

Secondary legislation for the regulation of Home Reversion and Home Purchase Plans: A response to the Government consultation

September 2006



HM TREASURY



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INTRODUCTION

1.1 HM Treasury published a consultation document, 'Secondary legislation for the regulation of Home Reversion and Home Purchase Plans', on 31st March 2006¹. That consultation concluded on 23rd June 2006.

1.2 The purpose of the consultation was to seek views on draft secondary legislation that will have the effect of bringing Home Reversion Plans, and Ijara and Diminishing Musharaka home financing products within the scope of Financial Services Authority (FSA) regulation². We refer to the latter products as Home Purchase Plans (HPPs).

Purpose of this document

1.3 This document, which is available from the HM Treasury website, summarises the responses received, and the resultant Government conclusions on regulating Home Reversion and Home Purchase Plans.

- In chapter 2 we summarise the responses.
- In chapter 3 we address Home Reversion Plans, and in chapter 4, Home Purchase Plans.
- In chapter 5 we set out the next steps, subject to Parliamentary approval.
- In chapter 6 we list the consultation respondents.

The FSA Consultation

1.4 In April 2006 the FSA published a separate consultation on 'Regulation of Home Reversion and Home Purchase Plans' (Consultation Paper 06/8 (CP 06/8)). This closed on 21st July 2006. The FSA will finalise their draft rules in the light of responses to their CP. The FSA intends to publish a policy statement once the secondary legislation amendments have been made.

1.5 We are grateful to everyone who responded to the consultation in writing or who participated in any of the meetings we held or attended during the consultation.

¹ The HM Treasury consultation document is available at http://www.hm-treasury.gov.uk/consultations_and_legislation/land_transaction/consult_landtransaction_index.cfm

² Generally references to Ijara products should be taken to include Diminishing Musharaka products.

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SUMMARY OF RESPONSES

Analysis of responses **2.1** We received 24 responses, comprising 6 from trade or professional bodies, 16 from firms active in the markets concerned, and replies from the Financial Services Consumer Panel and an Islamic finance consultancy.

2.2 Responses were generally strongly supportive of the need for regulation, and endorsed the approaches we had taken. A number of points of detail were raised and the following sections of this response (parts three and four) analyse these.

Home Reversion Plans **2.3** Most respondents focused on the home reversion element. Seventeen responses made points about these proposals. The responses addressed:

- The proposed definition of a home reversion;
- Our proposals for defining plan providers – the persons who buy all or part of the home from the reversion seller;
- Our proposals for defining the activity of administering a home reversion;
- Our proposals for the treatment of intermediaries;
- The scope of our proposed exemptions;
- The draft consequential amendments; and
- The draft Regulatory Impact Assessment.

Home Purchase Plans **2.4** Nine respondents made comments on our Home Purchase Plan proposals. Generally respondents were supportive of our detailed proposals for defining and regulating these products.

Market innovation **2.5** We are grateful to those who discussed innovative new products with us. We have not, as part of this exercise, considered it appropriate to comment on the possible regulatory treatment of the specific schemes that were discussed with us. It will be for individual providers and others initially to assess their business in the light of the final legislation.

GOVERNMENT CONCLUSIONS

2.6 In the light of responses to the consultation we will amend the definition of administering a Home Reversion Plan to add recovery of payments due from the reversion seller under the plan. We have also inserted interim authorisation provisions and made minor drafting amendments to the Orders.

2.7 The Government will otherwise proceed with the legislation as proposed in the consultation, which is subject to Parliamentary approval.

NEXT STEPS

2.8 The necessary steps to bring these arrangements into FSA regulation are as follows:

- The Government will bring forward secondary legislation to bring activities relating to Home Reversion Plans and Home Purchase Plans into FSA regulation, taking into account responses to this consultation.
- Subject to Parliamentary approval, this secondary legislation will take effect from 6 April 2007.
- The FSA will publish rules regarding activities relating to Home Reversion Plans and Ijara home financing arrangements.
- Firms will need to apply for permission from the FSA to conduct activities relating to Home Reversion Plans and Ijara home financing arrangements.

2.9 Our intention in proposing that regulation will come into effect on 6 April 2007 is to have regard to the need to allow firms sufficient time to adapt their systems to the introduction of regulation, and to apply for the necessary permissions.

2.10 There will be special provisions for interim authorisation of firms as part of the main Order (see section 5).

3

HOME REVERSION PLANS

Introduction **3.1** As we set out in the consultation document “Secondary legislation for the regulation of Home Reversion and Home Purchase Plans”, the Government seeks a regulatory regime for Home Reversion Plans (HRPs) and Ijara home financing arrangements (Home Purchase Plans, (HPPs)) similar to that already in place for Regulated Mortgage Contracts (RMCs). This will ensure a level regulatory playing field within the equity release market and within the Sharia compliant home financing market. The consultation focused on the definitions of the different financing arrangements and on activities where deviations from the RMC model are proposed.

Question 1: Do you think the definition of a Home Reversion Plan is accurate and will it capture all available Home Reversion products without capturing other products with similar features?

3.2 Several responses addressed the definition of HRPs. While there was broad satisfaction with the approach adopted, questions were raised about the precise definition, the boundary between home reversions and mortgages, the use of the term ‘qualifying termination events’, and the parameters of regulation.

‘40 per cent occupation’ and timeshares **3.3** Four respondents questioned these parts of the HRP definition. The exclusion of timeshare properties and the 40% occupation “as or in connection with a dwelling” element of the definition are both derived from the existing definition of a Regulated Mortgage Contract.

3.4 We are not aware that it is possible to take out a home reversion on a timeshare property in practice. Where, after the introduction of regulation, a consumer chooses to use money raised through a home reversion to acquire a timeshare that home reversion will be subject to regulation under these rules. However the acquisition of the timeshare would continue to be dealt with under the Timeshare Act 1992.

Hybrid products **3.5** Several respondents raised the possibility that providers might seek to develop home reversion products using mortgage structures. We explained in the consultation that we were unaware of any products that share the features of Home Reversion Plans and RMCs, and that we had made no special provision for them³.

3.6 If products were developed that economically ‘mimicked’ a Home Reversion Plan but used only mortgage structures they would fall to be regulated as mortgages. But providers and others would have to ensure that the products did not contain the features of a Home Reversion. If the arrangement constitutes a Home Reversion Plan it would be regulated as such.

Qualifying events **3.7** The HRP definition specifies that it must include at least one “qualifying terminating event”. Four responses questioned this approach. The definition is not an attempt to define specific products or restrict commercial innovation or choice by prescribing all permissible termination events. For an arrangement to be an HRP, it needs to include only one of the three qualifying termination events. It can also include other termination events. Therefore it is possible for an HRP to include one or more qualifying termination event and any other termination events the parties agree upon.

³ See paragraph 3.10 of the Treasury consultation document, “Secondary legislation for the regulation of Home Reversion and Home Purchase Plans”, March 2006.

Lifetime leases 3.8 Three respondents raised the issue of lifetime leases, suggesting that these should be brought into FSA regulation. Under a lifetime lease the consumer enters into a lifetime lease of a residential property, (i.e. he is entitled to reside in the property for life in the same way as an HRP consumer might when he sells a home reversion). There is no equity release in a lifetime lease as there is no property sale involved. And an HRP typically involves a peppercorn rent or no rent, whereas there is significant rent payable for a lifetime lease.

3.9 In our view the HRPs and lifetime leases are sufficiently different for us to justify not extending FSA regulation to lifetime leases. In particular, lifetime leases are essentially a form of property transaction and do not involve the provision of finance, which is an essential ingredient for the products we are seeking to regulate here (indeed the Land Transactions Act only extends to arrangements for the provision of finance). Therefore we do not propose to amend the current HRP definition to cover lifetime leases.

Summary

We will retain the definition of Home Reversion Plans on which we consulted.

Question 2: Do you agree with the definition and use of 'plan provider'?

3.10 Four respondents were supportive of the approach we adopted to defining plan providers. A further ten respondents, while broadly supportive, made specific comments about our proposals. These comments focused on three main areas.

The plan provider 3.11 Entering into a home reversion as a plan provider will be a regulated activity. The draft secondary legislation states that that the person (whether legal or natural) who buys all or part of the home of the reversion seller under a home reversion arrangement will be the plan provider. We proposed to go beyond the existing mortgage regulation model here, so that where a new plan provider buys a reversion from the original provider (even where the initial contract predated regulation) we will require the new provider to be regulated.

3.12 We believe regulation is justified because there is a large secondary market in these products, and there are additional risks involved when consumers sell their homes while they continue to live in them. There are, for example, ongoing requirements placed on consumers to ensure the properties are fully maintained, and there is potential for disputes about how those are enforced.

The 'business test' 3.13 For an activity to be regulated it must be conducted 'by way of business'. Several respondents questioned this approach, emphasising that there is significant activity by private investors acting either as initial plan providers or secondary market investors. The 'by way of business' rules are a fundamental feature of financial services regulation. There is no compelling consumer protection reason to depart from that policy. The effect of applying financial services regulation to private plan providers who are not acting by way of business could be significantly to increase costs or deter private capital from entering this market.

3.14 Important consumer protections will remain in place even where providers are unregulated. Intermediary activities (see below) will continue to be regulated, for example, where a home reversion is transferred from a regulated (business) provider to

a provider who does not undertake Home Reversion Plan provider activities by way of business.

3.15 Additionally, the FSA propose that special disclosure requirements will apply when intermediaries advise consumers about “non-business” providers. These will draw attention to the issues raised by entering into a plan with an unregulated provider.

Summary

We will retain the treatment of Plan Providers on which we consulted.

Question 3: Do you agree with our approach to administering activities relating to Home Reversion Plans?

3.16 There was general support for our approach, which was derived from the treatment of mortgage administration, although, as the main flow of payments under a home reversion is to the consumer, our draft definition only captured the administration of those payments. Responses drew attention to possible liabilities owed by consumers under Home Reversion Plans to plan providers or others, such as peppercorn rents or other liabilities, for example in respect of repairs. We acknowledge the concern, expressed during the consultation, that consumers could be exposed to risks as a result of abusive or irresponsible behaviour based on those liabilities. We will therefore add the administration of payments by the consumer to the definition of administering a regulated Home Reversion Plan, to strengthen consumer protection in these cases.

Summary

In the light of consultation responses we have amended the draft definition of administering a Home Reversion Plan to add recovery of payments due from the reversion seller under the plan.

Question 4: Do you agree with our approach to the regulation of intermediaries?

3.17 Respondents were generally supportive of the regulation of intermediaries. One respondent pointed to a difference of approach between requiring advice to plan providers to be regulated and not regulating activities of providing, advising on or administering buy-to-let mortgages (which are excluded from mortgage regulation). Our intention has been to ensure that the FSA is able to make rules that address consumer protection needs when intermediaries deal especially with smaller plan providers that might otherwise not be regulated because of the ‘by way of business’ test. But, as we explained in the consultation, the intention is not to regulate the activities of investors in companies that buy home reversions⁴.

Summary

We will retain the treatment of intermediaries and intermediary activities on which we consulted.

⁴ See paragraph 3.19 of the Treasury consultation on “Secondary legislation for the regulation of Home Reversion and Home Purchase Plans”

Question 7: Do you agree with our approach to activities to be excluded from the Home Reversion and Home Purchase Plan regulatory regime?

3.18 Respondents to this question fell into two groups. One group was straightforwardly supportive of our approach, which reflects that for RMCs, of excluding Registered Social Landlords and Local Authorities from FSA regulation. Others questioned the approach arguing that all Home Reversion Plan providers should be brought within the scope of FSA regulation.

The intention of the Department for Communities and Local Government is to ensure that equivalent protections apply to transactions involving Registered Social Landlords and Local Authorities⁵.

Summary

We will retain the exclusions for Registered Social Landlords and Local Authorities on which we consulted.

Question 8: Do you agree with our approach to consequential amendments relating to the Home Reversion and Home Purchase Plan regulatory regime?

3.19 Respondents endorsed our proposals.

3.20 We have added further consequential amendments to the main Order and we have also amended the consequential amendments to the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the Money Laundering Regulations, to add references to an interest in land bought under an HRP.

Question 9: Do you agree with the partial regulatory impact assessment at Annex C?

3.21 Respondents were generally supportive of our approach, which was, for example, described as consistent with a firm's own estimate.

3.22 Individual respondents drew attention to the relatively high costs compared with the current level of market activity.

3.23 We have revised the cost estimates in our RIA based on the analysis published by the FSA in their CP 06/8 in April 2006. That suggests that both the introductory one-off costs of the measure, and the recurring costs, will, overall, be substantially lower than we had initially estimated.

3.24 We now expect the one off costs to industry of both HRP and HPP measures to be about £1.83M, instead of £8.57M, and the recurring costs will be about £400,000 instead of £4.4M.

A regulatory impact assessment is available alongside this response.

⁵ The Department for Communities and Local Government (DCLG) was created on 5 May 2006 with a remit to promote community cohesion and equality, as well as responsibility for housing, urban regeneration, planning and local government.

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HOME PURCHASE PLANS

Introduction 4.1 We asked nine questions in the consultation document. Five of those questions relate wholly or partly to HPPs. Subject to the points noted there was strong endorsement of our approach.

Question 5: Do you think the definition of a Home Purchase Plan is accurate?

4.2 Respondents were generally supportive of our approach to defining HPPs. One respondent suggested being more explicit about the different legal forms the trust arrangements referred to in the HPP definition could take, but we do not think that this would aid legal certainty. One respondent argued that Istisna arrangements should also be regulated. Our understanding is that this structure is not typically used for funding the purchase of residential property. One respondent questioned our approach to hybrid products. Our view remains that where a product has features of both a HPP and a RMC it would fall to be treated only as a HPP.

Summary

We will retain the definition of Home Purchase Plans on which we consulted.

Question 6: Do you agree with our approach to the regulation of Home Purchase Plans (and therefore Ijara and Diminishing Musharaka home financing products)?

4.3 Respondents were supportive of our approach.

Question 7: Do you agree with our approach to activities to be excluded from the Home Reversion and Home Purchase Plan regulatory regime?

4.4 No specific points were raised about our proposals to exclude Registered Social Landlords and Local Authorities from HPP regulation by the FSA.

Question 8: Do you agree with our approach to consequential amendments relating to the Home Reversion and Home Purchase Plan regulatory regime?

4.5 Respondents were wholly supportive of our approach.

Question 9: Do you agree with the partial regulatory impact assessment at Annex C?

4.6 Comments on the RIA have been covered in part three.

Overall summary

We have not amended our proposals for Home Purchase Plans.

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NEXT STEPS

Next steps 5.1 The necessary steps to bring these arrangements into FSA regulation are as follows:

- The Government will bring forward secondary legislation to bring activities relating to Home Reversion Plans and Ijara home financing arrangements into FSA regulation, taking into account responses to this consultation. There will be three Orders, the main Order that amends the Financial Services and Markets Act 2000 (Regulated Activities) Order and introduces all of the main changes, and two further Orders that will make consequential changes to the money laundering rules under the Terrorism Act 2000 and the Proceeds of Crime Act 2002.
- Subject to Parliamentary approval, this legislation will take effect from 6 April 2007.
- The FSA will publish rules regarding activities relating to Home Reversion Plans and Ijara home financing arrangements.
- Firms will need to apply for permission from the FSA to conduct activities relating to Home Reversion Plans and Ijara home financing arrangements.

Interim authorisation 5.2 When first charge residential mortgage regulation was introduced in 2004, the Government made interim authorisation arrangements for firms coming into FSA regulation. The Government is bringing forward, as part of the main Order, legislation that will introduce interim authorisation arrangements for firms engaging in regulated activities relating to Home Reversion and Home Purchase Plans.

5.3 The effect will be to confer interim authorised status on firms which have applications for authorisation or variation of permission, or appeals to the Financial Markets Tribunal against FSA decisions that are undecided on the date regulation comes into force.

5.4 Interim authorised status will only be available to firms conducting business before the date on which the FSA opens its doors for applications. In the case of intermediaries, these arrangements will apply for a specified period of 12 months after the commencement date.

5.5 Firms with interim authorised status will be subject to FSMA and FSA rules and to the FSA's supervisory jurisdiction, including the application of the approved persons regime and the associated sanctions and penalties that the FSA can apply. As with mortgage regulation, the Government will allow the FSA to decide the extent to which the Financial Services Compensation Scheme (FSCS) will cover claims made in connection with regulated activities carried on by firms with interim authorised status.

5.6 The exact detail of these arrangements will be for the FSA to determine.

6

LIST OF CONSULTATION RESPONDENTS

The Actuarial Profession (The Faculty of Actuaries, and the Institute of Actuaries)
Ahli United Bank (UK) plc
Association of British Insurers
Association of Mortgage Intermediaries
Bristol and West plc (Bank of Ireland)
Bridgewater Equity Release Ltd.
Cavendish Property Investments Ltd.
Cheltenham & Gloucester plc
Council of Mortgage Lenders
The Ellis Campbell Group
Financial Services Consumer Panel
HBOS plc
Home & Capital Trust Ltd.
Home Equity Release
In Retirement Services (Reversions) Ltd.
The Institute of Chartered Accountants in England and Wales
Islamic Bank of Britain plc
Legal & General
London Rebuilding Society
Norwich Union
Retirement Plus Ltd.
SHIP (Safe Home Income Plans)
Sovereign Reversions plc
Zest Advisory LLP

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