Sale and rent back – a market study

Annexe B - Equity release

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B.1 REGULATED EQUITY RELEASE PRODUCTS

B.1.1 The FSA regulates two forms of equity release - lifetime mortgages and home reversion plans.

- A lifetime mortgage allows a consumer to take out a mortgage loan secured on their home which is repaid, usually through the sale of the house, when the homeowner dies or moves out of it (perhaps to a care home). Most lifetime mortgages come with a no-negative equity guarantee. They are generally only available to people over a certain age limit (usually 55).

- A home reversion plan is a form of equity release under which a consumer sells all or part of their home, at a discount to the market value of the house and, in return, has the right to live in the house as a tenant until they die or move out of it (perhaps to a care home). The minimum age is usually higher than that required for lifetime mortgages.

B.1.2 Thus, lifetime mortgages are essentially a loan secured on the property, while home reversion involves sale of the property which is then rented back with a secure lease. Home reversion is therefore very similar to sale and rent back, although the lease in a home reversion product is much more secure. A comparison of home reversion, lifetime mortgages and sale and rent back is included in Table B.1.
Table B.1: Comparison of lifetime mortgage, home reversion, and sale and rent back

<table>
<thead>
<tr>
<th></th>
<th>Lifetime mortgage</th>
<th>Home reversion</th>
<th>Sale and rent back</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Availability</strong></td>
<td>Age limit applies (usually at, or close to, retirement age; older for home reversion). Significant equity in property required.</td>
<td>No age restriction, although some equity in property required.</td>
<td></td>
</tr>
<tr>
<td><strong>Payment to customer</strong></td>
<td>Customer obtains lump sum or income from mortgaging of home.</td>
<td>Discounted (usually 35%- 60%) value of sale of all or part of home; or income from sale of all or part of home</td>
<td>Discounted value of the home (usually 70% – 90%).</td>
</tr>
<tr>
<td><strong>Payments by customer</strong></td>
<td>Interest payments (sometimes added to mortgage debt); mortgage debt repaid by sale of home when customer dies or moves into care home.</td>
<td>Usually none, or only token rent, but some schemes offer higher rent in return for more money from sale.</td>
<td>Rent agreed on case by case basis, often at market rates.</td>
</tr>
<tr>
<td><strong>Fees and Costs</strong></td>
<td>A range of fees and costs are likely to be payable, including arrangement and valuation fees, legal costs, building insurance.</td>
<td>Varies from provider to provider</td>
<td></td>
</tr>
<tr>
<td><strong>Tenure</strong></td>
<td>Customer continues to own home (but has to keep up interest payments, where required).</td>
<td>Leasehold terminated by one of three terminating events: death, move to a care home or expiry of 20 years. Before terminating event, tenant can only be evicted if fails to pay rent or breaks terms of lease.</td>
<td>AST. Tenant can be evicted after initial 6 or 12 month period.</td>
</tr>
<tr>
<td><strong>If decide to</strong></td>
<td>Can usually transfer to new property if</td>
<td>Some plans can be transferred to new</td>
<td>No significant restrictions (although</td>
</tr>
</tbody>
</table>
move acceptable to lender. Otherwise, repayment of mortgage debt required. Cancellation may be expensive.

| property if acceptable to the provider. If the scheme can’t be transferred, customers must pay off entire proceeds of sale. Cannot usually cancel an agreement. | loss of equity in home will not be refunded. |

Sales of equity release products

B.1.3 Sales of equity release products are shown in Figure B.2. The market has been growing rapidly over recent years, and in total around 30,000 products are now sold per year. Of these, the vast majority are lifetime mortgages rather than home reversion plans.

Figure B.2: Numbers of equity release products sold, 1997 – 2007

Source: Mintel (Based on SHIP data)
B.1.4 The market is quite concentrated with a few large firms dominating the industry, as shown in Figure B.3.

**Figure B.3: Estimated equity release market shares, 2007**

![Equity Release Market Shares](image)

Source: Mintel

**Self-regulation of equity release**

B.1.5 Both types of equity release products are covered by the trade association Safe Home Income Plans (SHIP). SHIP was established in 1991 following concerns around the previous generation of equity release products which left some consumers in negative equity. It has since established a significant reputation. Membership is voluntary but accounts for 90 per cent of the market (21 firms).¹

B.1.6 SHIP has a strict code of conduct which covers aspects such as clear presentation of the plan and costs, fixed or capped interest rates for lifetime mortgages, requirements for independent legal advice, a

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¹ Mintel, Equity Release, Financial Intelligence, May 2008
guarantee that customers can move home with no financial penalty, and a 'no negative equity' guarantee. All sales of SHIP plans are advised and advisers must hold a specific qualification in equity release. Entry into a SHIP plan takes about three months.

B.1.7 SHIP charges a £25,000 annual membership fee to fund its activities. There are significant costs in complying with the SHIP code of conduct. For example, the cost of independent legal advice, an independent survey and advice on all financial options from an IFA is around £1,500 per transaction.

**FSA regulation of equity release**

B.1.8 Both forms of equity release are now regulated by the FSA.

B.1.9 The regulatory protection afforded to equity release transactions is wide-ranging. Firms which enter into, administer, arrange or advise on equity release products must be authorised by the FSA to carry on these activities. Like all regulated firms, they are required to comply with the FSA’s High Level Standards under which they must, for example, pay due regard to their customers’ interests and treat them fairly. They must also pay due regard to the information needs of their clients and communicate information to them in a way which is clear, fair and not misleading.

B.1.10 Firms must also comply with rules set out in Mortgages and Home Finance: Conduct of Business Sourcebook (‘MCOB’). MCOB rules regulate, amongst other things, financial promotions, disclosure, advising and selling standards, including the requirement to provide a Key Facts Illustration (KFI). The KFI contains information on the benefits and risks

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4 Ibid.
6 See footnote 3.
of the product and the costs and fees the customer incurs.\(^7\) The FSA’s rules on training and competence also apply to firms whose employees carry out certain activities relating to equity release transactions, such as advising or overseeing non-advised sales.\(^8\)

**B.1.11** In addition, the FSA has extensive powers to enforce compliance with FSMA and its principles and rules.\(^9\) These include the imposition of financial penalties\(^10\) and public censures,\(^11\) power to vary or cancel an authorised person’s permission to carry on regulated activities,\(^12\) power to prohibit individuals who are not fit and proper from carrying out functions in relation to regulated activities,\(^13\) to apply to the court for injunctive relief\(^14\) or restitution,\(^15\) or to require restitution itself for contravening a requirement imposed by or under FSMA.\(^16\)

**B.1.12** Consumers may also have direct forms of redress against an authorised person in certain circumstances. FSMA provides for the FSA to make rules to establish a scheme (the Financial Services Compensation Scheme) for compensating persons where an authorised person is unable or likely to be unable to satisfy claims against them.\(^17\) This serves to protect consumers of regulated services against the risk of loss as a result of the default or insolvency of an authorised person. The scheme is required to provide for the payment of compensation to claimants in respect of claims made in connection with regulated activities carried on by an authorised person or an appointed representative of the authorised person.

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\(^7\) See MCOB 9, Annexes 1 and 2.  
\(^10\) FSMA, section 206.  
\(^11\) FSMA, section 205.  
\(^12\) FSMA, section 45.  
\(^13\) FSMA, section 56.  
\(^14\) FSMA, section 380.  
\(^15\) FSMA, section 382.  
\(^16\) FSMA, section 384.  
\(^17\) FSMA, section 213.
B.1.13 Customers of equity release products also have access to The Financial Ombudsman Service (FOS). The FOS has significant powers to determine a complaint, which may include a money, interest or costs award against the respondent or a direction to the respondent. The maximum money award the FOS may make is £100,000.

**Rationale for government regulation of equity release**

B.1.14 Lifetime mortgages came under FSA regulation in 2004, along with other mortgages.

B.1.15 Home reversion schemes were only added in April 2007. The rationale for adding home reversion plans was that regulation 'would protect consumers who may have complex advice needs and may be vulnerable to being sold a reversion plan that is unsuited to their needs'. The objective was to 'create a level regulatory playing field with already regulated mortgage products and extend essential consumer protection to potentially complicated financial decisions affecting individuals' lives'.

B.1.16 At the time that regulation of home reversion was proposed, there was no specific evidence of consumer detriment, and little information about the size of the market, but there was concern about the projected expansion of the market leading to increased detriment in the future. In particular, the following risks were identified:

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21 Financial Services Authority ‘Regulation of Home Reversion and Home Purchase Plans Volume 1 – Consultation Proposals’ page 17 and 18.
• **Potentially vulnerable consumers:** Home reversion plans, like lifetime mortgages, are designed for older and potentially vulnerable consumers.

• **Mis-buying:** Consumers may not appreciate the implications of taking out a home reversion plan.

• **Mis-selling:** Consumers may be advised to take out a home reversion plan where an alternative means of raising the required funding would have been preferable.

• **Need for legal advice:** Consumers may not appreciate the importance of obtaining professional legal advice before entering into a home reversion plan.

• **Fair valuation:** Consumers may not receive a fair price for their property as a result of an unreasonably low valuation.

• **Rights as tenant:** Consumers could be disadvantage if the provider failed to exercise its rights as 'landlord' fairly throughout the life of the plan.

• **Security of tenure:** If the provider sells their house to a third party or becomes insolvent, consumers may also be at risk of losing the right to stay in their own home or, in the case of partial reversion, their residual financial interest in the property.

• **Access to redress:** Consumers may not have access to appropriate redress if they suffer financial loss as a result of a firm's actions, for example, negligent advice.

• **Consumer awareness:** Consumers may not have access to the information about the products available and their different features and risks to enable them to make an informed choice and may not be aware they can shop around to get a good deal.

B.1.17 The regulation only covers home reversion plans with one of three terminating events – death, care home or twenty year minimum. It was
decided not to include flexible tenure products, such as sale and rent back, as, at the time, these products were mostly provided by local authorities and registered social landlords. However, HM Treasury stated that it intended to keep the 20 year figure under review and the ability to regulate flexible tenure products was included in the primary legislation (Regulation of Financial Services Act 2005).^{22}

**Impact of regulation**

B.1.18 Estimated costs to firms of compliance with home reversion regulation (bearing in mind that some firms were already regulated by the FSA for other activities) were £115,000 per firm, with annual ongoing costs of £2,500. The FSA estimated there were six providers, with a total of 2,500 sales per year, suggesting one off costs per product of £277 and ongoing annual costs per product of £6.^{23}

B.1.19 Intermediaries who were already authorised had costs of £8,000 per firm, with annual ongoing costs of £2,000, and those who were not already authorised had costs of £22,000 per firm and ongoing costs of £13,000. On-going costs mainly related to rules on complaints, financial promotions and costs of professional indemnity insurance.^{24}

B.1.20 The share of equity release accounted for by home reversion plans still accounts for less than 10 per cent of the equity release market. The dominance of lifetime mortgages is attributed in part to the increased integrity conferred by earlier FSA regulation. Regulation of home reversion plans does not appear to have affected the growth of the smaller players, who have gained some market share at the expense of more established players. However, there is some suggestion that suitability requirements have made some large businesses reluctant to

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^{22} HM Treasury, Secondary legislation for the regulation of Home Reversions and Home Purchase Plans: A consultation, March 2006. page 7, 10 and 42.

^{23} Financial Services Authority ‘Regulation of Home Reversion and Home Purchase Plans Volume 1 – Consultation Proposals’ Annexe A

^{24} Financial Services Authority ‘Regulation of Home Reversion and Home Purchase Plans Volume 1 – Consultation Proposals’ page 18 and 19.
enter the equity release market - suitability can be very hard to assess and these firms are fearful that they will be accused of misselling.\textsuperscript{25}