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Equity Release Mortgages Life conference

IFoA ERM Working Party

Tom Kenny (Chair) – Just
Gina Craske - KPMG

November 2017

Agenda

- Background to working party
- Background to ERM market
- Regulatory environment
- Capital requirements and profitability
- Snapshot of results from survey



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Background to working party



The Working Party and the IFoA Support

Working party members

- Tom Kenny (Chair)
- Charles Golding (Deputy)
- Gina Craske
- Sam Achord
- Scott Robertson
- Nigel Hayes
- Owen Griffiths
- Raj Saundh
- Alex Mockridge
- Stuart Farrell
- David Evans

Working party members (ctd)

- Sam Gunter
- Radu Tunaru
- James Thorpe
- Andrew Dobinson
- Jyotsna Kaushik

IFoA support team

- Mairi Russell
- Marion Collins
- Rebecca Deegan



Why was the working party formed?

“The expansion of **insurers** investing in the Equity Release Mortgages (ERM), and the **asset’s** long term use to back **annuity portfolios**, brings ERM into scope of the “**matching adjustment**” of Solvency II”

High risk-adjusted returns



Illiquid assets

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What do we plan to do?

- Publish a report covering:
 - Market overview and importance of equity release to supporting retirement incomes
 - Valuation methodologies
 - Approaches to modelling no-negative equity guarantees
 - Structuring of ERMs
 - Common assumptions used for modelling ERMs
 - Results of our survey

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Background to ERM market

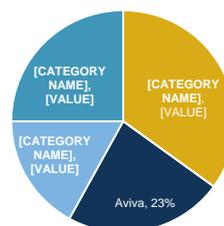
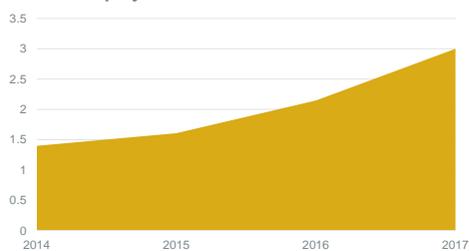


What does the market look like

- Growing rapidly - 43% growth in 2017 (Source: Equity Release Council)
- Top 3 providers in 2017 (L&G, Aviva, Just)
 - L&G entered the market in 2015 and now market leader in 2017
- Interest rates have fallen 66bps over the year
 - average rates dropped from 5.96%pa to 5.30%pa (annual change to July 2017)

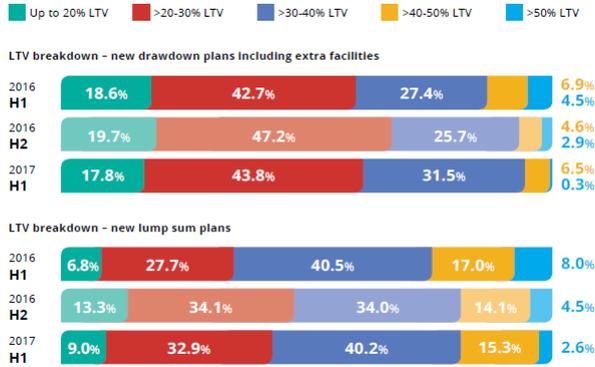


Equity release market volumes £bn



What does the market look like

- Average LTVs available (Source: Equity Release Council)



- Distribution – all equity release mortgages are sold through an advised sale
 - Over 50% of sales are via two advisory firms

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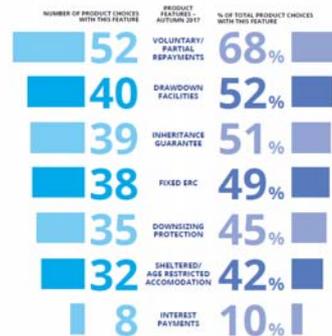
Products available in the market

- Summary of products available (Source: Equity Release Council)
 - Fixed rates vs capped rates
 - Interest serviced vs roll-up
 - Inheritance protection – featured on around 50% of plans
 - Early redemption charges - Over 2/3's of plans now allow ERC free ad-hoc payments

PERIOD	NUMBER OF PLANS AVAILABLE	CHANGE IN NUMBER OVER EACH PERIOD	% CHANGE OVER EACH PERIOD	CHANGE IN % SINCE 2007
AUGUST 2017	78	+20	+34%	+225%
AUGUST 2016	58	+31	+115%	+142%
AUGUST 2014	27	+10	+59%	+13%
AUGUST 2012	17	-7	-29%	-29%
AUGUST 2007	24	-	-	-

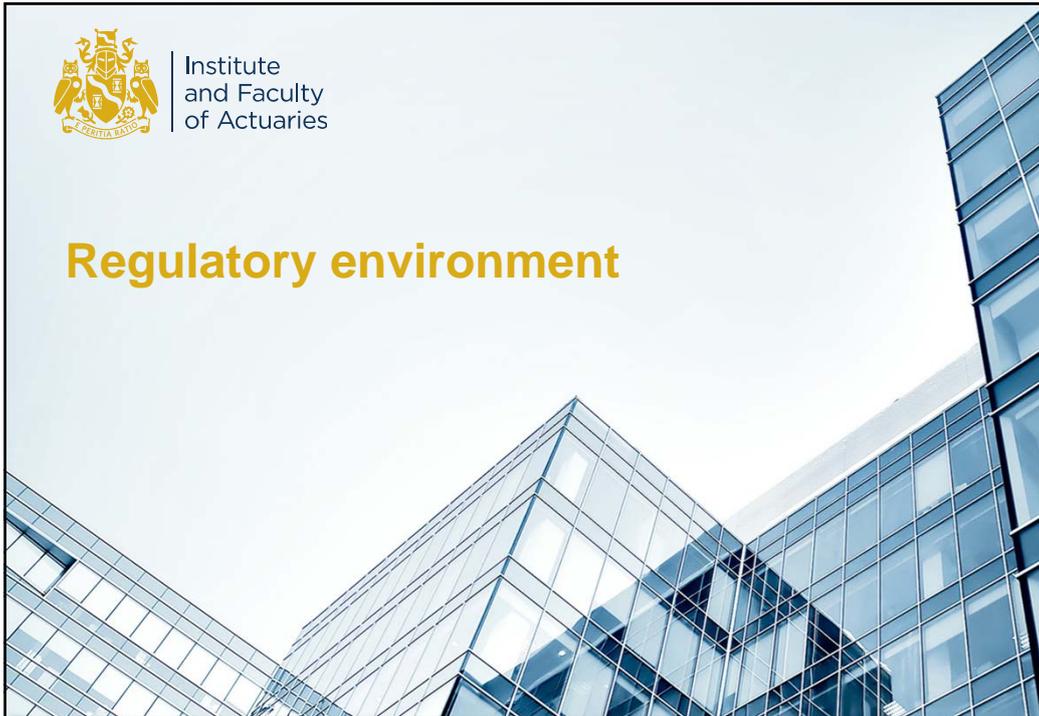
Source: product data supplied by Key Retirement

Product features



Source: product data supplied by Key Retirement

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How is the regulatory environment changing?

- March 2016: PRA DP1/16 – Equity Release mortgages – good practices
- December 2016: PRA CP48/16 – Solvency II: Matching Adjustment – illiquid unrated assets and equity release mortgages
- July 2017: PRA SS3/17 – Supervisory statement on CP48/16
- October 2017: FCA CP17/32: Quarterly Consultation – Retirement Interest Only Mortgages
- October 2017: PRA CP21/17 – Solvency II: Matching Adjustment
- November 2017: PRA CP24/17 – Solvency II: Internal Models – modelling of the matching adjustment



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Update on working party

Valuation Methodologies

- Relevant metrics [IFRS 4, IFRS 9, IFRS 17, IAS 39, S2,]
- Definition – investment versus insurance
- Projected cash-flows
- No day-1 gain
- NNEG
 - Closed form
 - Full stochastic
 - Real world versus market consistent
- Impact of PRA SS3/17

Structured notes

- Scenarios used for rating methodology of notes
- Risks are included within rating frameworks
- Qualitative assessments
- Mapping back the models to the rating class required to set fundamental spreads
- Rating agency views

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Assumptions

- Margins - repayment rates
- Deterministic v Stochastic assumptions
- Property volatility
- Idiosyncratic risk of ERMs e.g. dilapidation, basis risks
- House price inflation
- Allowance for property price cycle

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Taster of survey



ERM WP Survey – A taster

- Insert charts summarising some key points from survey



Questions



Comments

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