FINANCIAL CONDUCT AUTHORITY

MS16/2.2: Annex 5

Market Study

Mortgages Market Study

Interim Report: Annex 5 – Findings on lifetime mortgages

May 2018

Annex 5: Findings on lifetime mortgages

Although growing in recent years, the lifetime mortgage market remains a small proportion of the wider mortgage market. Our evidence on lifetime mortgages is more limited than that for the wider mortgage market, but we found that:

- the relative financial vulnerability of older consumers can make it difficult for these consumers to choose a lifetime mortgage.
- almost all sales are advised (over 99%) and intermediated (over 97%).
- as in the mainstream market, there is little evidence to indicate that commercial relationships are adversely affecting consumer outcomes.
- information tools (aimed at both consumers and intermediaries) are relatively basic and similar to those available for products the wider non-lifetime mortgage market. However, these tools appear less tailored and less helpful for comparing lifetime mortgages given their distinctive nature.
- some mortgage sourcing systems appear less suited to lifetime mortgages and mortgage sourcing system use appears less prevalent, with some intermediaries appearing to rely on their own information gathering to compare products.
- unlike mainstream mortgages, currently lifetime mortgages are largely not designed with the expectation that borrowers switch after a few years. However, there has been some movement towards early repayment charge structures and amounts that, in some instances, might make it more attractive to switch.

Introduction

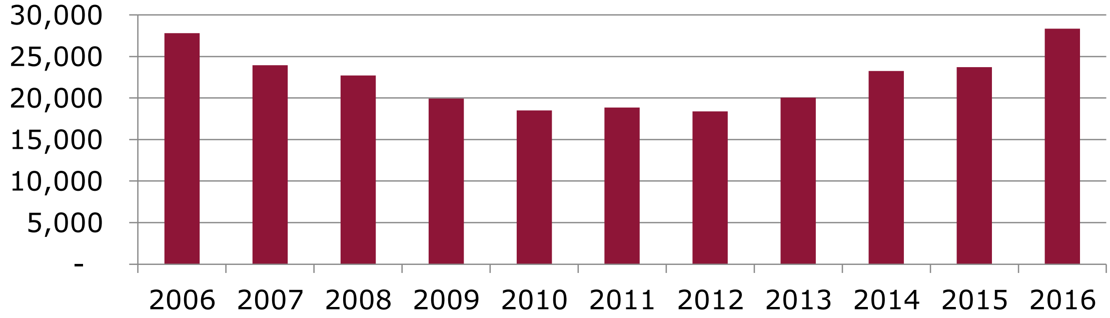
1. Lifetime mortgages are in the scope of the mortgages market study. However, with fewer transactions and less data available on this market, and the distinctive nature of these products and how they are sold, our work on lifetime mortgages has provided less insight than our work into non-lifetime residential mortgages. This Annex brings together our findings and conclusions on lifetime mortgages, a common form of equity release.

Market data

2. This section presents a short overview of the market from regulatory data on mortgage transactions (PSD001).
3. Lifetime mortgages account for a very small but growing proportion of all residential first-charge mortgages sold. They accounted for 1.5% of mortgages arranged in 2016 (28,300 out of 1.9 million). Figure 5.1 shows how the market shrank during

and in the period following the financial crisis, but started growing again in 2012. On average volumes have grown by 12% each year between 2012 and 2016. Anecdotal evidence indicates that growth continued in 2017.[1]

Figure 5.1: Volume of lifetime mortgages sold per year (2006-2016)[2]



4. Lifetime mortgages are designed to convert accumulated equity into regular income, drawdowns and/or initial lump sum. They are designed for older borrowers, typically 55 years or older. This is reflected in our regulatory data, where the average age of new lifetime mortgage consumers in 2016 was 70, with half of the lifetime mortgages arranged in that year sold to consumers between the age of 66 and 75. We discuss below how this older target population can have distinctive needs and vulnerabilities that can make it more difficult for them to find the right mortgage.

5. Our advice rules on lifetime mortgages differ from those for non-mainstream mortgages. For lifetime mortgages our rules require all consumers to take advice, though a consumer can choose to reject advice they have been given. And, in addition to factors that would need to be covered if advising on a mainstream mortgage, a lifetime mortgage adviser must also consider important aspects such as the consumer’s health and life expectancy, preferences for their estate, impacts on their tax position and alternative methods of raising the funds.

6. As to be expected, given mandatory advice, the lifetime mortgage market is almost entirely advised and intermediated. Over 99% of lifetime sales were advised.[3] Intermediation is also very high, with over 97% of the sales intermediated in 2016. Unlike in the mainstream mortgage market, where intermediation appears to have grown following the introduction of new advice rules with the MMR, high levels of intermediation in lifetime market were present before our advice rules for lifetime were introduced. Also, the high-levels of intermediation in the lifetime market can be explained by the fact that very few lenders offer advice.[4]

7. The numbers of lifetime mortgage lenders and intermediaries operating in the market have remained stable in recent years. However, a new entrant to the market in 2015 has grown rapidly to become one of the largest providers.

8. In 2016 there were 15 active lifetime mortgage lenders (who sold 5 or more products) in the UK, though the sector appears highly concentrated[5] with the top five

[1] See, for example, https://www.telegraph.co.uk/financial-services/retirement-solutions/equity-release-service/equity-release-schemes-popularity/

[2] Source: PSD001. Data excludes internal switches.

[3] The small proportion of sales not reported as advised is likely to consist of consumers who chose to reject the advice or due to reporting errors in the data.

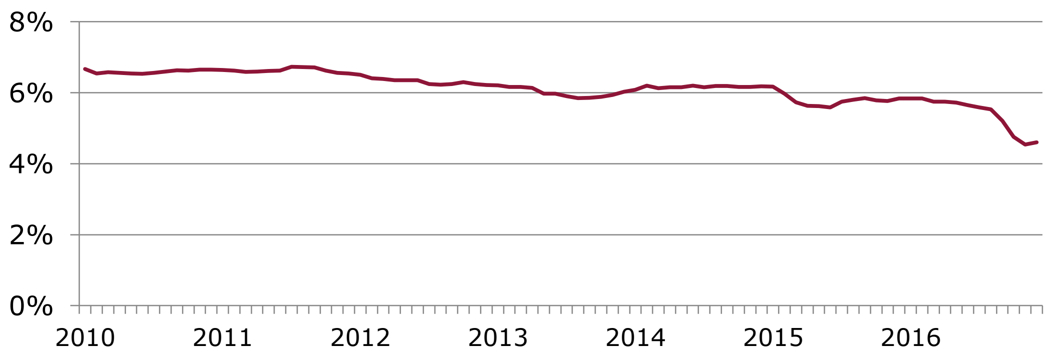
[4] A small number do offer advice for ‘direct’ sales (i.e. the sale is through an intermediary firm that is part of the same group as the lender that only sells products from those lenders).

[5] From the market shares of lifetime lenders in 2016 we estimate a HHI of 2284 (above 2000 can indicate a highly concentrated market).

providers accounting for over 89% of the sales.[6] The top 5 providers all specialise in lifetime mortgages. The high concentration of providers may be a sign that choice in the market is somewhat limited and competitive pressure on lenders is weak.

9. Figure 5.2 presents how average mortgage rates on lifetime mortgages evolved since 2010, showing a rapid decrease in mortgage rates in the second half of 2016. This broadly coincides with significant market entry into the lifetime market in 2015, and subsequent rapid growth in 2016, which appears to have triggered a response from competitors.

Figure 5.2: Average lifetime mortgage rate by month (2010-2016)[7]



10. There were 1,382 intermediaries that sold at least one lifetime mortgage in 2016. Most, however, is done by a much smaller number of intermediaries that specialise in lifetime mortgages. The top 13 intermediaries accounted for around 80% of the sales, and the top 2 for 50%. So the market for intermediation appears moderately concentrated.[8] Most intermediaries also send the majority of the business to the top 5 lenders (as expected given the high concentration of sales amongst these lenders).

11. Unlike the wider mortgage market, lifetime mortgages are largely not designed for consumers to switch to another mortgage a few years after origination (i.e. once an introductory period ends). Lifetime products typically have a rate fixed for the life of the loan rather than an introductory rate followed by a reversion rate. Early repayment charges have tended to be much higher than for non-lifetime mortgages (for example up to 25% of the initial loan). While the latter reflects the costs incurred by lenders for early repayment, it also acts as a strong disincentive to switching.

12. However, this could change. There are early signs of lenders changing the structure of early repayment charges, for example, towards introducing fixed rather than variable early repayment charges dependent on the balance outstanding. This could increase existing lifetime consumers' incentives to switch and drive competition in the sector.

Making it easier for consumers to find the right mortgage

13. In Chapter 4 we explain how choosing a non-lifetime mortgage can be challenging. Some consumers find it difficult to calculate mortgage costs, compare products and/or establish for which products they qualify. Information and tools available to

[6] PSD001

[7] Source: PSD001. Data excludes internal switches.

[8] From the market shares of lifetime intermediary firms in 2016 we estimate a HHI of 1514 (above 1500 can indicate a moderately concentrated market).

consumers are of limited usefulness in helping them make effective decisions, especially if consumers have more complex or unusual circumstances.

14. As a product which is designed for older borrowers who are more likely to be vulnerable, it may be even more difficult for a consumer to find the right lifetime mortgages.

15. For example, our 2017 Occasional Paper on Aging Population and Financial Services, OP31[9], found that older borrowers may experience a number of life events during the term of their mortgage. This could include cognitive decline, bereavement, or the onset of health issues. Older consumers may therefore have distinct service needs or require additional support and flexibility during the mortgage term. As with other financial services products aimed at older borrowers, this may pose risks in the lifetime market for both the consumer and the firm, and have implications for product and service design.

16. Lifetime mortgages can also be viewed as complex products. One lifetime lender who responded to our request for information reported research they had carried out indicating several confusing features of lifetime mortgages. Consumers found it difficult to understand the meaning of specific terms such as enhanced (a lifetime mortgage which takes your health into account), and interest roll-up. Also, with relatively little switching in the market currently, there are also fewer opportunities in this market for consumers to gain experience of which products best meet their needs.

17. A typical consumer journey for lifetime mortgages is different than for non-lifetime mortgages. For example, a borrower may approach a conventional mortgage intermediary who will typically refer them to a specialist lifetime mortgage intermediary (and may receive payment from that intermediary for doing so). The process of purchasing a lifetime mortgage also tends to be longer, and these consumers approach their purchasing decision differently to mainstream mortgage consumers. In 2008 the FSA's Mortgage Effectiveness Review[10] found that lifetime consumers are more likely to spend time over their buying decisions, and will review information with friends, family and professionals.

18. Lifetime mortgage tools provided by lifetime lenders and intermediaries are basic and provide high-level information only on eligibility and the amount that can be borrowed. Three price comparison websites (PCWs) offer services for equity release/lifetime mortgages and other forms of equity release, either in addition to comparison services for mortgages more generally or as a specialist PCW. Our findings for PCWs in Chapter 4 also hold for those also offering comparison services in this market.

19. As with non-lifetime mortgages, the lack of information on whether a borrower qualifies for lifetime products could also make it harder for consumers (and to a lesser extent intermediaries) to assess and compare lifetime mortgages and their prices. However, unlike non-lifetime mortgages there are fewer products on the market for consumers to consider.

20. We did not include a similar analysis of lifetime mortgages to that for mainstream mortgages in Chapter 5 because eligibility criteria for lifetime mortgages are different and we lack detailed data on these across products available in the market. This relative lack of data makes it difficult to identify and compare the costs of lifetime

[9] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-31.pdf

[10] http://www.fsa.gov.uk/pubs/other/MER2_report.pdf.

mortgage products that a borrower is likely to be eligible for. So we cannot assess the extent to which lifetime consumers are obtaining value for money.

21. Our request for information indicated that the tools for intermediaries selling lifetime mortgages appear similar to those for residential mortgages. Tools include dedicated lender websites with product, eligibility and lending criteria information, lender contacts for support and mortgage sourcing systems.

22. Unlike residential mortgages, however, mortgage sourcing systems appear more limited in their effectiveness for lifetime mortgages. One lifetime lender cited, in their response to our request for information, that the mortgage sourcing system they used was expensive and almost acted as a barrier to launching new products. A different intermediary, specialising in lifetime mortgages, said they did not use a mortgage sourcing system, instead collating information to compare providers - this makes sense given there are fewer lifetime products to compare in the market, but also means that narrowing the range of lenders considered would lead to a more significant time saving.

23. In summary, the tools for lifetime mortgages are similar to those for residential mortgages but with some mortgage sourcing systems less well adapted to the specifics of lifetime products. As a smaller market, it may be that mortgage sourcing systems see lifetime products as a lower priority to mainstream mortgages. As a result, lenders and intermediaries appear to rely more on their own tools and knowledge of the market.

24. One potential remedy we describe in Chapter 9 explores whether lenders can make sufficient information available to intermediaries (including via mortgage sourcing systems) to support the development of tools that give consumers an early and much clearer understanding of the products for which they qualify. This has the potential to be just as relevant for lifetime mortgages. We welcome views on this, bearing in mind:

- there are fewer providers and products in the market so intermediaries are already in a stronger position in this respect to identify and compare products, though this may still mean that only a sub-set of providers are considered .
- in the non-lifetime mortgage market, affordability is a major, and at times opaque, factor in determining whether a customer can qualify for a particular product. However, affordability assessments are not required for most lifetime mortgages (e.g. that are based on, or can convert to, interest roll-up).
- the scale of the market might limit commercial appetite for developing such tools, though it appears to be growing consistently.

A wider range of tools giving consumers more choice about the support (including advice) that they need

25. In Chapter 9, we discuss ways to remove barriers that might prevent consumers accessing the tools they need to take out the right product. This is because, for at least some consumers, advice might not be necessary.

26. Unlike mainstream mortgages, however, there is no interaction trigger that can lead consumers to take advice. Instead, as mentioned above, our rules require all lifetime mortgage consumers to take advice, though they can choose to reject it. We have not considered impacts of advice for lifetime mortgage customers on price or other

outcomes, reflecting the data limitations previously mentioned and the scale of the market.

27. Lifetime mortgage intermediaries told us that they generally have little appetite for online advice. This may be due to the length of these transactions, the greater likelihood of customer vulnerability and the need for tax/estate discussion, as well as the market lacking sufficient scale to justify the investment. These together could make this challenging to deliver. However, firms considering online services can currently consider the support offered through our Advice Unit – see Chapter 9.

More help for consumers when choosing an intermediary

28. In 2016, 97% of lifetime mortgage sales were intermediated. Fees (and procuration fees) for lifetime intermediaries are typically higher as a percentage than for non-lifetime products, reflecting that these products are more complex, involve consideration of wider circumstances and so may require more work on the part of the intermediary.[11]

29. Chapter 5 explains that choice of intermediary matters in terms of borrowing cost in the mainstream market. Data limitations meant that we could not analyse lifetime mortgages in the same way. Lifetime mortgage consumers might not have as strong a need for better tools to compare intermediaries. There are fewer lifetime mortgage intermediaries in the market compared to non-lifetime, and the smaller number of active lifetime lenders may mean it is less likely that an intermediary will present consumers with a partial view of the market.

30. However, given the high level of intermediation in the market and the distinctive considerations involved in lifetime mortgage purchases (health, life expectancy and estate and tax preferences), there are potential benefits to lifetime mortgage consumers from information that helps them to identify and compare different intermediaries. This could also help lifetime consumers make a better choice of intermediary, improving their own experience and helping to drive competition.

31. In addition, as some borrowers go first to a mainstream mortgage intermediary who refers them to a specialist, easily-accessible information to help consumers compare intermediaries and identify lifetime mortgage intermediaries earlier on could potentially speed up and reduce costs to consumers in identifying and purchasing a lifetime mortgage.

Reducing barriers for those consumers who do not or cannot switch

32. The findings presented in Chapter 6 excluded lifetime mortgages because our data on switching for these products are limited and switching currently appears to be rare.

33. Unlike mainstream mortgages with introductory periods, where consumers entering a mortgage contract might expect to be able to switch after that period ends, lifetime mortgages tend to have one rate and attract early repayment charges for the life of the loan. Given this, the risk that lifetime consumers may be losing out by not actively switching will be lower than for mainstream products.

[11] The higher percentage fees may also partly reflect that fact that loan amounts for lifetime products tend to be lower on average than those for mainstream mortgages.

34. It is possible that some existing lifetime borrowers could be losing out by being on significantly higher rates than those currently available (see Figure 9.2). If so, then some of these borrowers might potentially benefit from switching, but may be discouraged from doing so due to high early repayment charges. Also, if these early repayment charges exceeded the cost to lenders of an early redemption (which would also be a breach of our rules) then this would be a disproportionate barrier to switching that would suggest lost benefits from frustrated increased switching. However, while possible, we do not have evidence to suggest that this is a problem.

35. Our preliminary view on our proposed switching remedies is that these are unlikely to be very relevant to lifetime mortgages. First, there is no significant evidence to indicate harm being experienced in the market from barriers to switching. Second, if there are barriers to switching for lifetime mortgages, these would appear, from our very limited evidence, to be associated with early repayment charges. This would derive from either product pricing or design and would require a qualitatively different approach to remedy.

Commercial relationships

36. As in the mainstream mortgage market, we found little evidence to suggest commercial relationships are leading to harm for lifetime mortgage consumers.

37. We received detailed information from a small number of lifetime mortgage intermediary firms. This did not indicate that, in the context of the smaller number of lenders in the lifetime market, intermediaries were typically recommending products from a narrow range of lenders.

38. We did identify an example of an arrangement between a lender and a number of individual intermediaries where the lender refers any consumers approaching it for advice to one of the intermediary firms. When dealing with a customer referred to it by the lender, the contract requires the intermediary firms to promote and sell only that lender's products (and not those of any competitor). The contract also includes a provision requiring the intermediary firms to comply with FCA rules on suitability of recommendation. We understand that in the event the lender does not offer products that meet the needs of the customer then alternatives must be sought within the marketplace and that, in practice, this occurs in a material number of cases. We understand there are other firms in the market who have similar arrangements. We would expect all firms providing advice to comply with FCA rules and guidance on suitability and pre-sale disclosure in all instances when providing advice, including when party to this type of an agreement of this type.

The relevance of our remedies to lifetime mortgages

In Chapter 9 of the interim report we request views on the extent to which our potential remedies (with further enhancement or refinement) are relevant to lifetime mortgages.

We welcome views broadly on this question and on our preliminary assessment in this Annex that:

- our potential remedy to explore whether lenders can make sufficient information available to intermediaries (including via mortgage sourcing systems) for them to develop tools to support decisions may not have as important a role for lifetime mortgages because there are fewer providers and products in the market. The scale of the market might also limit commercial appetite for developing such tools

- there may be potential benefits to lifetime mortgage consumers from information that helps them to identify and compare different intermediaries,
- our proposed remedies in Chapter 9 to reduce barriers to switching are unlikely to be very relevant to lifetime mortgages. Our evidence does not show how much harm is being experienced currently from barriers to switching. If barriers are present, they are likely to be qualitatively different from the mainstream market.

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