Institute and Faculty of Actuaries

CP17/32: Quarterly Consultation Chapter 9: Retirement Interest-only Mortgages

IFoA response to Financial Conduct Authority

1 November 2017

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute
and Faculty
of Actuaries

Pippa Lane
Mortgage Policy
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

1 November 2017

Dear Pippa,

IFoA response to CP17/32: Quarterly Consultation
Chapter 9: Retirement Interest-only Mortgages

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's consultation on its proposed changes to access to retirement interest-only mortgages.

2. The IFoA's Equity Release Mortgage working party, Life Standards and Consultations sub-Committee and Life Board have all been involved in the drafting of this response. Some members of the working party, Committee and Board work for product providers active in the equity release mortgage market.

3. Our response focusses on one of the two questions within the FCA's consultation on this topic:

Q9.1 Do you agree with our proposed approach to retirement interest-only mortgages?

4. We believe that the proposed approach may be incompatible with the FCA's general duties under section 1B of FSMA, to protect and enhance confidence in the UK financial system. This relates to the points made below regarding advice, and our question over there being appropriate levels of consumer protection under the proposal.

5. The equivalent of retirement interest-only mortgages are currently sold in the market as variants of interest roll-up lifetime mortgages. In our opinion similar safeguards should continue to apply to both types of mortgage.

6. We do not agree with the premise expressed in paragraph 9.3 that retirement interest-only mortgages have significantly different risks compared to lifetime mortgages. The risk of rapid equity erosion still exists in a retirement interest-only mortgage since, by not featuring the roll-up of interest, a higher loan-to-house value is likely to be offered. The arrangement remains exposed to the risk of a house price crash.

7. The payment of interest introduces further risks: pensioner income and expenditure may not be stable. For example, income may drop significantly on the death of a spouse, and in the light of the recent pension freedoms, it is plausible that fewer pensioners will have an annuity in the future. The risk of an interest payment shortfall leading to early repossession is therefore greater than for roll-up lifetime mortgages.

8. We also disagree with the comment that consumers are more likely to be familiar with the product features of a mortgage involving interest payments. We think there is significant scope for confusion among elderly consumers of the product features of a retirement interest-only mortgage. There is the risk of repossession if the customer cannot keep up repayments on their mortgage, irrespective of their age or state of health.

9. There is a no-negative-equity guarantee on interest-serviced mortgages. Such a guarantee protects family estates from having to pay any outstanding debts due to the property sales proceeds being less than the accrued loan. However, there is no such protection on a retirement interest-only mortgage. We believe that allowing retirement interest-only mortgages to be issued without a no-negative-equity guarantee could lead to consumer detriment, and goes against the FCA's aim 'to promote effective competition in the interests of consumers'.

   Although not an FCA requirement, lifetime mortgages meeting the Equity Release Council's standards are required to have a no-negative-equity guarantee.

10. We also believe that financial advice should be mandatory for anyone seeking to take out a retirement interest-only mortgage. If an individual does not receive independent financial and legal advice as standard, it could then lead to consumer detriment. This is particularly the case if they are using the mortgage to release equity from their property, which could have a negative impact on their entitlement to benefits or to tax payable. It could also lead to borrowers having less protection than that currently available in the equity release market for those borrowing from providers who are members of the Equity Release Council.

11. We also believe that there should be greater clarity in the FCA's proposals over what will happen when a consumer defaults on their interest payments. If consumers are allowed to continue in their property with interest rolling-up, then will the provider be required to hold capital for the implicit no-negative-equity guarantee that is being offered? This in turn could see any increase in provider costs passed on to future consumers.

Should you want to discuss any of the points raised please contact Steven Graham, Technical Policy Manager at Steven.Graham@actuaries.org.uk or on 020 7632 2146 in the first instance.

Yours sincerely,

Marjorie Ngwenya
President, Institute and Faculty of Actuaries