whether equity release meets individual needs). It has been argued that some consumers already have the wherewithal to take their own decisions on the basis of full information.

### Option 2

The main benefits of FSA regulation seem to be:

- all equity release products will be subject to the same regulatory regime, redress and compensation arrangements;
- a potential level regulatory playing field for firms;
- less confusion for consumers
- avoidance of the possibility of regulatory arbitrage;
- consumers may have access to the Financial Ombudsman and Financial Services Compensation Schemes.

### **Calculating the costs**

Complete and accurate information on the size of the home reversion market itself is difficult to obtain. In total we have been able to trace forty-one firms currently in the equity release market. There may be many more intermediaries that sell equity release products, including reversions as part of their range of business. This consultation seeks further information about the equity release market.

If home reversions were to be subject to FSA regulation then the costs of regulation for those firms that only sell reversions and are not regulated by the FSA could be substantial. The costs would include the one-off costs of setting up systems, training staff, and so on, as well as ongoing compliance costs. However, the costs for firms that are already regulated by the FSA, for example, because they sell lifetime mortgages as well, would be less. They would not need to apply for formal authorisation from the FSA and would already be subject to some rules governing the unregulated activities of regulated firms. However, they would need to apply to vary their permission and it is likely there would be some systems, training and ongoing conduct of business costs associated with complying with FSA requirements governing the selling of home reversions, were the selling of reversions to become a fully regulated activity.

The overall cost of regulation might be substantial if the equity release market expands as the CML has projected and new reversion companies were able to come into the market and take advantage. But it is not possible to assess or predict the total costs with any degree of accuracy, not least because we have no way of knowing how many new firms would sell reversions in the future.

In calculating the costs, we have attempted a read across to the arrangements that the FSA is putting in place for firms that will be selling lifetime mortgages when mortgage regulation comes into force as from 31 October 2004. We have used the cost benefit analyses that the FSA carried out for this purpose in CP 174<sup>6</sup> and CP 186<sup>7</sup>. These papers are available from the FSA website – [www.fsa.gov.uk](http://www.fsa.gov.uk).

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<sup>6</sup> Prudential and other requirements for mortgage firms and intermediaries – FSA March 2003.

<sup>7</sup> Mortgage regulation: draft conduct of business rules and feedback on CP 146 – FSA May 2003.

We have chosen to look at implications for types of individual firm. We are assuming that the one-off costs for year one for each type of firm are:

- pure reversion providers that are not already regulated by the FSA - £475,000;
- providers already regulated by the FSA for lifetime mortgages - £233,000;
- intermediaries and property firms that are currently unregulated by the FSA - £11,000; and
- intermediaries already regulated by the FSA for lifetime mortgages - £6,000.

### **Small firms impact test**

We cannot be sure what will happen once lifetime mortgages are regulated by the FSA.

There is likely to be a significant impact on the small reversion firms whether reversions are regulated or not. If regulated, the firms will have to comply with FSA rules and incur costs - some could leave the market. Regulation could also act as a barrier to entry for new small reversion firms. Those firms that are already regulated by the FSA for other activities will face some minor increase in compliance costs but this is not seen as significant.

However, if reversions are not regulated the equity release market may move more towards lifetime mortgages with consequential impact on the firms selling reversions. On the other hand, the way could be open for new firms to move into the reversion business.

### **Competition assessment**

The consultation seeks views on the likely market impact following FSA regulation of home reversions.

There may be relatively little impact on the market. However some stakeholders have suggested the market could be distorted in favour of reversion plans because providers will not need to incur the costs of complying with the FSA regime, whereas lifetime mortgage providers will have to meet those costs. Unscrupulous firms may be tempted to move into the home reversion market because it is not FSA regulated.

On the other hand, some reversion plan providers have suggested that regulation of lifetime mortgages would be a powerful marketing tool, so that consumers may favour these products.

## **Enforcement, sanctions, monitoring and review**

It would be for the FSA to enforce and monitor compliance. The FSA will have a number of sanctions available if lenders and intermediaries fail to comply including fines, and ultimately withdrawal of permission to carry on the business. But firms have the safeguard of the right of appeal to an independent tribunal against FSA decisions.

## **Consultation**

This document provides an opportunity for formal consultation with stakeholders.

## **Summary**

The Government would welcome views on the assumptions made in the RIA. It would be helpful to receive views on both the costs and the benefits to businesses and consumers of the proposed regulation. The Government would particularly welcome views on the likely impact on competition and small firms.

**HM Treasury  
November 2003**

## ANNEX

### The estimated costs of FSA regulation of home reversion plans to individual firms

	Reversion provider – unregulated	Reversion provider – regulated for lifetime mortgages	Unregulated intermediary	Intermediary – regulated for lifetime mortgages
	£	£	£	£
<b>Compliance costs</b>				
<b>Authorisation</b>				
Application	622	-	476	-
Variation of permission		311	-	238
Application fees	15,000	7,500	1,200	600
FOS	Not known	Not known	Not known	Not known
<b>Total</b>	<b>15,622</b>	<b>7,811</b>	<b>1,676</b>	<b>838</b>
<b>Conduct of business</b>				
IT Systems	235,000	Minimal	5,000	500
Training and competence	25,000	25,000	2,500	2,500
Management and supervision	200,000	200,000	2,000	2,000
<b>Total</b>	<b>460,000</b>	<b>225,000</b>	<b>9,500</b>	<b>5,000</b>
<b>Grand total</b>	<b>475,622</b>	<b>232,811</b>	<b>11,176</b>	<b>5,838</b>
<b>(Rounded)</b>	<b>475,000</b>	<b>233,000</b>	<b>11,000</b>	<b>6,000</b>

### Notes

1. The figures used assume that the FSA will regulate home reversion schemes in a similar way to lifetime mortgages and therefore firms will incur similar kinds of costs. The precise costs will, of course, depend on the regime the FSA decides based on consultation and its own cost benefit analysis.
2. The figures are year 1, one-off costs.
3. Estimates based on FSA cost benefit analyses in CP 174<sup>1</sup> and CP 186<sup>2</sup>.
4. Application fees based on the FSA policy statement on consultation paper CP 180<sup>3</sup>.

<sup>1</sup> Prudential and other requirements for mortgage firms and intermediaries – CP 174 – FSA March 2003

<sup>2</sup> Mortgage regulation: Draft conduct of business rules and feedback on CP 186 – FSA May 2003

<sup>3</sup> Fees for mortgage firms and insurance intermediaries – FSA October 2003

5. The unregulated reversion provider is assumed to be the equivalent of a medium-sized mortgage lender with annual gross advances of between £10 and £100 million.
6. The provider regulated for lifetime mortgages is assumed to be the equivalent of a medium-sized mortgage lender with annual gross advances of between £10 and £100 million.
7. The unregulated intermediary is assumed to be a small mortgage broker.
8. The intermediary regulated for lifetime mortgages is assumed to be a small mortgage broker.
9. The costs of completing the application for the first time are based on the figures in CP 174 – large mortgage lender = £622, and a small intermediary = £476.
10. The costs of completing the application to vary permission are based on the figures in CP 174 – large mortgage lender = £311, and small intermediary = £238.
11. Application fees based on the FSA policy statement in response to comments on CP 180. We have assumed that the unregulated reversion provider would pay £15,000 for a medium-sized mortgage lender, and the unregulated broker would pay the maximum of £1,200 for a small mortgage broker. Those firms that are already regulated would pay 50% of these fees.
12. The costs of IT systems for an unregulated reversion provider are estimated to be £235,000. This is based on the average cost of mortgage lenders set out in CP 186. (£36.4 million divided by 155 lenders.) We do not think that there would be any significant additional IT costs for reversion providers that are already regulated for lifetime mortgages. As to an unregulated intermediary, and a regulated intermediary, we have assumed there would be costs of £5,000 and £500 respectively. This is based on an estimate of the need for an unregulated intermediary to set up new IT systems from scratch, and for minimal adjustments to a regulated intermediary's IT systems.
13. On training and competence, we have assumed that 100 advisers in both the unregulated reversion and regulated providers would require training which is assumed to cost £250 each. Similarly, each of the 10 advisers in the unregulated and regulated intermediaries will require similar training.
14. The management and supervision time is assumed to be £200,000 for unregulated and regulated reversion providers, which is the approximate average cost of mortgage lenders as set out in CP 186 (£31.2 million divided by 155 firms.)
15. We assume that management and supervision time for unregulated and regulated intermediaries would be £2,000, which is the approximate average cost of mortgage intermediaries as set out in CP 186 (£23.9 million divided by 13,725 firms rounded).