

# **Defining Home Reversions**

## **Summary of consultation responses**

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December 2004



HM TREASURY





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## **HM Treasury contacts**

This document can be accessed from the Treasury Internet site at:

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For further information on the Treasury and its work, contact:

Correspondence and Enquiry Unit  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: [ceu.enquiries@hm-treasury.gov.uk](mailto:ceu.enquiries@hm-treasury.gov.uk)

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# CONTEXT

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**1.1** Following a full public consultation the then Financial Secretary, Ruth Kelly, announced on 10 May 2004 that home reversion plans would be regulated by the Financial Services Authority (FSA). She also announced that legislation to regulate home reversion plans would be brought forward as soon as parliamentary time allows.

**1.2** The activities that the FSA has the power to regulate are specified through a combination of primary and secondary legislation. Primary legislation (the Financial Services and Markets Act 2000 - FSMA) sets out the kinds of investments and activities within the scope of FSA regulation. Secondary legislation (the Regulated Activities Order 2001 - RAO) specifies which activities have been brought under the scope of FSA regulation.

**1.3** A consultation document 'Defining Home Reversions' was published on 28 July 2004. The purpose of that consultation was to seek views on the types of sales and purchases of land and interests in land that should or should not fall into the definition of a home reversion for the purposes of the primary legislation. Responses were requested by the consultation closing date of 27 September 2004.

**1.4** This document summarises the responses received to that consultation and the resulting Government response about which home reversion type arrangements will be included in the primary legislation.

**1.5** The steps to bring these arrangements, detailed on the next page, into FSA regulation are as follows:

1. The Government first intends to bring forward primary legislation to amend Schedule 2 of FSMA to make it clear that these home reversion type arrangements are within the scope of potential FSA regulation.
2. The Government will consult on and bring forward secondary legislation to amend the RAO to bring home reversion type arrangements into FSA regulation.
3. The FSA will draw up and consult on rules regarding the sales of home reversion type arrangements.
4. Firms will need to apply for permission from the FSA to sell home reversion type arrangements.



# 2

## SUMMARY OF RESPONSES

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### Summary

- The Government received 20 responses to the consultation.
- Of the 17 responses that specifically answered the question, just over half supported the inclusion of Ijara home finance products in the definition of a home reversion in primary legislation.
- Of those that did not consider Ijara products should be included (8), the majority (5) were of the opinion that they should be regulated to create a level playing field with the Murabaha products (which are now regulated by the FSA, as of 31 October 2004), but expressed concerns about using a Home Reversions Bill as the vehicle to achieve this.
- The majority of respondents (12) stated that flexible tenure schemes should be included in the definition. Of those that disagreed (4), one also stated they thought such products should be regulated.
- Only 2 respondents felt that there should be an age limit included in the primary legislation definition.
- All respondents agreed that there should not be a de minimis threshold applied to the value of the reversions being carried out.

### Government Decision

The FSMA definition will be drafted to:

- include home reversion schemes;
- include Ijara home finance products;
- include flexible tenure products;
- not include an age limit; and
- not include a de minimis threshold.



# 3

## SPECIFIC COMMENTS

**Question 1a:** Should Ijara home finance arrangements fall within the primary legislation definition of a home reversion?

**3.1** The main point of contention raised in responses to this question was whether the agreed benefits of regulation (level playing field and consumer protection) were outweighed by the perceived risk of having a single set of regulatory rules applied to a product that was clearly different from a home reversion plan.

**3.2** The vast majority of respondents believed that Ijara products should be regulated, giving the following reasons:

- it is important to provide protection to consumers along the same lines as for other similar products
- it is necessary to have a level playing field between Ijara products and the other Shari'a compliant home purchase product, Murabaha, that is already regulated by the FSA.

**3.3** Though supportive of FSA regulation, respondents expressed concerns about trying to use this particular legislative vehicle for this purpose because:

- home reversion and Ijara products are inherently different
- there is a concern that stretching the home reversion definition to include Ijara products would
  - i. be unworkable;
  - ii. unintentionally catch other products;
  - iii. mean firms would have to comply with an overly stringent set of regulatory rules.

**Question 1b:** Are there further types of Islamic finance arrangements for home purchase that might be caught by the primary legislation definition of a home reversion? If so please provide details of such arrangements and indicate whether you consider such arrangements should fall within the primary legislation definition of a home reversion.

**3.4** Two further arrangements were brought to the Government's attention: Istisna (deferred payment financing) and Diminishing Musharaka (co-ownership or equity participation).

### Government Response

We note that the majority of respondents are in favour of regulation but that there are a number of concerns about using the Home Reversions Bill to achieve this.

After due consideration the Government has decided to include Ijara products in the scope of this Bill. Relevant considerations are:

- the FSA are obliged to apply their rules in a proportionate manner, and would therefore be required to analyse the characteristics of Ijara products before defining a suitable regulatory regime,
- it is important to ensure that primary legislation appropriately sets the scope of activities and products that may come to be FSA regulated. However, products that are ultimately brought within the remit of FSA regulation are fully defined in secondary legislation, the Regulated Activities Order. A broad primary legislative definition should therefore not cause concern,
- this Bill provides a rare opportunity to amend primary legislation. If Ijara products are not included at this time, there may be some delay before Ijara products can be brought within scope of FSA regulation.

The Diminishing Musharaka arrangement is based on the Ijara structure, and is for the purchase of a house. For the same reasons that we are bringing Ijara products into regulation, these products will also be included in the FSMA definition. Istisna is an arrangement that defers the provision of finance and is not a product specifically tailored to the purchase of a house. As such it will not be included in the FSMA definition.

**Question 2:** Should flexible tenure products provided by providers other than local authorities and exempted registered social landlords fall within the primary legislation definition of a home reversion where such products involve the buying back of portions of the property from the homeowner?

**3.5** Some local authorities and Registered Social Landlords (RSLs) offer a form of flexible tenure in the low-cost home ownership market, where they buy back portions or shares in a property if the owners find themselves in financial difficulty. Such schemes offer flexibility in house ownership. Participants can ‘staircase’ up or down their level of equity ownership over time. Rent may be paid for that part of the home owned by the co-owner.

**3.6** Twelve out of sixteen respondents agreed with bringing flexible tenure schemes into regulation for the following reasons:

- to ensure a level regulatory playing field;
- to protect consumers.

**3.7** Those against including flexible tenure products held the following views:

- regulatory costs may prevent lenders making such schemes available;
- such schemes should only be included if they apply to older people.

**Government Response**

We note that the majority of respondents would like to see flexible tenure products included in the definition. In light of the reasons cited above such schemes will be included in primary legislation.

**Question3:** Do you agree that there should be no age limit in the primary legislation definition of a home reversion?

**3.8** There was strong feeling that there should be no age limit defined in the FSMA definition, because the age of the applicant is a completely arbitrary factor and goes against the principle of treating everyone equally. For example, the financial implications and need for advice may be just as great for someone aged 40 as they are for someone aged 60.

**3.9** Some respondents commented that this issue should be addressed either:

- when considering the content of the RAO; or
- when the FSA consults on its detailed rules for this sector of the market.

**Government Response**

The Government agrees with the vast majority of the views expressed in the responses, and that it would be inappropriate to set an age limit in primary legislation.

**Question 4:** Do you agree that the primary legislation definition of a home reversion should not have a de minimis threshold?

**3.10** The government’s view that a de minimis threshold should not be included was supported by all respondents, based on the risk that providers could offer reversions just below the de minimis threshold and therefore avoid regulation. Consumer protection is as relevant for a series of small reversions as it is for one large reversion.

**Government Response**

All respondents agreed that there should not be a de minimis threshold applied to the value of the reversions being carried out. Given this, and for the reasons set out above, a de minimis threshold will not be included in primary legislation.

**Question5:** Do you have any other comments on the primary legislation definition of a home reversion? Specifically are there any other arrangements that should definitely be included or excluded from the definition?

**3.11** Further comments were received, summarised below:

- the definition of home reversion plans should be as inclusive as possible;
- regulation should be designed with potential new social products provided by non-profit organisations in mind;
- HMT should make clear the timetable for bringing the home reversions into regulation and progress must be rapid in order to minimise the potential for market distortions to arise between the regulated and unregulated sectors;
- the shift from self-regulation under SHIP, to statutory regulation under the FSA will have some impacts on firms and the nature of their obligations to their customers and this should be considered in the future;
- it should be ensured that the lifetime mortgage rules from 31 October 2004, and future home reversion rules dovetail together.