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Equity Release Mortgages: Irish Experience

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What is an Equity Release Mortgage?

- Loan taken out by a property owner, secured on the property.
- The loan is repaid when the borrower dies (or goes into long-term care).
- Interest (eg at 5% pa) is rolled up on the loan balance so the borrower, while alive, makes no interest payments.
- No-negative-equity guarantee (NNEG): if loan balance on death exceeds the house value, then lender absorbs the shortfall.



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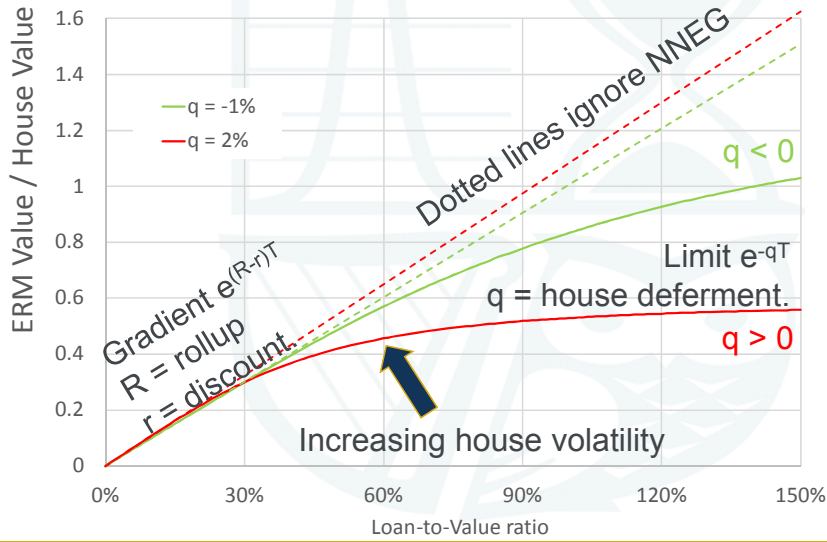
How big is the Market?

- The ERM market has grown substantially in the UK; in Q3 2019 £988m was lent (source: Equity Release Council)
- Irish market is (disproportionally) smaller, more often floating rate than fixed, and has been financed by banks rather than insurers.
- No recent lending in IE and outstanding balances around €300m. However, at least one lender (Seniors Money) has stated an intention to re-enter the market in 2020.

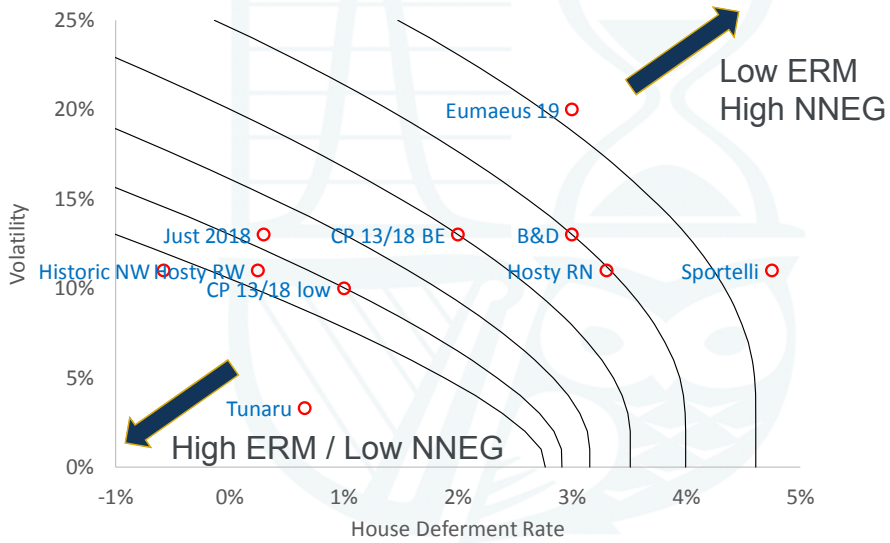
Regulatory Impact: Discounting Annuities

- Why do annuity writers fund ERMs?
 - ERMs initially excluded from Solvency II Matching Adjustment
 - But fixed rate ERMs now permitted with some restructuring
 - Discount rate boost higher for ERMs (+2%) than any other asset class.
 - Floating rate ERMs (as common outside UK) not MA eligible.
- Ongoing NNEG valuation debate, with PRA on one side and insurance industry on other.

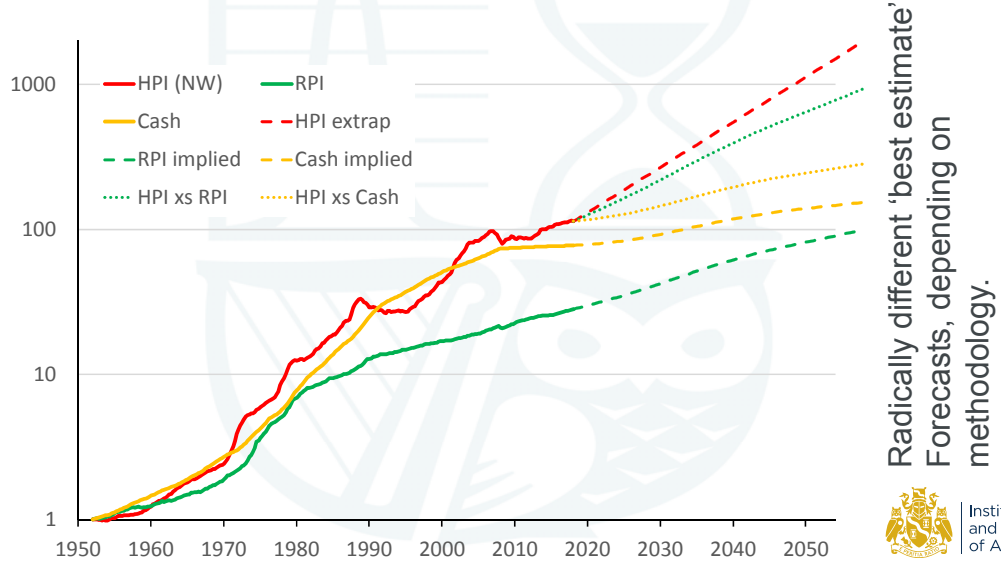
Key Valuation Assumptions (death fixed at T)



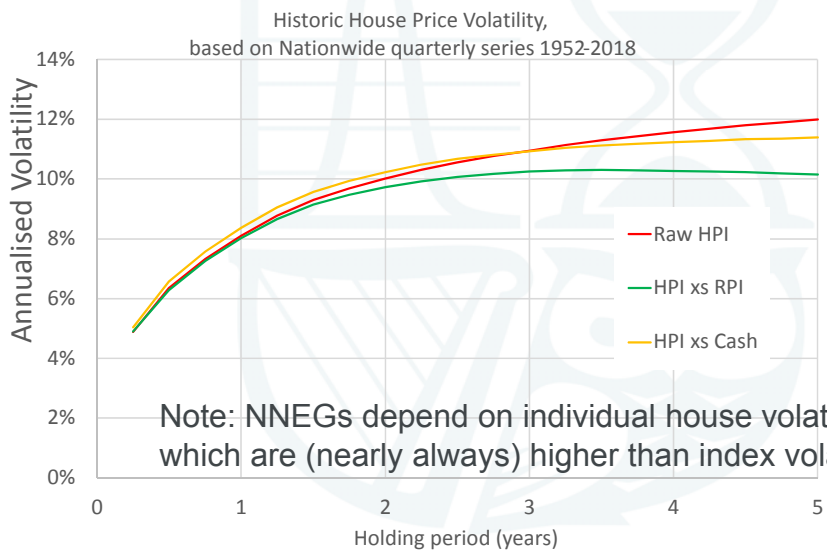
Assumptions and Valuation Contours



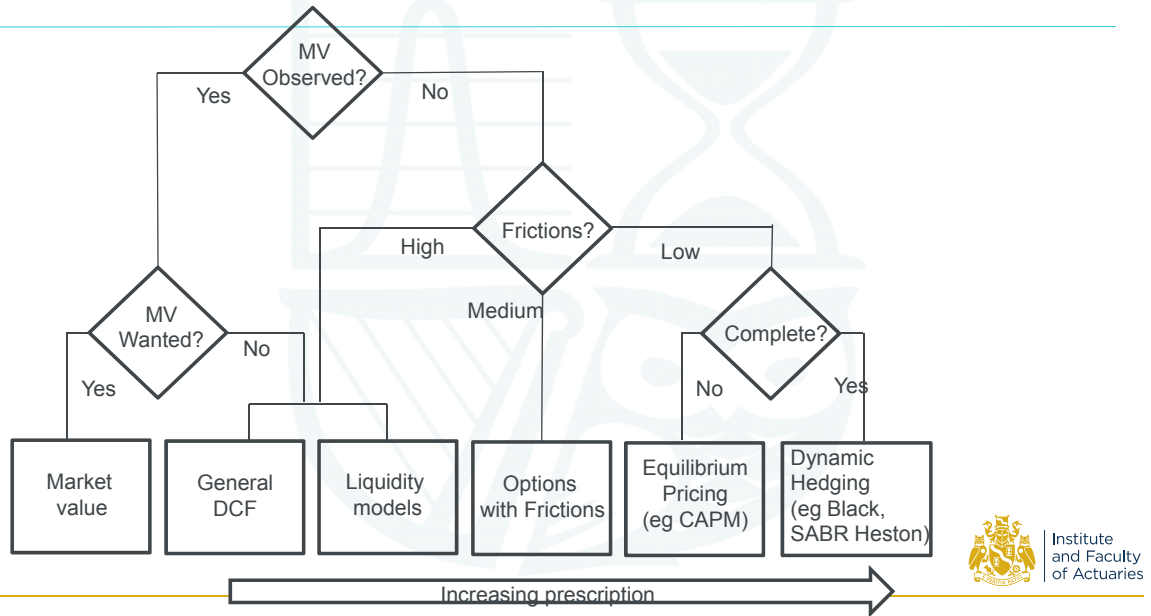
Best Estimate House Price History and Forecasts (UK data)



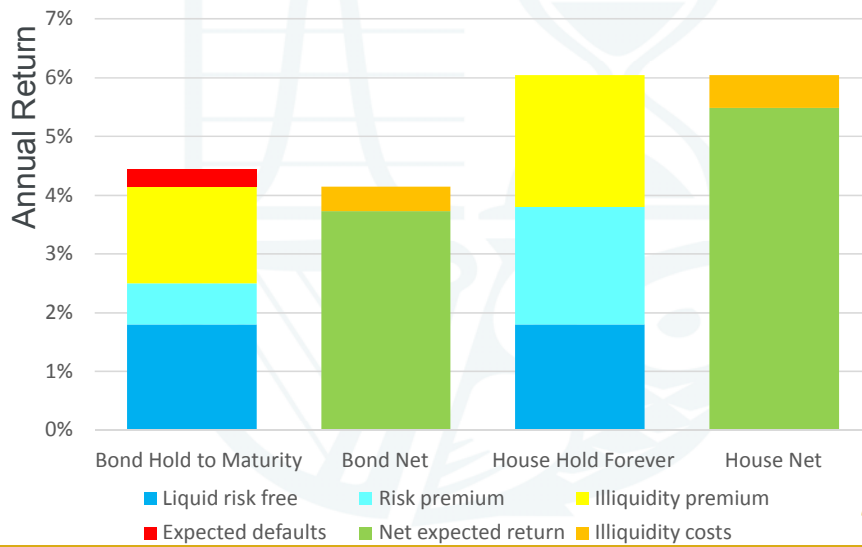
Historic House Index Volatility



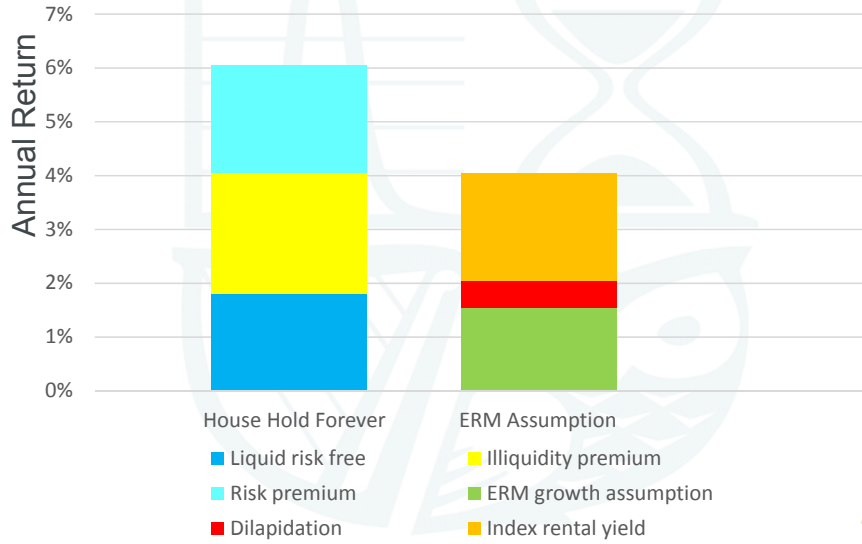
Fair Value Approaches: Many Possible Models



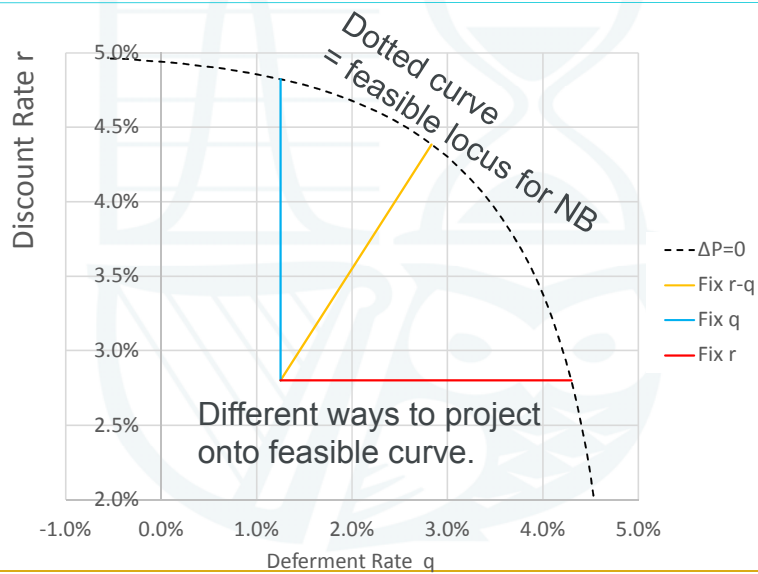
Decomposition of Total Returns on Bonds and on Houses



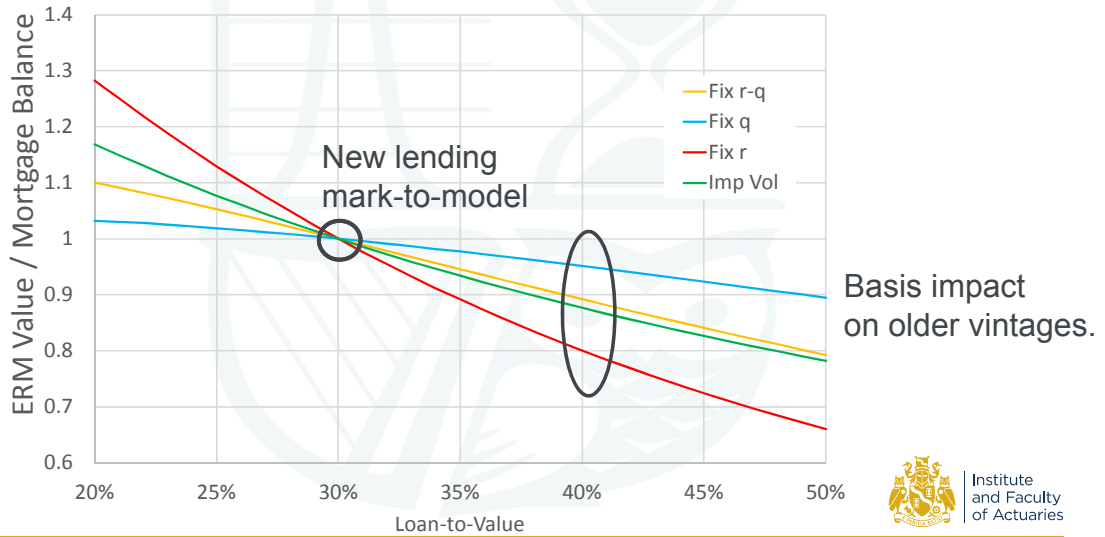
For ERM Pricing, Exclude Risk Premium and Dilapidation from TR



Marking the Valuation Model to New Lending



Loan-to-Value Sensitivity: Calibration Methods

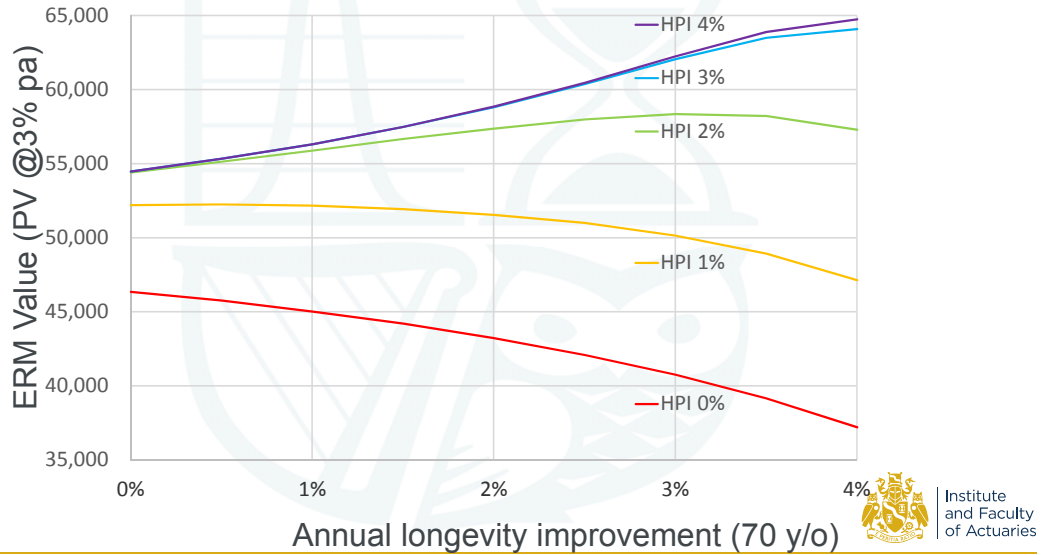


Are ERMs suitable for backing annuities?

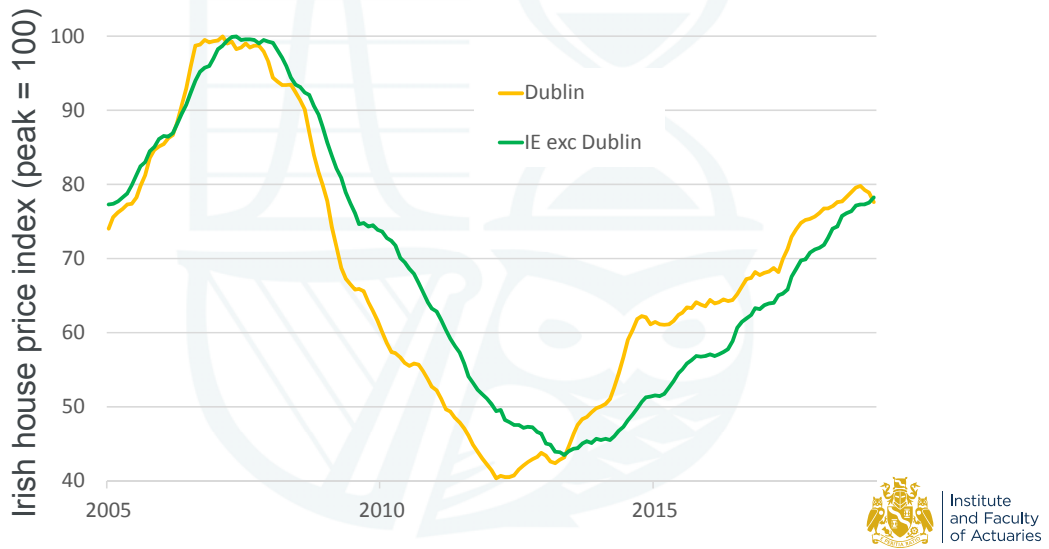
- Yield
- Longevity hedge
- Liquidity
- Property risks
 - General
 - Specific
 - Dilapidation
- Macro-economics.



Do ERMs hedge Annuity Longevity Risk?



Deriving Irish Residential Property Stresses



Should individuals downsize?

- Are geared investments really suitable for older people?
- Is down-sizing better?
- Are ERMs suitable for those who are either unable or unwilling to down-size?



Conclusions: Public Interest

- Cash flow for asset-rich, cash-poor.
- High yields may flow to higher individual and bulk annuity rates.
- Cash for home improvements and green retro-fits.
- Down-sizing eases house shortage.
- Best care not always in own home.
- Dilapidation; younger owners likely to invest.
- Insurers reliant on house price growth.

Questions

Comments

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