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Equity Release Mortgages – can we stop talking about regulation?

IFOA ERM Working Party
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28 November 2019



Agenda

- Overview of the market - the last 12 months
- Industry focus areas
- So where next?



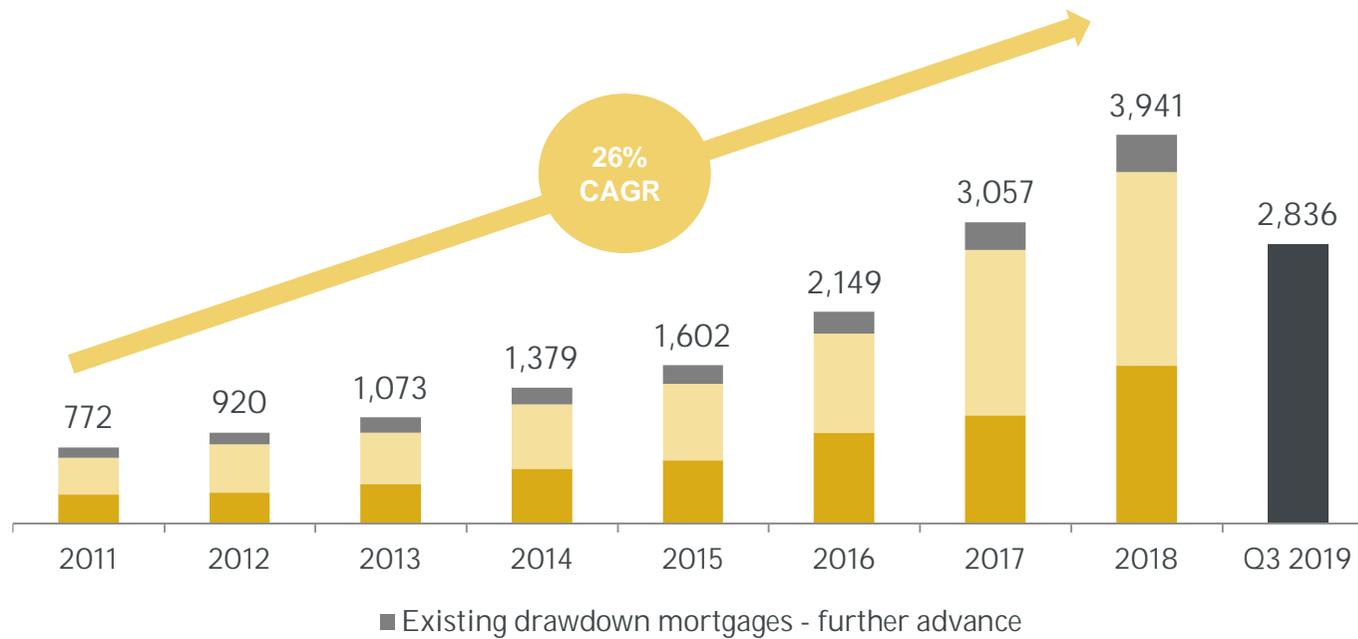


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Overview of the market

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Overview of the market – market size and growth £m



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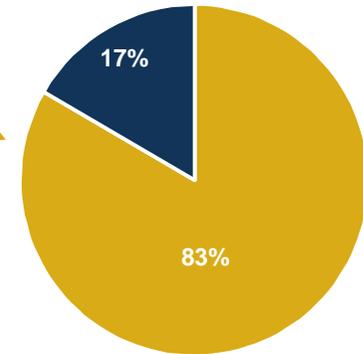
Overview of the market – key players and changes

- Key players



- Entrants / changes to the sector

- Significant growth of more2life
- High LTV/high rate segment of the market led by



Overview of the market – rates and LTVs

- LTM mortgage rates have continued to fall
 - Over 58% of products offer a rate below 5%
 - Average rate has fallen from 6% in 2015 to 4.9% in 2019 (Source: ERC Autumn Report)

Equity release average interest rates, July 2015 to July 2019



Source: Moneyfacts Group plc.

Product pricing	Up to 4.00%	4.01% to 5.00%	5.01% to 6.00%	6.01% and above
Jan 2019	7%	40%	28%	25%
July 2019	21%	37%	23%	19%

Source: Moneyfacts Group plc.

- Average LTVs have reduced by 1-2% across most age segments in 2019



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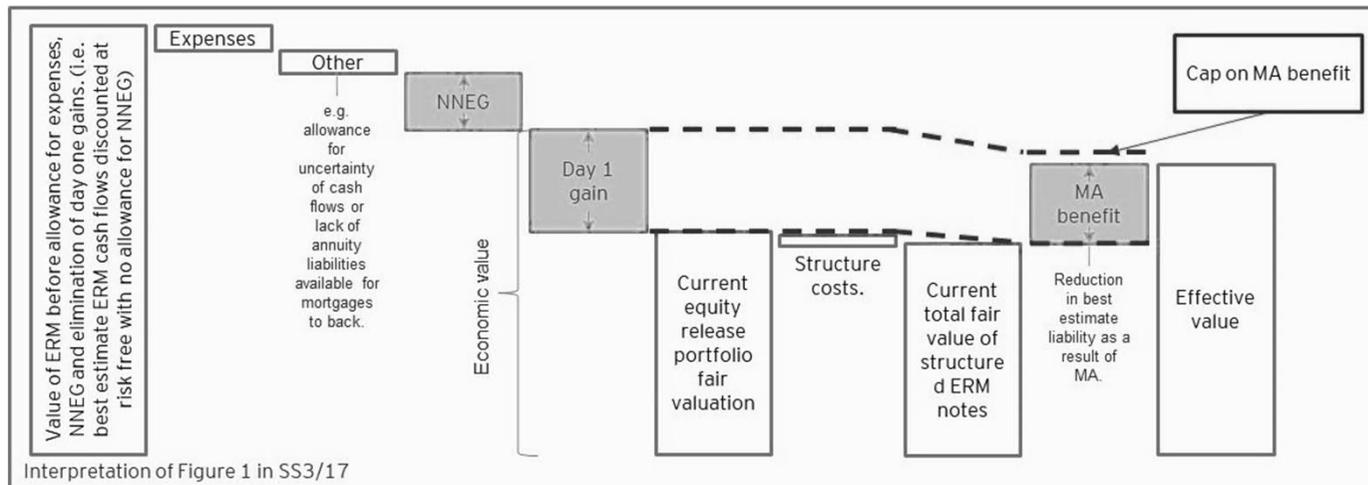


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Industry focus areas

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What does SS3/17 mean for the UK market?



- Internal model firms only impacted by this, but that is the majority of the market
- Higher NNEG risk loans the most heavily impacted
 - High LTV
 - Low ages
 - Higher issuance rates



We said that we weren't going to talk about regulation...but it's quite difficult not to....

- **ERM specific PRA publications** have continued to be of significant importance
 - Equity release specific - SS3/17 consultation through CP7/19, subsequent finalisation with the Policy Statement PS19/19, focused on
 - Reviewing and updating the minimum deferment rate and volatility parameter.
 - The treatment of assets other than ERMs in the EVT.
 - The treatment of ERM loans with uncertain principal and/or interest.
 - The use of an 'EVT in stress' as a validation technique for internal models.
- **Broader consultations that impact the asset class that are in circulation**
 - Prudent person principle (CP22/19)
 - Liquidity management for insurers (SS5/19)



What actions might (or have) firms taken?

Internal

- Recapitalisation – debt and equity injections into some firms
- Portfolio sale / de-risking
- Hedging / structuring solutions – growing interest if not execution
- (Internal) model refinements

Market facing

- Funding at higher LTVs – different players / sources to the low LTV market
- Overseas opportunity potentially arising for the asset class and warehousing
- Product pricing and LTVs on offer



Some areas of debate

- **NNEG remains a significant area of debate**
 - Independent research by Professor Tunaru *
 - Investigated a number of different model and a helpful step for the industry in new techniques
 - Openly recognised a number of important questions / areas remain open
 - Risk neutralisation
 - Some of the key assumptions underpinning the model
 - Model calibration / parameterisation
 - Broader commentary from Smith, Turnbull and others with papers offering different perspectives.
- **What have we done in response**
 - Responses to consultation and discussions with the PRA
 - Going forwards
 - Reset ToR and updated membership in the face of recent developments
 - Building on independent research to define some IFOA views

** note that this research does not represent the view of the IFOA*



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So where next?

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* These are only examples of the options that have been published within market literature to date and do not represent the view of the IFOA or the Working Party

Important areas that remain open to debate

	Examples in literature *	Some key questions
The “model”	Many forms from Black-Scholes to ARMA-EGARCH	<ul style="list-style-type: none"> • Complexity – does it help accuracy or hinder plausibility? • Is there sufficient information to calibrate a more complex model
Volatility	Published ranges from c. 5% to > 20%	<ul style="list-style-type: none"> • Allowing for autocorrelation effects • Index versus individual housing – modelling idiosyncratic risk • Consistency with existing actuarial techniques
Deferment rate	0.5% - 5%+ per annum.	<ul style="list-style-type: none"> • Is deferment rate equivalent to net rental yield? Are there any market data that we can use to estimate it? • What are the upper and lower bounds for this parameter, and could it ever become negative?
Illiquidity premium	Not covered	<ul style="list-style-type: none"> • What is the potential impact of mortgage illiquidity on the valuation of the mortgage • What is the potential impact of house illiquidity on the valuation of the NNEG

.....and all of the items above interact with one another



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Enhancing broader risk management

- Focus on broader risk management of ERMs
 - Property risk management – managing the real NNEG
 - Valuation of the underlying
 - Portfolio “hot spotting” – current vs future LTVs and the associated risks
 - Practical ways to make sure our projections are realised
 - Some of the basics of actuarial management may require some thinking
 - Voluntary Early Redemption – can the past be a predictor of the future?
 - Other demographic trends
 - Longevity risks
 - ALM and liquidity management



The product and the market

- Distribution challenges
 - Access
 - Cost
- RIO market development
- How far could the market grow?



Questions

Comments

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