

# Institute and Faculty of Actuaries

## Regulatory Board

### Approval report

|   |   |
|---|---|
| <b>Subject</b>                          | Thematic Review Programme – Equity release propositions and pricing           |
| <b>Regulatory Board meeting</b>         | 16 November 2022  |
| <b>Previous Board Steer/Approval</b>    | July 2021 – deep dive and scope discussion                                    |
| <b>International issues considered?</b> | Yes   |
| <b>Author</b>                           | Alan Marshall, Review Actuary   |
| <b>Reviewer</b>                         | David Gordon, Senior Review Actuary<br>Emma Gilpin, Head of Regulatory Policy |
| <b>Purpose</b>                          | Approval  |

#### A: Executive summary

1. The Actuarial Monitoring Scheme (AMS) Review Team has completed its thematic review on the involvement of actuaries in equity release propositions and pricing.
2. This paper sets out the key findings and conclusions from the review and seeks approval for publication of the Report. The Board's response to the review findings, including any possible actions, are discussed under a separate item.
3. The findings cover possible implications for the work of actuaries in equity release under the following key themes:
  - High level of actuarial involvement in proposition and pricing work
  - Large potential market for equity release
  - Rapidly changing economic environment
  - Significant existing regulatory focus
  - Potential legacy issues
  - Coverage in education and lifelong learning material
4. **The main conclusions are:**
  - Given significant involvement of actuaries in many areas of equity release work, a key consideration is the balance of customer and commercial outcomes, ensuring that propositions are both fair and well understood.
  - There is considerable UK regulatory focus on the equity release market, both from a consumer and prudential perspective. This provides important context as to whether there are any material gaps which actuarial standards or guidance could address to further support members working in this market.

#### B: Introduction

5. Actuaries have played a leading role in developing the market for equity release products, where property wealth of individuals forms the basis for loans. The long-term nature of the

product, coupled with risks such as longevity, long-term care need, and pricing of options, means that the actuarial skillset is ideally positioned to help deliver a suitable product for both customers and firms.

6. Concerns about equity release products regarding fair treatment of customers, especially potentially vulnerable customers, have been a regular source of media, consumer group, and regulator interest.
7. The market is not driven only by actuarial activity, either within insurance firms or more widely, as the value chain consists of a variety of experts and financial services providers. Financial advisers, in particular, play a key role in the market as the first point of contact with customers.
8. The Equity Release Council (ERC) plays a role in setting standards and principles for all participants in the UK market, including how products should be designed to meet customer needs and protect them from potentially significant adverse financial outcomes.
9. Property wealth is a significant asset for many people and, as part of a wider financial services offering, it is right that relevant products exist as an option. It is important that equity release products are designed, priced, and sold in a way that inspires confidence in this market.
10. It is important to recognise that actuaries' skills and judgement can play a key part in balancing the requirements of consumers and firms and assessing the complex risks of this product.

### **C: Scope and Participation**

11. The original published scope of the review set out the following:  

“The actuarial inputs to the design and pricing of equity release mortgages have a direct impact on long-term financial products that are provided to the public. This is a broad and complex area utilising a wide range of actuarial skills including market and product knowledge, technical competency in areas such as option-pricing, property risk, and longevity risk, as well as the requirement for clear communication.”
12. Review methodology:
  - Collecting information from organisations through a review questionnaire.
  - Asking for examples of material produced by actuaries.
  - Researching the business and regulatory environment for equity release products.
  - A high-level review of the current actuarial education and lifelong learning material relevant to equity release.
  - Follow-up interviews with actuaries at participating organisations to understand the context of the questionnaire responses and any work examples received.
13. We invited a range of organisations involved in the equity release market, employing actuaries, to take part in our review. The review was based on responses to a questionnaire and analysis of examples of (redacted) actuarial work.
14. A total of seven organisations took part in the review and are listed below:  
LBG Insurance, L&G, LV=, Key Group, Aviva, Pension Insurance Corporation, Just Group

We believe these organisations represent a sizeable proportion of the equity release market.

## **D: Detailed Review Findings and Conclusions**

15. These headline findings and conclusions aim to highlight the involvement of actuaries in the equity release market, along with key areas of potential risk.

16. **High level of involvement of actuaries**

Our review found a high level of involvement of actuaries in equity release activity beyond the more traditional areas of valuation and capital. This is particularly the case within pricing teams, extending also to wider proposition activity at some organisations. There is some evidence that actuaries are not as directly involved with equity release customer treatment compared to other activities, although there is awareness of the importance of balancing commercial and customer outcomes.

17. **Large potential market for equity release**

There is a large potential market capacity (ie, property wealth), and this, coupled with both industry and customer demand, could lead to material growth in coming years. There may be increased actuarial involvement, with an ongoing public interest role ensuring that long-term risks and potential outcomes are considered on behalf of both customers and firms, from both a conduct and solvency perspective.

18. **Rapidly changing economic environment**

Changing economic conditions, and potential shocks, at the time of preparing this report, mean actuaries, and their organisations, are actively considering assumptions, risk appetite and customer outcomes to ensure products and pricing remain appropriate. The impact of rising inflation and interest rates, at a time of historically high property prices, are likely to create challenges for proposition design, pricing, and fair value assessments. Customers, and their advisers, will also face new challenges in assessing the suitability of equity release in different economic circumstances.

19. **Significant regulatory focus**

In recent years there has been significant UK regulatory activity by both the key insurance market regulators: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). PRA focus has been on the valuation and capital approaches taken by firms holding equity release mortgages on their balance sheets, principally to match annuity portfolios. FCA equity release activity has specifically centred around advice and distribution, looking to ensure that customer fairness and the suitability of the product are key considerations.

20. **Potential legacy issues**

As already highlighted, the involvement of actuaries in equity release extends into proposition and pricing roles. In common with most financial products there is the potential for legacy issues to arise. There has been consumer group, financial media, and regulatory interest in customer fairness outcomes for equity release, understandable given the older demographic for the product. Although actuaries may be more involved in non-customer facing roles, professional and organisational risk still exists.

21. **Coverage in education and lifelong learning material**

Equity release is covered within current IFoA education material and a range of wider potential learning material. Participants in the review indicated that competencies relating to wider property risk and complex illiquid assets may be areas where further support could be

provided for members. Some curation of lifelong learning material was also mentioned as potentially beneficial.

## 22. **Main conclusions**

Our review found that organisations and actuaries view much of equity release pricing and proposition work as (technical) actuarial work, in common with valuation and capital activity. A consideration alongside this is the balance of customer and commercial outcomes, ensuring that propositions are both fair and well understood. This is likely to involve continued interaction with other experts involved in equity release activity at organisations.

There is considerable UK regulatory focus on the equity release market, both from a consumer and prudential perspective. There is also an active industry group (the ERC) that applies its own standards to a wide range of participants in the market. This provides important context as to whether there are any material gaps which actuarial standards or guidance could address to further support members working in this market.

## **E: Discussion**

23. The Board is asked to approve publication of the report and provide a steer on wording of report Foreword.

## **F: Appendices**

24. **Draft full report (pre-design) - Equity release: actuaries working in propositions and pricing**

# Thematic Review Report

Equity release: actuaries working in  
propositions and pricing

by Alan Marshall

# Contents

|  |    |
|--|----|
| Foreword PLACEHOLDER .....               | 3  |
| Introduction.....                        | 4  |
| Executive summary .....                  | 5  |
| Report structure .....                   | 7  |
| Key product features .....               | 9  |
| Business and regulatory environment..... | 11 |
| Involvement of actuaries .....           | 15 |
| Education and lifelong learning .....    | 22 |
| Findings and conclusions.....            | 23 |
| Appendix 1 – Scope and Approach .....    | 25 |
| Appendix 2 – References.....             | 27 |
| Appendix 3 – Abbreviations .....         | 29 |

DRAFT

# Foreword PLACEHOLDER

Neil Buckley, Lay Chair of the IFoA Regulatory Board

[insert chair photo at design stage]

I welcome the publication of the Actuarial Monitoring Scheme's (AMS) latest report, Equity release: actuaries working in propositions and pricing. This continues the regulatory work of the Institute and Faculty of Actuaries (IFoA) in independently reviewing key areas of work in which actuaries have significant involvement and influence. I would like to thank all those IFoA members and organisations that took part.

Equity release products are an established part of the financial services landscape, with actuarial involvement a key aspect of this. This report provides both a clear picture of where actuaries are applying their skills in this market and areas of potential risk as the market for this product continues to grow.

We will consider the findings and conclusions in the context of the regulatory strategy of the IFoA, liaising where necessary with co-regulators with an interest in this.

**Neil Buckley**

**Lay Chair of the IFoA Regulatory Board**

December 2022

# Introduction

## Alan Marshall / Review Actuary

[insert author photo at design stage]

Actuaries have played a leading role in developing the market for equity-release products, where the property wealth of individuals forms the basis for loans. The long-term nature of the product, coupled with risks such as longevity, long-term care need and pricing of options, means that the actuarial skillset is ideally positioned to help deliver a suitable product for both customers and firms. However, this leads to challenges as firms endeavour to develop products that are commercially attractive, while ensuring good value and fair outcomes for consumers. Concerns about equity-release products regarding fair treatment of customers, especially given the potentially vulnerable demographic for these products, have been a regular source of media, consumer group and regulator interest. More recently, there has been added focus on the value placed on these products by firms holding them on their balance sheets, driven principally by regulatory attention from a Solvency II perspective.

The market is not only driven by actuarial activity, either within insurance firms or more widely, as the value chain consists of a variety of experts and financial services providers. Financial advisers, in particular, play a key role in the market as the first point of contact with customers. The Equity Release Council<sup>1</sup> (ERC), a trade body for participants in the UK market, plays a role in setting standards and principles, including how products should be designed to meet customer needs and protect them from potentially significant adverse financial outcomes.

Property wealth is a significant asset for many people and, as part of a wider financial services offering, it is right that relevant products exist as an option. It is important that equity-release products are designed, priced and sold in a way that inspires confidence in this market. Actuaries can employ their skills and judgement to play a key part, balancing the requirements of consumers and firms, and assessing the complex risks of this product.

We would like to thank all actuaries and organisations that took part in our review and hope that the findings are useful to a range of stakeholders.

**Alan Marshall**  
**Review Actuary**  
December 2022

---

<sup>1</sup> The Equity Release Council – the industry body for the UK equity release sector

# Executive summary

These headline findings and conclusions aim to highlight the involvement of actuaries in the equity-release market, along with key areas of potential risk.

## **High level of involvement of actuaries**

Our review found a high level of involvement of actuaries in equity release activity beyond the more traditional areas of valuation and capital. This is particularly the case within pricing teams, extending also to wider proposition activity in some organisations. There is some evidence that actuaries are not as directly involved with customer treatment compared to other equity release activities, although there is awareness of the importance to balance commercial and customer outcomes.

## **Large potential market for equity release**

There is a large potential market capacity (ie property wealth), and this, coupled with both industry and customer demand, could lead to material growth in coming years. There may be increased actuarial involvement, with an ongoing public interest role ensuring that long-term risks and potential outcomes are considered on behalf of both customers and firms, from both a conduct and solvency perspective.

## **Rapidly changing economic environment**

Changing economic conditions, and potential shocks, at the time of preparing this report, mean actuaries, and their organisations, are actively considering assumptions, risk appetite and customer outcomes to ensure products and pricing remain appropriate. The impact of rising inflation and interest rates, at a time of historically high property prices, are likely to mean challenges for proposition design, pricing and fair value assessments. Customers, and their advisers, will also face new challenges in assessing the suitability of equity release in different economic circumstances.

## **Significant regulatory focus**

In recent years there has been significant UK regulatory activity by both of the key insurance market regulators: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). PRA focus has been on the valuation and capital approaches taken by firms holding equity-release mortgages on their balance sheets, principally to match annuity portfolios. FCA equity-release activity has specifically centred around advice and distribution, looking to ensure that customer fairness and the suitability of the product are key considerations.

## **Potential legacy issues**

As already highlighted, the involvement of actuaries in equity release extends into proposition and pricing roles. In common with most financial products, there is the potential for legacy issues to arise.

There has been consumer group, financial media and regulatory interest in customer-fairness outcomes for equity release – understandable given the older demographic for the product. Although actuaries may be more involved in non-customer facing roles professional and organisational risk still exists.

### **Coverage of education and lifelong learning material**

Equity release is covered within current IFoA education material and a range of wider potential learning material. Participants in the review indicated that competencies relating to wider property risk and complex illiquid assets may be areas where further support could be provided for members. Some curation of lifelong learning material was also mentioned as potentially beneficial.

### **Main conclusions**

Our review found that organisations and actuaries view much of equity-release pricing and proposition work as (technical) actuarial work, in common with valuation and capital activity. A consideration alongside this is the balance of customer and commercial interests, ensuring that propositions are both fair and well understood. This is likely to involve continued interaction with other experts involved in equity-release activity in organisations.

There is considerable UK regulatory focus on the equity-release market, both from a consumer and prudential perspective. There is also an active industry group (the ERC) that applies its own standards to a wide range of participants in the market. This provides important context as to whether there are any material gaps that actuarial standards or guidance could address to further support members working in this market.

# Report structure

## How this report should be read

We have set out in this report the detailed results of our thematic review. The Executive Summary sets out our key findings and conclusions; a full list can be found on page 23.

## Findings and conclusions

The main output of this review is a series of findings based on the questionnaires and examples of actuarial work submitted, conversations with actuaries in this field, and analysis of other sources and material relevant to the topic.

We have also set out conclusions highlighting where actuaries, regulators and other stakeholders might consider further work to follow-up in light of one or more of the findings.

## Good practice examples

During this review, we observed instances of what may be considered good practice. Each good practice example is based on one or more of the examples of advice we reviewed. Note that the appropriate wording will depend on the specific context so the same wording may not be appropriate in all scenarios. There will be other ways of conveying a particular point.

## References and abbreviations

Referenced documents or webpages are shown by footnotes on the relevant page. A full list of documents is set out in Appendix 2. Although abbreviations are defined when they first appear in this report, a full list is set out in Appendix 3.

## Status of report

This report has been prepared by the IFoA Review Team and is issued by the Regulatory Board of the IFoA. Its purpose is to report on findings of the thematic review on the involvement of actuaries in equity-release mortgages proposition and pricing work.

This report imposes no obligation upon members over and above those embodied in the Actuaries' Code<sup>2</sup> or the IFoA Standards Framework,<sup>3</sup> which includes compliance with the Technical Actuarial Standards (TASs) set by the Financial Reporting Council (FRC). It is intended to be helpful to the IFoA and other regulators when considering developments in regulation. It is also intended to help actuaries in their work in this field.

This report does not constitute legal advice. While care has been taken to ensure that it is accurate, up to date and useful, the IFoA does not accept any legal liability in relation to its content.

---

<sup>2</sup> The Actuaries' Code is the ethical Code of Conduct that all members of the IFoA must adhere to

<sup>3</sup> Standard Setting at the IFoA (2020)

### **Review of this report**

An earlier draft of the report has been subject to review by an IFoA colleague with equity-release knowledge, who did not otherwise take part in the review.

This, along with additional editing reviews, is considered by the author to meet the Work Review requirements of Actuarial Profession Standard (APS) X2.<sup>4</sup>

We wish to thank the above individuals for their review comments, although the contents of this report, in particular the findings and observations within, remain the responsibility of the IFoA Review Team.

### **Conflicts of interest**

We are not aware of any conflicts of interest arising from the contents of this report in relation to the Review Team that carried out the work or the Regulatory Board that has commissioned the review work.

### **Questions about this report**

We welcome questions about this report which should be sent to [reviews@actuaries.org.uk](mailto:reviews@actuaries.org.uk) or to:

Actuarial Monitoring Scheme  
Institute and Faculty of Actuaries  
Level 2, Exchange Crescent  
7 Conference Square  
Edinburgh EH3 8RA

---

<sup>4</sup> APS X2 – review of actuarial work

# Key product features

## What is an equity-release product?

Equity-release products are provided by financial services organisations to homeowners based on the value of the property and other criteria, depending on the product and customer circumstances. There are two main types of products in the UK market:

- Lifetime mortgages
- Home reversion plans

Most historical loans, and the vast majority of products currently in the market, are lifetime mortgages; these are the focus of this report.

The key features of lifetime mortgages are as follows:

- The customer (or customers for a joint-life mortgage) is given a lump sum, which tends to roll-up with interest, and is repayable on the death, or movement to long-term care, of the customer, using sale proceeds of the property.
- The size of the lump sum depends on the value of the property and the age of the customer at the time the loan is taken out. Loan providers apply a sliding scale of 'loan-to-value' (LTV) percentages, ranging from around 20% at younger ages to 50% at older ages, that determine the maximum amount of loan they are prepared to offer the customer.
- It is also common for products to have a drawdown feature by which additional amounts can be borrowed at a later date, subject to LTV constraints.
- Products on the market today, and most of those sold historically, have a 'no-negative equity guarantee' (NNEG), that means the customer, or their beneficiaries, will not have to repay any amount above the sale value of the property at the point the loan is repaid.
- Many products allow for partial or full early repayments to be made, although this may attract an early repayment charge. It is also usually possible to transfer a loan to a new property, subject to underwriting conditions being met.

Key considerations for potential customers may include:

- Advice options and range of product providers
- What other sources of savings or income do they have access to?
- Are there tax and/or welfare benefit implications from taking out a lifetime mortgage?
- Are there other options they could consider in relation to their property, eg downsizing?
- Is it important to them that their family to inherit the property?

A combination of these important considerations, the complexity of the product and the long-term nature of the commitment means that most mainstream providers have in place a requirement for financial advice to be taken before a customer takes out the loan. This may be with an adviser linked to a specific lifetime mortgage provider or through an independent financial adviser who has access to products across a range of providers.

### **Why do insurance companies sell these products?**

Insurance companies are the main source of funding for lifetime mortgages, either selling directly or through distribution-focused organisations. Ultimately, the underlying mortgages will end up on an insurance company balance sheet.

The main reason for this is that the product is considered a good match to annuity liabilities and is therefore held, alongside other assets, as part of Solvency II matching adjustment portfolios (ring-fenced asset portfolios identified as a specific match for annuity liabilities).

DRAFT

# Business and regulatory environment

## The UK equity-release market

The ERC publishes regular key [market statistics](#)<sup>5</sup> and [reports](#).<sup>6</sup> Recent publications indicate that something in the order of £4bn of equity was released through lifetime mortgage products during each of 2018-2020, increasing to almost £5bn in 2021. The average property value of new customers has also grown steadily in recent years and sits around the £400k-450k mark. Around 60% of products are drawdown plans, with average initial loan amounts of c. £90k. For lump-sum products the average loan amount is c. £120k.

Over the period 2016-2021 the average rate of interest charged reduced from a little over 6% to a little under 4% (this makes a material difference to the rolled-up amount over the lifetime of a typical mortgage). Current market conditions (Q4 2022) have seen rates move back up towards 6% again, with further increases possible given the volatile economic environment.

The average age of customers taking out new plans is 68-70, hence the focus on how products are sold.

An [Actuary magazine news item](#)<sup>7</sup> from August 2022 mentioned that equity in UK homes owned by over-55s had reached £800bn for the first time, indicating a measure of potential market capacity.

**Finding 1:** The lifetime mortgage market has grown over 2021 and 2022, and there is significant capacity of house wealth in the UK.

As mentioned above, the key providers in the market are insurance companies. However, in our discussions with insurance actuaries it was mentioned that pension funds, and other types of investors seeking diversification, are becoming interested in providing funding to the market.

## UK regulatory activity

In recent years there has been significant UK regulatory activity by both of the key insurance market regulators: the PRA and the FCA.

---

<sup>5</sup> ERC Q4 and FY 2021 market statistics

<sup>6</sup> ERC Autumn 2022 Market Report

<sup>7</sup> Actuary magazine – record level of equity

PRA focus has been on the valuation and capital approaches taken by firms holding equity-release mortgages on their balance sheets, principally to match annuity portfolios.

In 2017 the PRA published Supervisory Statement SS3/17,<sup>8</sup> with updates in 2019 and 2020. These set out regulatory expectations for the treatment of equity release for Solvency II purposes (see also PS31/18 and PS19/19), which came into force on 31 December 2019. The concept of the Effective Value Test (EVT) was introduced as a means of ensuring that firms did not take undue matching adjustment benefit for restructured equity-release assets. This has direct relevance to actuarial work, as it is in these areas where actuaries are most likely to be involved.

Following submissions by relevant firms to the PRA since the introduction of this approach, a 'Dear Chief Actuary' feedback letter<sup>9</sup> was published by the PRA in March 2021, setting out points of clarification and areas where increased consistency is being sought.

Specific FCA equity-release activity has centred around advice and distribution. The FCA carried out some investigative work in relation to the activities of mortgage advisers for later life lending. This resulted in key findings released in June 2020: The equity release sales and advice process,<sup>10</sup> with guidance for both advisers and consumers, flagging the importance of advice reflecting the needs and circumstances of the individual. The FCA is undertaking further work to review the suitability of advice in this market, and recently issued a 'Dear CEO' letter<sup>11</sup> that highlighted the regulator's view of key harms and intended supervisory strategy for lifetime mortgages.

Additionally, the recent FCA Consumer Duty policy statement<sup>12</sup> and guidance are also very relevant from both a legacy and new business standpoint. Pricing and product management work, and actuaries involved in these, are directly impacted by this regulation, which comes into force in the second half of 2023. For actuaries in decision and influence roles it may be that they have responsibility for meeting the specific rules set out by the FCA.

**Finding 2:** There has been a high level of regulatory activity in recent years, both by the PRA, from a prudential perspective, and the FCA, from a consumer perspective.

In the Joint Forum on Actuarial Regulation (JFAR) Risk Perspective<sup>13</sup> (including in the most recent 2021 refresh) equity-release mortgages are mentioned as part of the 'Unfair outcomes for individuals' and 'Geopolitical, legislative, and regulatory risk' hotspots. In addition to describing PRA and FCA

---

<sup>8</sup> PRA Supervisory Statement SS3/17 – illiquid unrated assets and equity release mortgages

<sup>9</sup> PRA Chief Actuary letter March 2021

<sup>10</sup> FCA – the equity release sales and advice process key findings

<sup>11</sup> FCA CEO letter June 2022

<sup>12</sup> FCA Consumer Duty PS22/9

<sup>13</sup> JFAR Risk Perspective 2021

activity, the *Risk Perspective* highlights the risk of consumers not having full understanding of the impact of compound interest roll-up within equity-release products.

The Equity Release Council is an industry body that sets standards and principles which all members must follow. This includes the requirement that all products must include an NNEG.

### **Changing economic environment**

Global events since 2020, as well as issues specific to the UK economy, are driving material changes in the economic environment for lifetime mortgages (and, of course, other financial services products). This may lead to changes both in customer behaviour and the proposition and pricing activity of organisations in the market.

In particular, cost-of-living pressures may mean consumers look for other available sources of finance available to them, which may be house wealth. The recent significant changes in interest rates will also affect affordability of products, with debt rolling up at potentially much higher rates. In this context it becomes even more important for consumers to fully understand the product and the impact of compounding interest.

Changing economic conditions, and potential shocks, mean actuaries, and their organisations, will need to actively consider assumptions, risk appetite and customer outcomes to ensure products and pricing remain appropriate. The impact of rising inflation and interest rates, at a time of historically high property prices, is likely to mean challenges for proposition design, pricing and fair value assessments.

**Finding 3:** Changing economic conditions, and potential shocks, mean actuaries, and their organisations, will need to actively consider assumptions, risk appetite and customer outcomes to ensure products and pricing remain appropriate. Customers, and their advisers, will also face new challenges in assessing the suitability of equity release in different economic circumstances.

### **Potential legacy issues**

In our discussions with actuaries, legacy issues were not seen as an issue specific to lifetime mortgages, when compared to other products provided by insurers. It was acknowledged that the complexity and long-term nature of the product could lead to some issues arising; however, this was not something organisations had experienced to a great degree.

There has been consumer group, financial media and regulatory interest in customer fairness outcomes for equity release, understandable given the older demographic for the product. A recent

Financial Services Consumer Panel (FSCP) research report<sup>14</sup> indicated some issues around how well vulnerable consumers, in particular, understood the product.

Although actuaries may be more involved in non-customer facing roles, there is still an important role to play in ensuring both professional and organisational risk is managed appropriately, in particular balancing consumer and commercial outcomes for this complex product.

**Finding 4:** In common with most financial products there is the potential for legacy issues to arise. There has been consumer group, financial media and regulatory interest in customer fairness outcomes for equity release, understandable given the older demographic for the product.

---

<sup>14</sup> Equity release and alternative products – a consumer perspective on experiences and outcomes

# Involvement of actuaries

## Scope and approach

The focus of this review was on the involvement of actuaries in proposition and pricing activity for equity-release loans. We invited a range of organisations involved in the equity-release market, that employ actuaries, to take part in our review. A review questionnaire comprised the main element of the review, along with follow-up interviews with participants. For more detail on the scope and approach please see Appendix 1.

## Use of terminology

Terminology used in the questionnaire and this report is explained as follows:

| Terminology                     | Explanation  |
|---------------------------------|--|
| <b>Propositions</b>             | Activities relating to the design and management of existing and new products                              |
| <b>Pricing</b>                  | Activities relating to the setting of customer prices, or origination prices                               |
| <b>Distribution</b>             | Consumer advice and sales activity   |
| <b>Manufacture</b>              | Product design and origination activity  |
| <b>Warehouse</b>                | Holding ERM on the balance sheet   |
| <b>Analytical and technical</b> | Roles focused on the data and modelling parts of the process   |
| <b>Decision and influence</b>   | Managerial and/or director roles with specific proposition or pricing responsibilities                     |
| <b>Validation and oversight</b> | First or second-line roles with responsibility for review and challenge of proposition or pricing activity |

Where we provided 'High', 'Medium' and 'Low' options in the questionnaire it was intended that answers should be given on a 'best endeavours' basis, providing a broad indication of the position at the organisation. An analogous scale might be 'Significant/Reasonable/Minimal'.

## **Participant information**

We received questionnaire responses from seven participating organisations. This represented annual new business of £3.7bn, and overall balance sheet amounts of £33bn (business models of different participants will mean some double counting in these figures). This represents a high proportion of both new business sales and historical volumes.

All but one of the participants are involved in the distribution, manufacturing and warehousing of loans to some extent. One of the participants was involved in distribution and manufacturing, with loans then sold to third-party firms to hold on their balance sheet. Most of the participating firms have sold loans for at least 10 years. Only lifetime mortgages are sold by the participating firms.

All the participating organisations are members of the Equity Release Council.

## **Overall involvement of actuaries in equity-release work**

We asked several questions about the overall involvement of actuaries in equity-release work (across a range of functions) and how actuaries interact with other specialists.

### **Customer treatment and conduct risk**

Involvement in this aspect is mainly low or medium, and actuarial involvement was typically less, or the same, as other specialists.

### **Propositions and pricing**

For these functions the involvement of actuaries is mainly high and either the same or higher than other specialists.

### **Valuation and capital**

Unsurprisingly, in this function involvement of actuaries is always high and more than other specialists.

### **Other specialists**

We asked about the involvement of a range of other potential specialists in equity-release work. Customer treatment specialists are the most common, closely followed by investment specialists and property underwriting specialists. Data scientists, banking specialists and risk specialists were mentioned, although less frequently.

## **Focus on propositions and pricing work**

We asked about actuarial involvement across a range of aspects of proposition and pricing work, considering different types of potential roles. The following table shows a 'heatmap' of the different aspects of activity we asked about (darker shade indicating a higher level of involvement).

| Activity                                 | Analytical and Technical | Decision and Influence | Validation and Oversight |
|--|--------------------------|------------------------|--------------------------|
| Product design                           | Medium/High              | Low/Medium             | High                     |
| Managing and reviewing existing products | High                     | Medium                 | High                     |
| Property Underwriting                    | Medium/High              | Low/Medium             | Medium/High              |
| Customer Pricing                         | Medium                   | High                   | Medium/High              |
| Origination Pricing                      | Medium/High              | High                   | Medium                   |
| Structuring                              | Low                      | High                   | Medium                   |

### Analytical and technical roles

The responses indicate a generally medium to high involvement of actuaries in product design and management analytical and technical activity. Property underwriting is also an area of significant involvement. Pricing activity scores less highly, origination a little higher than customer pricing. It is sometimes the case that technical customer pricing sits with a third-party organisation. Finally, structuring (where underlying mortgage cashflows are split into different investment notes to meet Solvency II requirements) is not an area of high involvement for analytical and technical work (but see the 'Decision and influence' summary below).

### Decision and influence roles

Overall, when considering decision and influence activity (compared to analytical and technical), the responses tended to reverse themselves to an extent. Actuaries have consistently high levels of involvement across pricing and structuring, perhaps suggesting more senior involvement in these aspects. For pricing and structuring activity, the involvement was high across all participants.

### Validation and oversight roles

For validation and oversight activity, there was more correlation to analytical and technical work. This suggests that where actuaries have high involvement in detailed activity there is more likelihood they will also be highly involved in the oversight of such work. The responses indicate a high level of actuarial involvement in the oversight of product design and ongoing product management activity.

### Key involvement examples

We asked for examples where actuaries had key involvement in proposition and pricing work. The responses show a wide range of examples across pricing, product design and profitability assessment activities.

*“The Lifetime Mortgage Pricing team is responsible for proposing rate changes and this team is comprised of 2 qualified actuaries and a nearly qualified actuary. Change proposals are subject to approval at the Lifetime Mortgage (LTM) Funding Committee, whose membership includes actuaries.”*

*“When a new product proposal is put forward by the product/propositions team (non-actuarial), the actuarial team will assess the commercial, pricing, and financial risk implications. The primary role is to assess profitability and manage Insurance and Market risks, involvement in assessing Conduct risk is more limited.”*

*“Interest rates charged to customers are updated regularly by the actuarial team under the Head of Pricing. There is also analysis work on loan-to-value levels.”*

*“Funding and Product team has two fully qualified and two part-qualified actuaries. This team is pivotal in creating pricing and proposition offers.”*

*“Actuaries are responsible for the day to day setting of prices (interest rates, fees, and loan to values) for equity release mortgages. This includes daily monitoring of the market (changes in economic environment as well as movements by competitors) and impact on profitability and customer value. Actuaries take the lead in proposing and approving changes to prices as well as providing second line oversight. Actuaries are also involved in both proposing changes to the ERM proposition as well as providing approval to any changes.”*

*“We have an ERM team that includes both actuaries and non-actuaries that work alongside manufacturers, conduct/compliance, investment, and risk professionals. 2nd line is covered by both actuaries and non-actuaries. We do not consider ERM to be the exclusive domain of actuaries and do not deliberately recruit actuaries to work in these roles (although as noted some team members are actuaries).”*

*“Areas of actuarial activity include:*

- *Calculating the contribution to new business profit and capital strain to establish appropriate LTM loan rates.*
- *Modelling and setting assumptions for cashflow projections (longevity, entry to care and voluntary repayment).*
- *Proposing maximum LTV scales and monitoring a NNEG budget to control risk on new LTMs.*

- *As an example, where the early repayment charge was varied an assessment by our demographic risk team (by actuaries) of the impact on voluntary repayment rates is performed.”*

### **Responsibility and governance**

There is a range of roles with ultimate responsibility for equity-release propositions and pricing, typically at Director or Executive level. Within this we found a broadly even split of actuaries and non-actuaries currently holding this role.

Actuaries are heavily involved in key governance forums, representing a range of functions within the process. Governance forums included pricing committees or forums, funding committees and proposition development committees. Key roles held by actuaries attending these groups included Chief Financial Officer, Head of Pricing and Head of Risk. Often more senior committees with a wider remit than just equity release will see strategic proposals, in addition to lower-level committees dealing with the underlying business-as-usual material.

### **Role of the Chief Actuary / actuarial function**

The involvement of the Chief Actuary, or their team, tends to be at a higher level of committee than those tasked with day-to-day decisions. This may typically be through committee meetings where significant pricing or proposition decisions are being taken, or through finance or risk committees to which equity-release matters were escalated. The Chief Actuary role may sit in either first or second line, with our findings indicating slightly more in first line.

### **Monitoring customer fairness**

The approaches adopted tend to combine an overarching conduct framework with ongoing monitoring reported to relevant forums or committees. Organisations mentioned to us approaches such as fair value assessments and gated review processes to monitor customer fairness for pricing and proposition proposals. Conduct issues are a key part of the processes adopted, and there are often metrics in place to provide regular performance monitoring in this area. Although actuaries are involved, this is an area where it is perhaps less prevalent, although those in senior pricing and proposition roles are present at key forums and committees. In one example actuaries managed the fairness of the product pricing and design, as opposed to day-to-day customer treatment, which was the domain of compliance professionals.

**Finding 5:** Our review found a high level of actuarial involvement beyond the more traditional areas of valuation and capital. This is particularly the case within pricing teams, extending also to wider proposition activity at some organisations. There is some evidence that actuaries are not as directly involved with customer treatment, although there is awareness of the importance of balancing commercial and customer outcomes.

## Climate-related risk

Following on from the Actuarial Monitoring Scheme information-gathering exercise in 2021, we asked organisations to what extent climate-related risk featured in equity-release proposition and pricing work and to describe actuarial involvement with this. For some organisations assessments are at an early stage, while for others there is more advanced consideration. This can be impacted by the business model and the extent to which property risk is maintained on the balance sheet.

The involvement of actuaries tended to mirror the organisational position on this.

## Actuarial standards and guidance in equity-release work

We asked questions to get a picture of how actuaries and their organisations view equity-release work in the context of actuarial standards.

### What is defined as (technical) actuarial work?

Many participants consider pricing, valuation and capital activity as being actuarial work, as defined by actuarial standards. Product management was not typically seen as actuarial work. Several documents were quoted as examples:

- Parameter calibration papers
- Basis and methodology reviews
- Key pricing and proposition proposals.

The standards that are in place are seen by our participants to be at around the right level, although one participant indicated that it was 'too little'.

Comments received on this included:

*"We are not aware of any specific reference to ERMs in current actuarial standards and guidance, nor do we see a need for any such standards or guidance."*

*"The guidance for actuaries appears to be sufficient and well in line with the guidance for other investment and insurance products (eg, annuities, protection, unit linked)."*

*"There is a range of actuarial involvement in activities connected to ERMs, ranging from simple BAU tasks to complex modelling involving data science techniques as well as the construction and use of stochastic models. The current actuarial standards and guidance mirror the potential range of activities."*

*"TAS 100 establishes sufficient principles that cover the modelling of ERMs. The regulator has established clear and precise minimum standards for capital treatment of LTM and the IFoA has issued several research papers over the years. The FCA has clear principles for the fair treatment of LTM customers through including the recent Customer Duty regulations."*

As part of the review, we received a small number of actuarial work submissions alongside the questionnaire responses. These were all committee-style papers, with clearly set-out topics and conclusions, and our review of these confirmed good coverage of TAS requirements. Additionally, there were best practice compliance statements in all the examples, covering both TAS and APS requirements.

**Finding 6:** From questionnaire responses, follow-up discussions, and the examples of work that we saw, it is clear that actuaries and their organisations consider equity-release pricing, in common with valuation and capital activity, as (technical) actuarial work.

DRAFT

# Education and lifelong learning

## Education syllabus

As part of the review, we considered at a high-level the current learning resources available to trainee and qualified actuaries. We also asked participants for their views on this.

In common with other product types, there is outline information provided on equity release within the current IFoA education material (within subject SA2 Life Insurance). Additionally, the more traditional risks of the product, both market and demographic, are covered in different parts of the overall syllabus. The April 2022 SA2 exam featured a question covering equity-release proposition and pricing considerations.

Review participants commented that the product is now seen as more mainstream, although, even within the life sector, many actuaries may not have come across it during their training and work to date.

The main risk that is peculiar to equity release is NNEG risk, essentially a long-term residential property put option. This is made more complex in that each property represents an individual risk, with both geographical and property-related sub-risks to consider (eg dilapidation risk).

Although firms may have other experts to manage such risks, for example property investment and underwriting specialists, review participants commented that it is important that actuaries have an awareness of the more complex risks faced for an equity-release product.

Participants in general did not think there needed to be additional material specific to equity-release products. However, some participants did say areas such as property risk, both residential and commercial, and more generally valuation techniques for illiquid assets could be competencies where actuaries may benefit from further support.

There is a large number of papers and presentations available on equity release, both academic and industry driven. Although the material has tended to focus on valuation and capital from an actuarial perspective, it also includes significant references to the specific risks of the product. Some participants suggested there may be value in curating some of this material for easier access to IFoA members and other interested parties.

**Finding 7:** Equity release is covered within current IFoA education material and a range of wider potential learning material. Participants in the review indicated that competencies relating to wider property risk and complex illiquid assets may be areas where further support could be provided for members. Some curation of lifelong learning material was also mentioned as potentially beneficial.

# Findings and conclusions

A full list of our findings and conclusions is given in the table below. These are set out in the order they appear in this report.

## Findings

| No | Finding   |
|----|---|
| 1  | The lifetime mortgage market has grown over 2021 and 2022, and there is significant capacity of house wealth in the UK.   |
| 2  | There has been a high level of regulatory activity in recent years, both by the PRA, from a prudential perspective, and the FCA, from a consumer perspective.   |
| 3  | Changing economic conditions, and potential shocks, mean actuaries, and their organisations, are actively considering assumptions, risk appetite and customer outcomes to ensure products and pricing remain appropriate. Customers, and their advisers, will also face new challenges in assessing the suitability of equity release in different economic circumstances   |
| 4  | In common with most financial products there is the potential for legacy issues to arise. There has been consumer group, financial media, and regulatory interest in customer fairness outcomes for equity release - understandable given the older demographic for the product.  |
| 5  | Our review found a high level of actuarial involvement beyond the more traditional areas of valuation and capital. This is particularly the case within pricing teams, extending also to wider proposition activity at some organisations. There is some evidence that actuaries are not as directly involved with customer treatment, although there is awareness of the importance to balance commercial and customer outcomes. |
| 6  | From questionnaire responses, follow-up discussions, and the examples of work we did see, it is clear that actuaries and their organisation consider equity release pricing, in common with valuation and capital activity, as (technical) actuarial work.  |
| 7  | Equity release is covered within current IFoA education material and a range of wider potential learning material. Participants in the review indicated that competencies relating to wider property risk and complex illiquid assets may be areas where further support could be provided for members. Some curation of lifelong learning material was also mentioned as potentially beneficial.                                 |

## Conclusions

| No | Conclusions  |
|----|--|
| 1  | Our review found that organisations and actuaries view much of equity-release pricing and proposition work as (technical) actuarial work, in common with valuation and capital activity. A consideration alongside this is the balance of customer and commercial considerations, ensuring that propositions are both fair and well understood. This is likely to involve continued interaction with other experts involved in equity-release activity in organisations. |
| 2  | There is considerable UK regulatory focus on the equity-release market, both from a consumer and prudential perspective. There is also an active industry group (the ERC) that   |

applies its own standards to a wide range of participants in the market. This provides important context as to whether there are any material gaps that actuarial standards or guidance could address to further support members working in this market.

DRAFT

# Appendix 1 – Scope and approach

This Thematic Review was announced in December 2020 as:

## **Equity-release mortgage product design and pricing**

The actuarial inputs to the design and pricing of equity release mortgages have a direct impact on long-term financial products that are provided to the public. This is a broad and complex area, utilising a wide range of actuarial skills, including market and product knowledge, technical competency in areas such as option-pricing, property risk and longevity risk, as well as the requirement for clear communication.

The review will look at current actuarial practice to understand the processes adopted and challenges faced when providing advice in this area. The review will also consider reserving approaches and the associated adherence to technical actuarial standards.

As indicated in this headline scope, our focus has been on the advice given by actuaries on proposition and pricing activity for equity-release loans. We commenced our review in December 2021.

The IFoA website provides more information on [the work of the AMS Team](#).

## **Submissions**

We invited a range of organisations involved in the equity-release market, who employ actuaries, to take part in our review. A review questionnaire comprised the main element of the review, and we also requested examples of (redacted) actuarial work to be submitted too.

## **Participation level**

A total of seven organisations took part in the review and are listed below:

LBG Insurance

L&G

LV=

Key Group

Aviva

Pension Insurance Corporation

Just Group

We believe these organisations represent a sizeable proportion of the equity-release market.

### **Review methodology**

The review was carried out in a number of ways:

- Collecting information from organisations through a review questionnaire
- Asking for examples of material produced by actuaries
- Researching the business and regulatory environment for equity-release products
- A high-level review of the current actuarial education and lifelong learning material relevant to equity release
- Follow-up interviews with actuaries at participating organisations to understand the context of the questionnaire responses and any work examples received.

DRAFT

# Appendix 2 – References

| Report footnote | Title   | Author      | Description   |
|-----------------|---|-------------|---|
| 1               | The Equity Release Council - the industry body for the UK equity release sector | ERC         | Website of the ERC  |
| 2               | The Actuaries' Code   | IFoA        | The Actuaries' Code is the ethical Code of Conduct that all members of the IFoA must adhere to  |
| 3               | Standard Setting at the IFoA (2020)   | IFoA        | Information about the Standards Framework and the principles that inform standard setting at the IFoA   |
| 4               | APS X2 – review of actuarial work   | IFoA        | Actuarial professional standard setting out types of review to be applied to actuarial work   |
| 5               | Q4 and FY 2021 market statistics  | ERC         | Regular market statistics released by the ERC   |
| 6               | Autumn 2022 Market Report   | ERC         | Annual market report released by the ERC  |
| 7               | Actuary magazine – record level of equity                                       | The Actuary | News item highlighting high and rising levels of home equity held by over 55s   |
| 8               | SS3/17 – illiquid unrated assets and equity release mortgages                   | PRA         | Supervisory statement which included the treatment of equity release for Solvency II purposes   |
| 9               | Chief Actuary letter March 2021   | PRA         | Follow-up letter with feedback from regulatory activity   |
| 10              | Equity release sales and advice process key findings                            | FCA         | Key findings from FCA review of equity release processes  |
| 11              | CEO letter June 2022  | FCA         | Letter setting out supervisory strategy for Lifetime Mortgage Providers   |
| 12              | Consumer Duty PS22/9  | FCA         | Policy statement setting out requirements for firms on the treatment of consumers   |
| 13              | Risk Perspective 2021   | JFAR        | Publication to raise awareness of the risks to, and the importance of, high-quality actuarial work in mitigating the risk to the public interest. |

| Report footnote | Title  | Author | Description  |
|-----------------|--|--------|--|
| 14              | Equity release and alternative produces – a consumer perspective on experiences and outcomes | FSCP   | A report from the Financial Services Consumer Panel setting out experiences gathered from a range of equity release customers. |

DRAFT

# Appendix 3 – Abbreviations

List of abbreviations used in this report:

| Abbreviation | Full term                           |
|--------------|-------------------------------------|
| ERC          | Equity Release Council              |
| ERM          | Equity release mortgage             |
| FCA          | Financial Conduct Authority         |
| FRC          | Financial Reporting Council         |
| FSCP         | Financial Services Consumer Panel   |
| IFoA         | Institute and Faculty of Actuaries  |
| JFAR         | Joint Forum of Actuarial Regulation |
| LTM          | Lifetime mortgage                   |
| PRA          | Prudential Regulatory Authority     |

**DISCLAIMER** The views expressed in this publication are those of invited contributors and not necessarily those of the Institute and Faculty of Actuaries. The Institute and Faculty of Actuaries do not endorse any of the views stated, nor any claims or representations made in this publication and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this publication. The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this publication be reproduced without the written permission of the Institute and Faculty of Actuaries.

### **Beijing**

14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004  
Tel: +86 (10) 6535 0248

### **Edinburgh**

Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA  
Tel: +44 (0) 131 240 1300 · Fax: +44 (0) 131 240 1313

### **Hong Kong**

1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong  
Tel: +852 2147 9418

### **London (registered office)**

7<sup>th</sup> Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP  
Tel: +44 (0) 20 7632 2100 · Fax: +44 (0) 20 7632 2111

### **Oxford**

1<sup>st</sup> Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD  
Tel: +44 (0) 1865 268 200 · Fax: +44 (0) 1865 268 211

### **Singapore**

163 Tras Street · #07-05 Lian Huat Building · Singapore 079024  
Tel: +65 6906 0889