

## Consumer Demand for Retirement Borrowing

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# Consumer Demand for Retirement Borrowing

Louise Overton and Lorna Fox O'Mahony  
November 2015

A report prepared for the Council of Mortgage Lenders (CML)

UNIVERSITY OF  
BIRMINGHAM



University of Essex

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# Executive Summary

As the UK population ages, and state responsibility for direct provision of income security, housing, and social care declines, individuals are required to take greater responsibility (and associated risk) for funding their own needs in retirement.

- The financial services industry has developed as a key player in this new world of welfare, with financial products and services becoming increasingly essential in older people's lives. However, a number of political, socio-demographic, and economic trends point to the need for more innovative and flexible approaches to retirement borrowing options; to meet the changing needs of an increasingly diverse group of older people. Indeed, the income needs and preferences of those recently retired who wish to remain active while potentially carrying mortgage debt into retirement, will vary quite considerably from those of the long-term retired, where advancing age and declining mobility creates an acute need to support independent living and care costs. A key challenge for the industry, and others, is thus the development of products (and advice services) that will meet the income needs of individuals *throughout* retirement.
- This report explores:
  - The drivers of demand for retirement borrowing while appreciating that customer needs are likely to change quite considerably over the next few decades.
  - The financial product options currently available for older people, including conventional mortgage borrowing, unsecured consumer borrowing, unregulated borrowing options and equity release, and the limitations associated with each of these 'options'.
- The report provides an overview of some of the key issues related to the current retirement borrowing landscape, and the challenges facing key stakeholders (financial services industry, regulators, and governments) in meeting the changing financial needs and preferences of older people. We look to examples of programmes and practices overseas where government plays a greater role in enabling the use of housing equity and housing finance, to consider what more the state could do in the UK context to share the risks and responsibilities inherent in retirement lending and borrowing.

## Drivers of demand for retirement borrowing

- There are a number of factors that will increasingly drive demand for additional sources of finance in later life as individuals take on greater responsibility for securing their financial security and well-being. These include:
  - **Demographic shifts** – The Office for National Statistics has projected that in England in 2030, compared to 2010, there will be 51 per cent more people aged 65 and over, and 101 per cent more people aged 85 and over. A key consequence of increased life expectancy is that people will have to manage their retirement income and assets over a longer period than past generations, but research suggests that people frequently under-estimate how long they will live<sup>1</sup> and find it difficult to plan ahead.

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<sup>1</sup> In 2005, 30 to 39 year olds underestimated their own life expectancy by at least six years (A New Pension Settlement for the Twenty-First Century – The Second Report of the Pensions Commission, 2005, pages 90, 94)

- **Inadequate pension income** – Key contributory factors here include a decline in the number of people saving into occupational pension schemes over the last two decades and the shift from Defined Benefit to Defined Contribution schemes. Recent reforms to end compulsory annuitisation are also likely to impact on borrowing behaviour. While it will be some time before the full effects of the reforms will be known, there has already been a considerable decrease in annuity sales, suggesting that retirees are opting against a guaranteed, secure income for life, with potentially serious implications for their future financial resilience.
- **Servicing outstanding debt** – Mortgage debt is increasingly being carried into retirement. In some cases this may be a deliberate and manageable income/asset strategy. However, a growing body of research points to the financial strain that this can place on households entering retirement. The maturing of interest only mortgages without repayment plans is also likely to drive demand for options to manage these financial difficulties. Research also suggests a fairly significant change in the profile of unsecured debt, with an estimated 1.1 million people over 50 years old reporting problem debt in 2013.
- **Paying for care** – People aged 85 and over are the fastest growing section of the UK population, and the group most likely to need care. Significant pressure on local authority budgets for care services means individual responsibility for meeting care costs is increasing, and, in light of the pressure on pensions, income alone is rarely sufficient to cover these costs. Increasing demands on older people to self-provide with respect to the costs of social care are therefore likely to be a further driver of demand for retirement borrowing. Products that allow the withdrawal of housing equity to support care at home are likely to be important here.
- **Limited opportunities for trading down** – the costs involved in trading down can be prohibitive for less well-off owners, while a lack of suitable and suitably priced property to facilitate trading down is a further barrier. The upheaval involved in moving house later in life coupled with the emotional attachment that many people have to their homes, is a further factor suggesting the growing need for borrowing options on existing properties. Meanwhile, improving the supply of suitable housing for older people will remain a key policy challenge.
- **Changing attitudes to housing wealth and inheritance** – Customer demand for retirement borrowing may also be influenced by changing attitudes to housing wealth and inheritance, particularly for successive generations of retirees. Research suggests that younger cohorts are much less inclined to sacrifice their own financial needs and preferences in favour of leaving bequests.

## Retirement borrowing options: opportunities and limitations

### Conventional mortgage borrowing

- The Mortgage Market Review (MMR) implemented significant changes to the Financial Conduct Authority's rules governing the sale and approval of mortgages to residential consumers. Key changes included the implementation of an affordability assessment, to ensure that borrowers will be able to afford repayments both now and into the future of the loan.
- Lenders appear to have responded by adopting a cautious approach to conventional mortgage lending into retirement, meaning that older people have experienced limitations to accessing conventional mortgage borrowing.
- CML figures show a significant drop in lending to the over 65s since a peak in 2007, while Age UK has reported an upsurge in calls about conventional mortgages. The most frequent complaints relate to the application by lenders of an age limit of 70 or 75, or callers being unable to re-mortgage or extend the term of an endowment or interest-only mortgage, even when they can afford the interest on their current mortgage.

### Unsecured borrowing

- Age is also a potential barrier to many older people seeking to access good quality consumer credit services in retirement, with several 'best-buy' personal loan products carrying age limits. While credit cards do not impose a maximum age criterion (since they are designed as short-term credit), many of the lead providers have minimum income requirements, ranging from £3,000 but with an average of about £15,000, which could exclude many older people.

### Unregulated borrowing

- With a quarter of the older population using unsecured credit and, of those, ten per cent (around 400,000) paying over £85 a week to service their debt, there is a risk of older people being caught in a spiral of debt, with options to repay or restructure debt increasingly limited. Since the financial crash has constrained access to credit, lack of access to affordable credit with mainstream lenders has led many people on low-incomes to turn to other sources of unregulated credit. Unregulated borrowing options include high-cost, short-term loans, and there is evidence that the market for high cost credit has expanded to meet the new demand stimulated by constraints in the regulated market. The growth in financial exclusion from regulated credit is compounded, for older people, by age-restrictions on regulated mortgage lending and personal loans.

### Equity Release

- Another option for borrowing in later life is equity release. Equity release products are a distinct category of home finance product offered exclusively to older consumers. They enable the release of housing equity without having to sell up and move out, or make repayments by instalment.
- While the equity release market remains small, at less than 2 per cent of the mainstream mortgage market, there has been a significant recent increase in sales.
- It is possible that recent trends in mainstream lending have fuelled some of this growth, by limiting the availability of conventional mortgage products for older people, especially older people with lower levels of income and assets.
- Equity release products might serve to plug some of the gap left by limited access to conventional mortgage borrowing, but they are not suitable for everyone and there remain a number of supply and demand-side barriers to wider up-take.
- These findings suggest the need for greater collaboration and a more joined up approach to retirement borrowing issues and potential solutions, between industry, regulators and government.

### Sharing risk and responsibility for lending in retirement

- While the Government has clearly articulated its expectation that the financial services industry will play a central role in facilitating retirement finance, questions remain about the extent to which the industry is fully equipped to deliver what is expected of it, and the role that the state should, or could, play, in better enabling both the industry and consumers to meet retirement needs more effectively.
- Planning for older age now requires the careful negotiation of a range of risks and uncertainties, from personal life events over which consumers have limited control (including health and disability risks, longevity risks), to the market risks associated with financial transactions, especially in respect of complex, non-discrete products.
- In light of this, we consider, in chapter 3, how other jurisdictions have approached the question of risk-sharing between the state and the market for meeting people's retirement borrowing needs in the context of housing wealth decumulation.
- In the US, lifetime mortgages sold under the Home Equity Conversion Mortgage (HECM) programme are insured by the Federal Housing Administration (FHA), which protects lenders against the risk that the loan balance may eventually exceed the value of the property. The insurance premium also guarantees that if the lender goes out of business, the government will ensure that borrowers still have access to their loan funds. Following the US example, a similar programme was developed in South Korea, which introduced the Jootaekyeonkeum (JTYK) reverse mortgage under the Korea Housing Finance Corporation (KHFC) Act in 2007.
- The state-backed guarantees offered in the US and South Korean markets enable lenders to offer lower interest rates and relatively large payments compared with the non-state-backed products offered in the UK. Such initiatives could improve the perception of poor value for money that surrounds equity release products in the UK.

- In a number of other ways, East Asian countries such as Japan and Singapore have sought to strengthen the contribution of home ownership to meeting older people's income needs. In Japan, for instance, recognition of considerable reluctance among older people to trade down led to the establishment of the 'house moving support scheme for the elderly' in 2006, while in Singapore, the Housing and Development Board (HDB) launched its Lease Buyback Scheme (LBS) in 2009; enabling owners of homes with three or less rooms to sell some of the remaining years of their lease to the HDB in return for a lifelong supplement to their income.
- In some European countries, such as Poland, released equity in income form is not subject to income tax, as in the UK, thereby facilitating the use of housing equity as a regular supplement to pension income.
- These overseas programmes and practices provide an illustration of the potential role that the state can play in supporting the retirement borrowing sector through greater risk sharing and facilitation. In the UK, the state plays a significant role in subsidising mortgage borrowing for working age people (for example, under Right to Buy schemes, Help to Buy, Funding for Lending scheme, Key Workers scheme, and so on), yet to date, governments have relied largely on the financial services industry to manage the risks and costs of equity lending in retirement. With policies geared towards encouraging more people to make use of the equity tied up in their own homes, to support themselves and remain financially secure after retirement, there is a case to be made for the state to rethink its role in sharing some of the risks associated with housing finance for older people.

## Gaps in the knowledge base

### How are older people meeting their borrowing needs and preferences in retirement?

- There is relatively little evidence regarding what people do when excluded from conventional secured borrowing. Are people turning to:
  - equity release;
  - higher-cost, higher risk, options;
  - or are they going without?

### Product development

- What do consumers want and need? Is it better access to conventional mortgage borrowing, equity release, or something in between? There has been some development of so-called hybrid products that offer a bridge between traditional lifetime mortgages where the debt rolls up over the course of the loan, and those that allow interest to be part paid/part rolled, but we currently lack knowledge and understanding of the appetite for these products. Are there other options? And what are the challenges with regard to funding and distribution?
- What are the particular features that would make retirement borrowing products more attractive, and what are people prepared to pay for?

### Advice

- How do people make decisions about retirement income and assets, particularly in the pension freedom environment?
- What are the challenges in providing advice aligned with the changing pattern of spending in retirement?
- How can holistic advice be given in a way that makes sense to the customer and engages them into thinking about their future tax, care costs and legal needs?

### Greater risk sharing and a more joined up approach to borrowing in retirement

- What do stakeholders (i.e. government, regulators, and lenders) think about a more joined-up approach to retirement lending? Is there an appetite for risk-sharing options, to support better outcomes for consumers and to reduce costs and risks to lenders?
- What lessons can be learned from other countries where the state plays a more active role in encouraging and enabling the use of housing equity in later life?

# Drivers of Demand for Retirement Borrowing

## 1.1 Introduction

Financial services and products are becoming increasingly essential in older people's lives. As the UK population ages, and state responsibility for direct provision of income security, housing, and social care declines, individuals are required to take greater responsibility (and associated risk) for funding their own needs in retirement.

The Office for National Statistics has projected that in England in 2030, compared to 2010, there will be 51 per cent more people aged 65 and over, and 101 per cent more people aged 85 and over. A key consequence of increased life expectancy is that people will have to manage their retirement income and assets over a longer period than past generations, but research suggests that people frequently under-estimate how long they will live<sup>2</sup> and find it difficult to plan ahead (Finney and Hayes, 2015). Furthermore, research indicates that retirement may follow a 'u-shaped' spending curve, with people tending to spend more in the early, more active years of retirement, spending decreasing in the middle years, and then increasing again with additional care and medical expenses. Again, however, individuals do not tend to plan for it and financial products and services do not necessarily cater for this pattern of spending (Age UK, 2014a, p. 11).

These difficulties have been compounded by the global financial crisis and subsequent recession which have constrained access to credit while increasing the cost of living. Research for Age UK has indicated that low returns from savings, decreasing annuity rates and rising prices for energy and other basic costs are adding to the financial pressures on older people, with more than 3 million people over the age of 50 reporting that they are 'very worried' about the cost of living (TNS, 2015).

At the same time, levels of home ownership and housing wealth remain relatively high among older cohorts. In 2011, 76 per cent of households (England and Wales) with the head of household aged 65-74, and 73 per cent aged 75 or over, were owner-occupiers (PPI, 2014), while the House of Lords Select Committee on Public Service and Demographic Change estimated that people over state pension age in 2009 owned roughly £250bn in housing wealth that was 'available' to be released (House of Lords, 2013).

The combination of these political, socio-demographic, and economic trends highlight the need for innovative and flexible approaches to retirement products (and the associated, and essential nature, of planning and advice services), to enable more older people to bridge the increasing gap between income and needs in later life. This chapter outlines key factors driving demand for retirement borrowing.

## 1.2. Drivers of demand for retirement borrowing

### 1.2.1 Inadequate pension income

Although recent reforms to the State Pension<sup>3</sup> are likely to increase the level of income that some pensioners receive from the state system in the future, current levels of state and private provision remain relatively low, with the Department for Work and Pensions estimating that 12.2 million people are facing inadequate

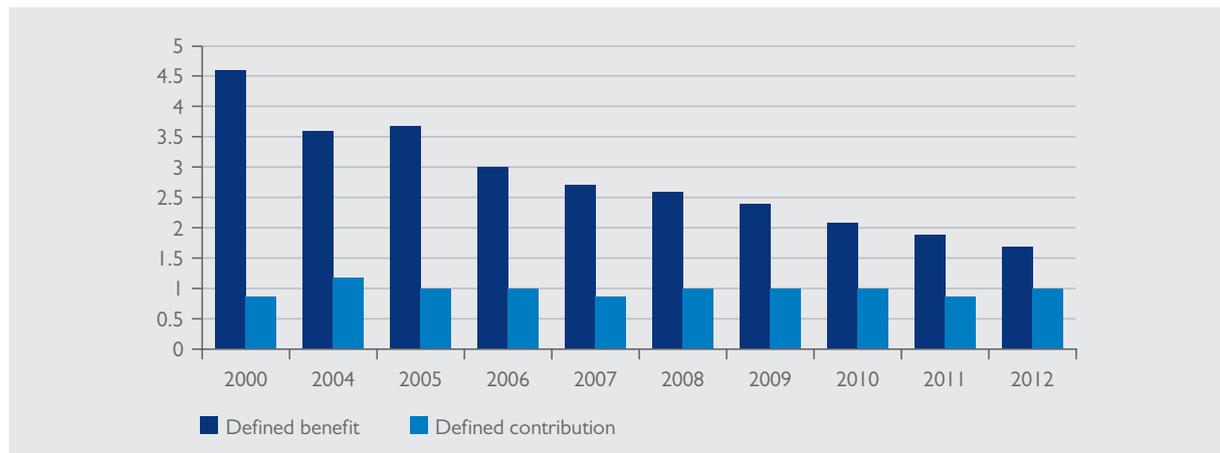
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2 In 2005, 30 to 39 year olds underestimated their own life expectancy by at least six years (A New Pension Settlement for the Twenty-First Century – The Second Report of the Pensions Commission, 2005, pages 90, 94).

3 For example, the reduction in the number of qualifying years for both men and women to be eligible for a full Basic State Pension and raising the state pension each year in line with prices, earnings or 2.5 per cent, whichever is highest. This has been termed the 'Triple Lock'.

retirement incomes (DWP, 2013). A key contributory factor here is a decline in the number of people saving into occupational pension schemes over the last two decades (See Figure 1), as well as a shift from Defined Benefit to Defined Contribution schemes. In 2013, the average employer contribution rate for private sector DB occupational schemes was 15.4 per cent, while for DC schemes it was 6.1 per cent (ONS, 2014). With DC retirement income being dependent on stock market performance and annuity rates at the time of purchase, savers also face considerable uncertainty over the eventual size of their pension pot. Annuity rates have fallen significantly over the last 25 years, so that even sizeable pots amount to only very modest annual incomes: an individual who wanted to start retirement with a nominal income of £10,000 would have needed a pension pot of £65,000 in 1990, but over £175,000 by 2013 (Lowe, 2014).

Figure 1.1 Number of active scheme members (million)



Source: ILC UK (2014), p.18.

While income from private pensions now accounts for a similar proportion of the average gross income of retired households as the state pension (41 and 38 per cent respectively in 2010/11), (ONS, 2012), increases in private pension saving have tended to be concentrated among the better off; many UK pensioners, particularly single women, continue to rely on state pensions and related benefits as an important component of retirement income (ONS, 2013a). Furthermore, women's traditionally lower levels of paid employment, earnings and membership of private pension schemes (Hills et al, 2010) continue to affect pension income levels: in 2012-13, the average gross weekly income of single female pensioners was £298 compared to £350 for single men (DWP, 2014a), and around two fifths of women aged 55-64 have no private pension entitlement at all (Age UK, 2014a).

A lack of sufficient private pension saving led the Coalition Government, based in part on recommendations from the Pension Commission (2006), to introduce auto-enrolment into non-state pensions. This will go some way to increasing the number of people saving into a private pension: By October 2014, 4.8 million people had been auto-enrolled, and opt-out rates have been lower than expected (DWP, 2014b). However, with contributions set to increase to a relatively modest 4 per cent for the employee, 3 per cent for the employer and 1 per cent in tax relief by 2018, savings levels are likely to remain low, with the gap between pension income and needs continuing into the future.

### 1.2.2 Private pension reforms and the end of compulsory annuitisation

In March 2014, the Government announced that all people with DC savings over the minimum pension age would no longer be required to purchase an annuity or a drawdown product in order to access their DC savings (from April 2015). This allows retirees to withdraw their DC savings in unlimited amounts, taxed at an individual's marginal rate (with 25 per cent of the amount withdrawn tax free) (PPI, 2014). While it will be some time before the full effects of the recent pension reforms will be known, we are already witnessing a considerable decrease in annuity sales (see Figure 1.2), suggesting that retirees are opting against a guaranteed, secure income, for life, with potentially serious implications for their future financial resilience.

Figure 1.2 Annuity sales by quarter 2013-2014 Q1-3



Source: Pensions Policy Institute (2014), p. 28, based on ABI statistics.

If these trends continue and more people use or invest their pension lump sums in the first few years of retirement, they will need to find alternative sources of income or borrowing later on. Inadequate pension income is therefore likely to be one of, if not the most significant, drivers of demand for additional sources of finance in later life, but a more recent trend – increasing indebtedness in retirement – is also likely to play a role here.

### 1.2.3 Servicing outstanding debt

The Prudential's (2013) retirement survey estimated that in 2013, one in five people would retire with outstanding debts, 43 per cent of whom would have outstanding mortgage debts. Within this figure, there was a slight decrease in mortgage debt, but more people retiring with large amounts of consumer debt in the form of credit cards and overdrafts.

#### 1.2.3.1 Mortgage debt

Changing patterns of mortgage management since the 1980s have fundamentally changed the retirement borrowing landscape in the UK. Home acquisition mortgages were traditionally granted for a term calculated to end by the time the mortgagor reached retirement age, to coincide with expectations regarding the ability to pay. Before the credit crunch, product innovation led to the development of a range of products to facilitate secured lending to older people. New features, including longer terms (of up to 50 years or longer), interest-only mortgages, and the growth in mortgage-equity withdrawal (MEW) – using flexible options on an existing mortgage, or re-mortgaging – had the potential to offer greater flexibility for borrowing during working lives and into retirement, as well as increased risk. The Family Resources Survey (2009-10) found that 34 per cent of homeowners who were still repaying a mortgage had borrowed equity from their homes at some point since they purchased them, a rise of 8.4 per cent since 1994-5.<sup>4</sup>

Since 2007, access to mortgage finance in retirement has been significantly constrained. Yet, more people are carrying mortgage debt into retirement, with forecasts indicating that this trend is likely to grow. Research by the PFRC and ILC UK (Collard and Hayes, 2014) shows that one in five (21 per cent) older households (defined as households headed by someone aged 50 years and over) had outstanding mortgage borrowing on their main home in 2008-10, owing an average amount of over £62,000<sup>5</sup>. Data published by the Council of Mortgage Lenders has demonstrated that the proportion of mortgage loans expected to extend beyond the age of 65 is continuing to increase, and is approaching 35 per cent (CML, 2015). And while mortgage borrowing and the amounts that households owe reduce steadily with increasing age (see Table 1.1), half of all oldest households (75 years and over) owed more than £21,000, and a quarter owed the equivalent of 25 per cent or more of the estimated value of their home (Collard and Hayes, 2014). The number of over 60s approaching StepChange

<sup>4</sup> [http://wealthgap.wp.st-andrews.ac.uk/files/2013/02/WealthGap\\_No\\_01\\_Equity\\_Borrowing.pdf](http://wealthgap.wp.st-andrews.ac.uk/files/2013/02/WealthGap_No_01_Equity_Borrowing.pdf)

<sup>5</sup> The analysis excluded equity release products.

Debt Charity for mortgage help went up by around 40 per cent between 2009 and 2012 (Age UK/ILC UK, 2013), indicating the difficulties that some older people are facing in servicing these debt repayments. It should also be noted, however, that carrying mortgage debt into retirement is not necessarily a source of financial strain, with many older households reporting that they are able to keep up with the mortgage payments on their main home (Collard and Hayes, 2014). For those that are not, or find them a heavy burden, age per se is not a key factor. The factors that most strongly predict mortgage difficulties include households' levels of savings and investments; and levels of non-mortgage borrowing (e.g. credit cards and personal loans) (Collard and Hayes, 2014).

Table 1.1: Amount owed and percentage loan-to-value among older households with any outstanding mortgage borrowing on the main residence, by age of household reference person (HRP) or their partner

Age of HRP or partner	Amount outstanding (Mean £)	Other type		Unweighted base
		Amount outstanding (Median £)	Loan-to-value (%)	
50 to 54	72,000	50,000	38	916
55 to 59	59,700	40,000	27	687
60 to 64	53,200	31,200	25	419
65 to 69	55,200	40,000	44	145
70 to 74*	45,900	22,700	21	91
75 and over*	30,900	21,000	19	75
All aged over 50	62,200	40,000	30	2,333

Source: *Wealth and Assets Survey 2008-10*, as quoted in *Collard and Hayes (2014)*. Base is all mortgaged households headed by someone aged 50 and over. Figures are rounded to the nearest 100. \*Treat with Caution due to small base size (<100 cases).

### 1.2.3.2 Interest-only mortgages

In addition to the demands of mortgage debt repayments by instalment, a further source of concern relates to interest-only mortgages, where the borrower does not have a strategy in place to repay the capital at the end of the term. Again, however, for those that do have a plan in place, borrowing on an interest only basis can provide a suitable and beneficial way of meeting income needs. But the FCA thematic review of interest-only mortgages found that 600,000 interest only mortgages will mature over the next seven years, with almost half of all borrowers needing more time to repay (FCA, 2013). Around 40,000 households aged 65+ will see their interest-only mortgage mature between 2017 and 2032, and half of these households will have a shortfall of more than £50,000. While many of these older households will have plans for repayment, some plans may be derailed by having to give up work earlier than expected because of ill-health or due to caring responsibilities. One in 10 endowment mortgage holders have no repayment plans, and in the years up to 2020, one-third of endowment shortfalls are expected to be over £50,000. Amongst the over-50s, older cohorts are more likely to have non-repayment mortgages, including interest only mortgages with no linked investment (see Table 1.2).

CML monitors the evolving profile of the interest-only back book. Its most recent data (autumn 2015) estimates the total book as at the end of 2014 at some 1.9 million pure interest-only mortgages; 480,000 of which are set to mature on or before 2020.

Table 1.2 Types of mortgage held on the main home among older mortgaged households, by age group of HRP or their partner

Age group of HRP or partner	Repayment (%) <sup>†</sup>	Other type		Unweighted base
		Any other type (including interest-only (%)	Unlinked interest-only (%) <sup>‡</sup>	
50 to 54	67	36	6	916
55 to 59	64	38	8	687
60 to 64	53	48	11	419
65 to 69	54	48	15	145
70 to 74*	42	59	32	91
75 and over*	34	66	40	75
All aged over 50	61	41	10	2,333

Source: *Wealth and Assets Survey 2008-10*, as quoted in *Collard and Hayes (2014)*. Base is all mortgaged households headed by someone aged 50 and over. Figures are rounded to the nearest 100. \*Treat with Caution due to small base size (<100 cases). Notes <sup>†</sup>Includes all in one or (or offset) mortgages. <sup>‡</sup>Comprises all mortgages linked to an endowment policy (including part-repayment, part-endowment), PEP, Unit trust, ISA or other investment, a pension mortgage, and interest only mortgages without a linked investment.

The Financial Conduct Authority has warned that providers cannot penalise older customers who are trapped with interest-only mortgages; but limited options in the regulated credit market reduce older people's freedom to shop around for a new product to re-finance, in the way that younger people can. As such, the problem of maturing interest-only mortgages is likely to be exacerbated by lack of access to further mortgage finance, as arbitrary age limits can make it difficult to extend a loan or re-mortgage. Linda Woodall, Director of Mortgage and Consumer Lending at the FCA has reiterated the Authority's support for lenders to help 'perfectly credit-worthy existing mortgage borrowers' (FCA, 2015a), by allowing these existing borrowers to move to a new deal with them. Woodall noted that while low mortgage rates have provided a number of borrowers with breathing space, and it is unlikely that rates will move up very quickly, many borrowers will find any increase difficult to manage. She concluded by emphasising that there is scope within the FCA rules for lenders to give credit worthy borrowers who are unable to re-mortgage the opportunity to protect themselves from rates rises, and urging all firms to look more closely at their interpretation of the rules to see whether they are really delivering the right outcomes for consumers.

### 1.2.3.3 Unsecured debt: consumer credit and cost of living

Research also suggests a fairly significant change in the profile of unsecured debt, with those who have debt in retirement now owing considerably more than they did fifteen years ago (McKay et al, 2008). The rate of growth in unsecured debt between 1995 and 2005 was fastest for those aged 55 to 59 (increasing almost five times) and those aged 60 to 64 (where four times as much was owed in 2005 as in 1995) (McKay et al, 2008). More recent analysis shows that one in four people aged 50 and over have non-mortgage borrowing, each owing an average of £4,500 (Collard and Hayes, 2014). These trends may reflect 'baby boomers' changing lifestyles and attitudes to consumption, as well as ease of access to credit (with the exception of the last few years), but the changes are also linked to lower income (pensions and savings), rising living costs, and the crunch on credit leaving people struggling to make ends meet.

Even before the financial crisis which started in 2007-08, about 25 per cent of people approaching retirement age had consumer debts, with some increases in the propensity for credit use after the age of 60 and again after 65 (Help the Aged, 2008). In 2013, an estimated 1.1m people over 50 years old were in problem debt, with one in five people retiring in 2013 carrying an average debt of £31,200 and more than one in 10 believing they would never be able to repay that debt (Prudential, 2013).

One consequence of growing indebtedness amongst the older population has been an increase in bankruptcy. In 2013, bankruptcy rates among over 65s rose by 470 per cent to 1,972 people, making pensioners the fastest growing group of bankrupts. Increasing consumer and mortgage debt into retirement; limited access to conventional mortgages and good quality personal finance products in retirement; and the high costs of servicing

consumer debt; combine with a bankruptcy landscape in which alternatives to personal insolvency (for example, the Individual Voluntary Arrangement (IVA) or other debt management arrangements) are unlikely to be available to older debtors, who are much less likely to have predictable future income and expenses than the population as a whole.

#### 1.2.4 Paying for care

As we saw at the beginning of this chapter, one of the most pronounced demographic changes in the 20th century and into the 21st Century has been the significant increase in average life expectancy. In the UK, the number of people aged 85 and over increased by 30 per cent between 2005 and 2014 (ONS, 2013b). However, healthy life expectancy has not kept pace with the overall increase in life expectancy (particularly for men), with those aged 85 and over being most likely to need care. Government spending on social care has fallen by £770 million since 2010, and waiting times for care home places, home care, and adaptations have increased (Age UK, 2014b). These changes reflect local authority funding pressures, leading many councils to raise eligibility thresholds for care funding contributions. By 2012, 85 per cent of local authorities had set their eligibility threshold for adult social care at 'substantial', with a further 2 per cent setting their threshold at 'critical'. Only a minority now pay for people with low and moderate care needs (Age UK, 2014c, p.8). Significant pressure on local authority budgets for care services increases individual responsibility for meeting care costs; and, in light of the pressure on retirement income, discussed above, income alone is rarely sufficient to cover these costs.

Increasing demands on older people to self-provide with respect to the costs of social care are therefore likely to be a further driver of demand for retirement borrowing; products that allow the withdrawal of housing equity to support care at home are likely to be of most importance here. Indeed, evidence suggests that when people need care, they prefer to stay in their own homes (Heywood et al, 2002). In a recent study of equity release consumers (Overton and Fox O'Mahony, 2015), participants unanimously agreed that care at home was preferable to care in an institutional setting, with the majority saying that they would be willing to use their own resources, including housing equity, for this purpose.

*It does seem to me that older people want to stay in their homes when they get old and their health isn't good... I think it's better for the individual, but also I think it's better for society that people can stay in their home with the support that they need... I think we would feel that's [paying for domiciliary care] a legitimate reason to draw down the money [release more equity] Like to pay for home help or even an adaptation or something like that with the bathroom. (Male, age 76)*

*All the while I can look after myself I shall continue to do so. But if I needed a little bit of help to come in occasionally and that has to be paid for, then so be it... That would be a legitimate use of my resources. (Male, age 75)*

Furthermore, the Care Act 2014 implemented a cap on the cost of long-term care with the hope that having a clearer idea of what people may need to provide for would make it easier for them to plan ahead (Commission on Funding of Care and Support, 2011). The Act was also underpinned by an assumption that the cap would create demand for new financial products to help people to manage their long-term care costs (Department of Health, 2013). However, there is a current lack of suitable product vehicles enabling older people to plan ahead for the costs of care, or pay for care at the point of use. The Universal Deferred Payment Scheme, for example, is set to apply only to care in an institutional setting, while commercial equity release products come to an end when someone moves into long-term care. This leaves open the opportunity for product development, particularly products that draw on housing equity to service domiciliary care costs.

### 1.2.5 'Trading down' vs. 'ageing in place': affordability and suitability

In theory, one option for older owners with financial needs after retirement would be 'trading down' to a lower value property; however, there are limited opportunities for this in the current UK housing market. For older homeowners, trading down might not always be possible or, indeed, desirable, for a number of reasons. Firstly, there can be significant costs involved in moving house. The Pensions Policy Institute (2009) estimated that downsizing from a property worth £350,000 to one worth £230,000 in order to release £120,000 could cost somewhere in the region of £13,100 when the costs of stamp duty, surveys, legal fees and so forth are taken into account. Secondly, a recent study has found that decisions to 'age-in-place' are also influenced by a lack of suitable (and suitably-priced) alternative housing options (Fox O'Mahony & Overton, 2014a). Less well-off consumers, in particular, indicated that there was a lack of suitable alternatives in their price range, leaving them with no choice but to release equity in situ. In several cases this was because they had already downsized to their current property. Finally, many people do not want to move house in later life due to the upheaval involved and/or because they want to remain in familiar surroundings; close to social networks (Fox O'Mahony and Overton, 2014a).

However, a recent online YouGov poll (December 2014) of 1,459 homeowners aged 55 and over (on behalf of the National Housing Federation) indicated that homes are not suitable for ageing in place. Just over half (52 per cent) of those surveyed think that their current home is unfit for living with care needs or mobility problems, while 38 per cent reported that their home would need to be adapted. Only a quarter said that their home would be suitable in the event of mobility problems or in case they became ill to the point of needing care<sup>6</sup>. With specialist retirement housing comprising just 2 per cent of the UK housing stock, or 533,000 homes, with just over 100,000 to buy (Wood, 2013); and older people potentially having to compete with first-time buyers for other smaller houses and flats, there is a continued and growing need for borrowing options on existing properties. Meanwhile, improving the supply of suitable housing for older people will remain a key policy challenge (ILC UK, 2014).

### 1.2.6 Changing attitudes to housing wealth and inheritance

Customer demand for retirement borrowing may also be influenced by changing attitudes to housing wealth and inheritance. Research by Smith (2004) examined people's attitudes to retirement, their financial plans and whether they might use their housing wealth in the future. She found that although the majority of respondents thought that they would rely on pensions and spouses' incomes as the main sources of retirement income, 52 per cent of mortgage holders in the 45-54 age group and 46 per cent of outright owners said they were likely to draw on housing equity. This is in contrast to 23 per cent and 37 per cent of mortgage holders and outright owners in the 65-80 year old age group which indicates that support for using housing wealth in older age is greater among those who have not yet retired. Just Retirement (2012) found a similar pattern, with changing attitudes to inheritance more pronounced among younger cohorts. While they found that people who were 'established retired' or 'long-term retired' were more likely to have a strong bequest motive, even if this meant going without during their retirement, those approaching retirement were much less inclined to sacrifice their own income needs and preferences in order to leave an inheritance. It is possible that there is an ageing effect here, with people's attitudes to inheritance altering as they age and their circumstances change. For example, as Rowlingson and McKay (2005, p.42) suggested, people in their 50s and 60s may decide they want to enjoy life more than they had previously thought, but as they progress into later life and reach their 70s and 80s, they may become more closely integrated with their families again, perhaps through grandparenthood or receiving care, and with the ability to cruise around the world declining, support for inheritance and the idea of leaving some kind of legacy after they die may return. However, without panel data on this subject, it is difficult to know if this is generally the case. It is also possible that differences in attitudes among the younger old, and the older old, age groups are the result of a cohort or generation effect. The baby boom generation(s) may well have different attitudes to family and money than older generations who experienced the second world war and lived through more austere times (Rowlingson and McKay, 2005).

<sup>6</sup> National Housing Federation (2014), p.10, based on wealth and assets survey 2010-12, available at <http://www.housinglin.org.uk/Topics/browse/Housing/Commissioning/?&msg=0&parent=3693&child=9541>

Alongside changing attitudes to inheritance, there has also been a shift in attitudes towards responsibility for income needs in retirement. Rowlingson (2006) found that while most participants wanted to leave some of their estate as an inheritance, they acknowledged that their incomes in later life were likely to be fairly low. Rather than expecting the state to resolve this by increasing pension incomes, the participants in her study expected that they might have to draw on the equity in their homes to maintain a reasonable standard of living.

As well as meeting their own welfare needs, there is also evidence to indicate that some older owners are using their housing wealth to support their children financially. This was a key finding in a study of UK equity release consumers (Overton, 2010) where 26 per cent of those surveyed had taken out equity release primarily to pass on some of their housing wealth to children or grandchildren. This group of consumers had used equity release as a strategy for asset transfer on the basis that their longevity would reduce the benefits to their children, and also so they would receive more benefit by being able to see the impact it had on their families' lives. Timing is a factor that a number of researchers have pointed to in explaining the changing nature and pattern of inheritance. Izuhara (2005), for example, suggests that as people live longer they may increasingly decide to make early bequests, since by the time they die their children are more likely to be established in terms of employment, housing, and so forth, and are therefore less likely to need the inheritance compared to when they were younger. Recent analysis by ILC UK (2014) found that the average age of a first time buyer without family assistance is now 33 compared with 30 in 2008, pointing to the growing importance of this type of support, and to the potentially increasing demand among older people for mechanisms enabling them to provide financial transfers.

# Retirement Borrowing Options – Opportunities and Limitations

## 2.1 Introduction

In this chapter, we provide an overview of the financial product options currently available for older people, including conventional mortgage borrowing, unsecured consumer borrowing, unregulated borrowing options and equity release (lifetime mortgages and home reversions).

We discuss the limitations on access to these borrowing ‘options’, and consider the implications for older people’s access to borrowing, with knock-on effects for their financial security. We also identify a number of barriers inhibiting market growth in some areas (e.g. equity release) and the impact of exclusion issues (including age and income/asset levels). Finally, we consider how the patchwork of barriers to, and restrictions on, retirement borrowing has narrowed the field of options within the regulated market, with implications for the shape and size of the market for later life borrowing.

## 2.2 Conventional mortgage borrowing

As we noted in Chapter One, for many people seeking to realise equity or raise cash, trading down is either not an option, or not an attractive option, leading them to look instead to the credit market. The development of innovative mortgage products has played a significant role in disrupting the traditional picture of owner-occupiers reaching retirement, having discharged their mortgage, as outright owners, and ready to exit the borrowing market. Increasingly, older people are carrying mortgage and non-mortgage debt into retirement, either as part of a deliberate income and asset management strategy<sup>7</sup>, or through little choice, in which case, putting increasing financial strain on household budgets as income drops. In addition, as noted in Chapter One, this has coincided with a range of factors – new drivers, including income needs and higher expectations of lifestyle in retirement, and the normalisation of flexible borrowing – which have generated new demand for retirement borrowing services. Yet, for older borrowers looking to the conventional mortgage market, supply has been drastically curtailed in the wake of the global financial crisis and the (then) FSA’s Mortgage Market Review.

### 2.2.1 Mortgage Market Review and post-Global Financial Crisis financial regulation

The Mortgage Market Review (MMR) (FSA, 2011) implemented significant changes to the Financial Conduct Authority’s rules governing the sale and approval of mortgages to residential consumers. Key changes included the implementation of an affordability assessment, requiring lenders to verify income in every mortgage application, including stress-testing interest rate changes and considering major outgoings such as heating and council tax, to ensure that borrowers will be able to afford repayments both now and into the future of the loan.

The MMR identified mortgage terms that extend into retirement as ‘high-risk’, on the basis that income may not be sufficient for mortgage servicing after the consumer retires, and highlighted a need for more rigorous assessment of affordability, with specific consideration given to lending beyond state pension age. In shaping its approach to retirement lending, the FSA explicitly stated that it did not wish to encourage an ‘excessively cautious approach on the part of lenders, thus restricting the availability and increasing the cost of mortgages into retirement.’

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<sup>7</sup> See research by Policis which reports that around half of mortgagors over fifty (53%) now have mortgages that stretch past age 65 with almost two thirds of this age range (65%), overall, intending to borrow into retirement to support their financial plans for later life (<https://policis.com/pdf/Mortgages/New%20Approaches%20to%20Mortgage%20Regulation%20and%20MMR%20final%20151110.pdf>)

*‘Our aim is to protect consumers from carrying foreseeably unaffordable debt into retirement. We do not want to prevent older consumers from accessing mortgages where they have the means to support the mortgage. So we are proposing that lenders should adopt a prudent and proportionate approach to assessing income beyond state pension age. This means that lenders may take a higher-level approach where retirement is a long way off, for example by requesting evidence of the existence of pension provision. Where retirement is closer, however, lenders might be expected to take more robust steps, for example by considering projections on pension statements.’ (FCA, 2011 [CPI 11/31]: 1.76)*

The Mortgage Market Review recognised the need for lenders to tailor their criteria to meet the needs of a diverse population of older consumers, noting respondent feedback that ‘[some] consumers carry unaffordable levels of debt into retirement, while others with more than adequate resources to sustain mortgages into retirement are refused mortgages because of their age’. It therefore recommended that lenders assess affordability on a case-by-case basis, making an informed lending decision, based on appropriate evidence (FSA, 2011: 3.292-3.298).

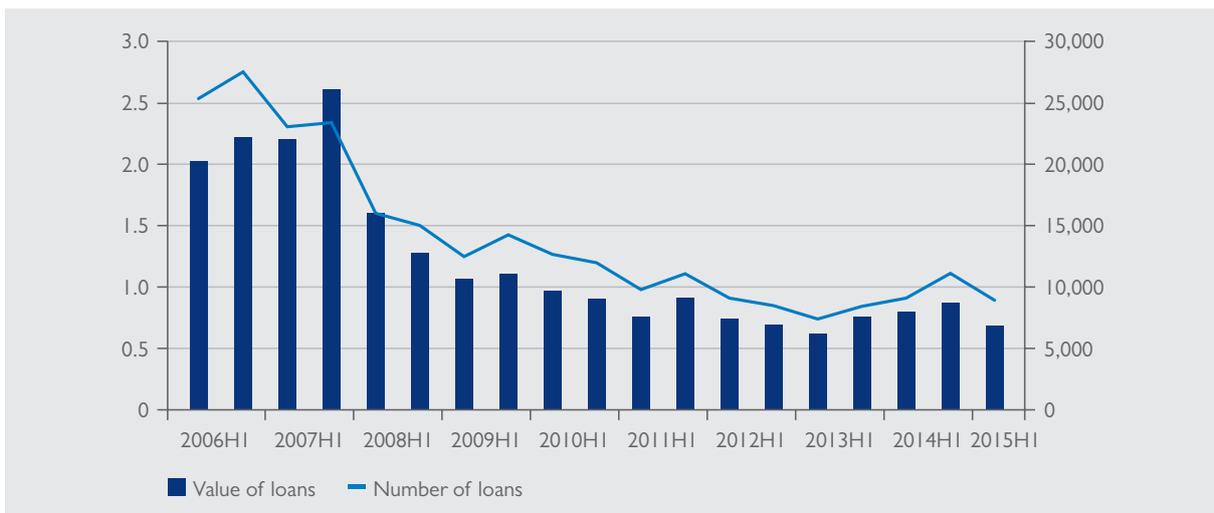
### 2.2.2 Limitations on access to mortgage borrowing following MMR and GFC regulation

#### 2.2.2.1 Age limits, discrimination and exclusion

In practice, the majority of lenders have responded to the GFC and MMR by adopting a cautious approach to conventional mortgage lending into retirement. In 2007, most banks and building societies were willing to lend money on a mortgage with a maximum age on repayment of up to 85. Following the financial crisis, some lenders reduced their maximum lending limits for conventional borrowing, and refocused retirement borrowing towards their retirement product ranges.

In addition to explicit maximum age criteria on conventional mortgage products, some apply additional criteria: for example, requiring borrowers who want their loan to run into retirement to have a private pension, regardless of their other savings and assets. It is therefore not surprising that since a peak in the second half of 2007, CML figures show a significant decrease in borrowing by those aged 65 and over in both the number and value of loans (see Figure 2.1).

Figure 2.1 Borrowing by those aged 65 and over, by volume and value (£bn)



Source: CML, data provided in personal communication.

Age UK has also reported an upsurge in calls about conventional mortgages. Some of these calls reveal further evidence of access issues for older people, with the most frequent complaints relating to the application by lenders of an age limit of 70 or 75, or callers being unable to re-mortgage or extend the term of an endowment or interest-only mortgage, even if they can afford the interest on their current mortgage.

The following anonymised quotes help to illustrate these experiences:

*“I was amazed to find today that as a current home owner, although I was approved for a small mortgage on line, when I went to branch they advised me that banks will not offer mortgages that extend beyond a person’s 75th birthday.”*

*“Caller and husband have an endowment mortgage with £139,000 outstanding which is due in March. The mortgage company says it won’t re-mortgage and referred the caller to Money Advice Service and Age UK.”*

*“Caller has an interest-only mortgage of £30,000 and is seeking further financial assistance of £3,000 to make housing improvements... Caller told that the rules have changed and caller cannot access further £3,000 unless she changes to a repayment mortgage, which would increase her monthly repayments to a figure caller feels would be unmanageable.”*

*(Age UK, 2015)*

Thus, while some older people may have been lent money that they cannot afford to repay (Chapter One), others do not have access to the loans they need. From the lender’s perspective, the potential risk of default may be higher where the borrower’s ability to repay is significantly curtailed by a drop in income during the repayment period, for example, on retirement, which could render the mortgage unaffordable. On the other hand, the exclusion of older people from access to conventional mortgage products – particularly under a ‘blanket ban’ based on age rather than individual affordability assessments – has implications for their access to mainstream, affordable credit. Age UK have raised concerns that it is unfair that those older people who can afford to service a loan in later life should be forced into higher-cost borrowing, or equity release (often offered by niche lenders), because they are excluded from the wider marketplace (Age UK, 2015).

Age UK recommend that the FCA review mortgage availability for the over 70s; noting that this is particularly timely in the context of the new pension freedoms, as industry anxiety about conventional mortgage debt after retirement may lead some lenders to steer people towards using their pensions to repay a mortgage, even if it is not in their best interests to do so.

These experiences of exclusion among older people have also led Age UK to suggest that it may be timely for the FCA to review the financial services industry exception in the Equality Act 2010. Under section 5 of the Act, ‘Age’ was identified as a ‘protected characteristic’, and Part 3 of the Act makes it unlawful for providers of services and products to discriminate on grounds of age. However, financial services were excluded from the scope of the Act, allowing financial service providers to assess risk, decide prices, and use age bands and age limits on specific products and services, so long as the approach is based on relevant information from a reasonably reliable source. This allows prices and products to vary where this is in line with risk or costs and not arbitrary; where ‘it can be justified by data showing that it fairly reflects the varying risk profiles of different age groups.’

Following its consultation on the draft Equality Act, the Government Equality Office concluded that there was insufficient evidence of harmful age discrimination in this area to justify increased legislative intervention, and that financial service providers (such as banks, insurance companies, credit reference agencies) could continue to use age in the provision of financial services. ‘Harmful age discrimination’ might be understood as differences in treatment which are arbitrary, or which result in financial exclusion for older people. The GEO concluded that these issues fall within the remit of the FCA, under its rules and guidance about treating customers fairly. The FCA is therefore charged, through its existing regulatory jurisdiction over the financial services industry, with addressing any real or perceived problems linked to harmful age discrimination.

### *Implications of restricting conventional mortgage lending into retirement for lenders*

One consequence for lenders of tighter lending criteria is a reduction in the volume of regulated mortgage transactions: age limits on the repayment term require repayments to be profiled over a shorter period; while accelerated repayment schedules to avoid lending beyond retirement mean higher instalments, which can render lending unaffordable in the short-term. As noted above, this has implications for consumers, who are – sometimes unnecessarily – excluded from the regulated mortgage market; but it also has implications for policy goals which seek to encourage people to save for their retirement through the accumulation of housing equity during working lives. The Intermediary Mortgage Lenders Association (IMLA) has argued that the MMR does not allow lenders to trade-off between repayment risk (affordability) and underpinning security (LTV ratio). From a prudential perspective, the over-weighting of repayment risk relative to LTV ratio within the overall risk profile of a loan book could actually raise overall risk profile, if providers decline business that carried a lower overall risk than repayment risk alone would suggest (IMLA, 2014).

Another factor highlighted by the IMLA is that, with most private sector employees now holding defined contribution (DC) pensions, many customers are not in a position to know what their pension income will be with any certainty, making it difficult for lenders to predict how affordable a loan extending into retirement might be. The new pension freedoms have compounded the difficulties in assessing affordability on mortgage applications for older borrowers. The end of compulsory annuitisation has introduced a new uncertainty around individual borrower behaviours, with consequences for their future income levels. Annuity sales have decreased since the end of compulsory annuitisation (see Chapter One), and if this trend continues, income in retirement is likely to be based on a much wider range of sources than was the case under compulsory annuitisation. This presents new challenges for lenders in making affordability assessments, not least because investment income, savings, and asset-holding are not typically foregrounded within post-MMR affordability assessment criteria.

The FCA's post-MMR thematic review offers an opportunity to reflect on whether the current emphasis on repayment risk (and, in the case of older borrowers, pension income) within the affordability criteria is preventing lenders from taking an holistic view to the affordability of conventional mortgage lending into retirement.

## 2.3 Unsecured borrowing

We noted in Chapter One that unsecured borrowing is increasing amongst the over 50s. Older people are both carrying consumer debt into retirement and continuing to accrue unsecured debt during retirement. There is also evidence of polarisation within the unsecured debtor population: Collard and Hayes (2014) found that credit use persists over time, with existing credit users, including those in their late 60s and early 70s, being more likely to become bigger borrowers than non-users were to become unsecured borrowers. They suggested that this could reflect escalating balances due to the effects of compound interest and fees, particularly if people fall behind with payments.

Research by Key Retirement Solutions found that the 65 and under age group had the highest levels of credit card debt (average balance £9,650), typically making average monthly repayments of £297. Whilst the 66-75 age group had, on average, lower amounts of unsecured debt (£8,494), making payments averaging £584 a month, average credit card balances begin to increase, and monthly repayments dropped considerably (£225) amongst the over 75s<sup>8</sup>.

### 2.3.1 Limitations on access to unsecured borrowing in retirement

#### 2.3.1.1 Age and income limits

Age is likely to present a barrier to many older people seeking to access good quality consumer credit services in retirement. Several 'best-buy' personal loan products carry age limits (Hitachi Capital impose an upper age limit of 60; Tesco and Clydesdale restrict their personal loans to people up to age 74; and across the sector, a maximum age limit of 79 is typical). While credit cards do not impose a maximum age criterion (since they are designed as short-term credit), many of the lead providers have minimum income requirements, ranging from

<sup>8</sup> See KRS UK Equity Release Market Monitor, Q1 2015, available at <https://www.keyretirement.co.uk/wp-content/uploads/Market-Monitor-Q1-20152.pdf>

£3,000 but with an average of about £15,000, which could exclude many older people. With average retirement incomes for people retiring in 2015 expected to be around £17,000 (Prudential, class of 2015), low-income is likely to be a significant barrier for many older people seeking to access good quality consumer credit.

## 2.4 Unregulated borrowing options

With a quarter of the older population using unsecured credit and, of those, ten per cent (around 400,000) paying over £85 a week to service their debt, there is a real risk of older people being caught in a spiral of debt, with options to repay or restructure debt increasingly limited. Since the financial crash has constrained access to credit, lack of access to affordable credit with mainstream lenders has led many people on low-incomes to turn to other sources of unregulated credit. Unregulated borrowing options include high-cost, short-term loans, and there is evidence that the market for high cost credit has expanded to meet the new demand stimulated by constraints in the regulated market (CSJ, 2013). The growth in financial exclusion from regulated credit is compounded, for older people, by age-restrictions on regulated mortgage lending and personal loans.

There is also evidence to suggest that mortgage market regulation may have created a lending bias which favours investors over residential home buyers, since the buy-to-let sector remains non-regulated and lenders are able to advance up to 85 per cent loan-to-value, interest-only, mortgages to landlords. Bank of England and FCA mortgage lending statistics show that the proportion of lending to first time buyers decreased by 2.4 percentage points to 19.4 per cent in Q1 2015, while the value of residential loans advanced to first time buyers also decreased over the past year by £0.5 billion to £8.9 billion. However, the buy-to-let proportion of lending increased from 14.9 per cent in Q4 2014 to 16.8 per cent in Q1 2015. There was also an increase in value terms over the past year – from £6.8 billion advanced in Q1 2014 to £7.6 billion in Q1 2015<sup>9</sup>.

The lack of restrictions on buy-to-let mortgages may tempt older people cashing in their pension pots into buy-to-let borrowing, prompting the ILC UK to warn against this relatively high-risk strategy. However, with research from pension advisers Portal Finance showing that, so far, only 9 per cent of people had decided to take their pension as a lump sum and, of those, only 5 per cent planned to invest in buy-to-let property, compared to 34 per cent who would use the money to pay off an existing mortgage or other debts, it is not yet clear that buy-to-let has, or indeed will, become a significant retirement borrowing strategy.

## 2.5 Equity Release

Another option for borrowing in later life is equity release. Equity release products are a distinct category of home finance product offered exclusively to older consumers. Marketed as facilitative products which enable older owners to tap into housing equity without having to sell up and move out, or make repayments by instalment, they enable homeowners to trade on their housing asset to release capital or income while continuing to occupy the property as their home. The UK equity release market is primarily comprised of two product types: lifetime mortgages and home reversion plans (both of which operate a minimum age threshold) with lifetime mortgages now comprising the vast majority of regulated sales (approximately 99 per cent). This has not always been the case, however, and a recent study of equity release consumers offers some possible insights into the decline in the reversion market in recent years. While both products offer the ability to access some of the value of the home without having to move or make monthly repayments, lifetime mortgages differ considerably from home reversions in terms of owners' ability to retain legal ownership of the property: in the case of reversions, this is transferred to the lender. This may be one of the factors contributing to their limited popularity, particularly for those with lower levels of income and wealth. In our 2013 study of UK equity release consumers, concerns about feeling safe, secure and in control often played a significant part in determining the choice of product, particularly for less well off participants, whereas the overriding consideration for better-off owners centred on value for money (Fox O'Mahony & Overton, 2014b).

<sup>9</sup> See <https://www.fca.org.uk/static/documents/mlar-statistics-jun-2015-commentary.pdf>

For some lower socio-economic status consumers, concerns about accumulating debt meant that the certainty of knowing the fixed share of equity they would retain under a home reversion offered greater security than maintaining the arguably ‘fuller status’ of owner under a lifetime mortgage. On the one hand, this reflects the likelihood that lower socio-economic status consumers live in lower value properties, and so are less likely to benefit from future house price rises; however, it also reveals a significant tension between tenure security and financial security. Lower socio-economic status owners who had opted for lifetime mortgages also tended to express the reasons for their preference in terms of wishing to avoid loss of control or insecurity. In explaining why they did not opt for a home reversion, one consumer said:

*I didn't like the thought of somebody owning it [the house] and being able to come round and inspect the property and say, 'Well, you aren't keeping it up', or, 'You've not done this', or, 'You haven't done that'. I didn't like that at all ... You feel as though you lose control of your house. If you like, you're in actual fact giving up some of your feelings about the place. I'm sure you wouldn't look upon your house in the same light if you'd given up the deeds as such. (Male, age 76, lower socio-economic status)*

We also found that participants product choices were influenced by the advice process, where there appeared to be a bias towards lifetime mortgages. Point six of the Equity Release Checklist for advisers asks:

*(Prior to any recommendations) have you provided the customer with a fair and balanced overview of the pros and cons of both lifetime mortgages and reversion plans?*

Comments made by participants in our consumer study included:

*Well, they skated over it, [home reversion] let's put it that way. (Female, age 81)*

*We didn't consider that at the time. I don't think we knew about it actually. (Male, age 80)*

*I think that [home reversion] was mentioned almost in a negative fashion I would say. (Male, age 77)*

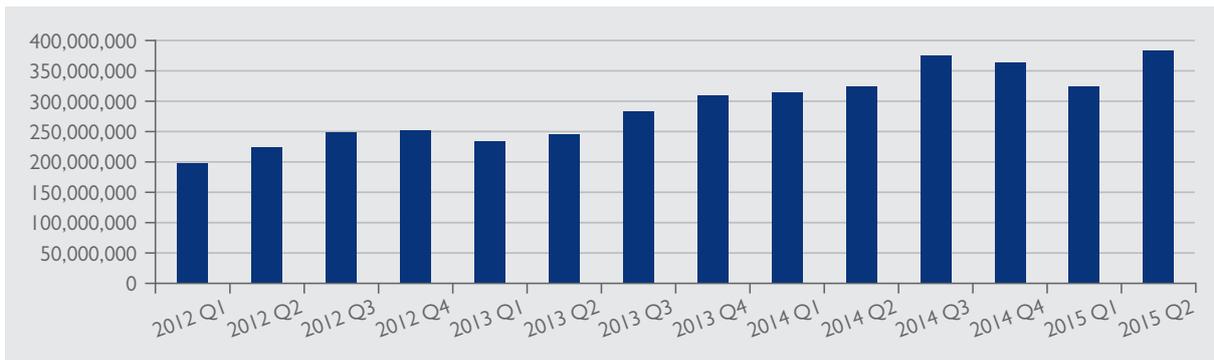
These findings raise questions about the extent to which the significant drop in reversion sales reflects the irrelevance of such a product in today's market; a (relative) lack of innovation in this sector compared with the lifetime mortgage sector, or, whether it is (at least partially) attributable to adviser bias. This, in turn, raises another important question regarding the extent to which consumers are being advised on the product options that are best suited to their circumstances, needs and objectives. In a context which requires an additional qualification to advise on reversions, yet permits authorised advisers to legitimately promote themselves as independent while providing advice only in relation to one kind of product (Sheldon et al, 2012), there is some potential for consumers to be misled and, ultimately, to purchase one product type (most likely a lifetime mortgage) when an alternative option may have been more appropriate. Regulatory rules state that advisers are required to disclose the scope of the service they offer, but our research suggests that it is not clear that consumers are sufficiently aware of this. In the absence of a level playing field, or a clear obligation on advisers to consider whether, or not, a home reversion would be the more suitable product in every transaction, we may reasonably question the extent to which consumers are receiving advice that takes account of the full range of options that may be available to them.

### 2.5.1 Uptake on equity release

With older people holding almost £1.4 trillion of housing equity in their homes, equity release is viewed by many as a potential source of finance for later life (House of Lords, 2013). Recent trends in mainstream lending have also positioned retirement borrowing provision towards equity release by limiting the availability of conventional

mortgage products for older people, especially older people with lower levels of income and assets. While the equity release market remains small, at less than 2 per cent of the mainstream mortgage market, there has been a significant recent increase in sales. Equity release lending to UK homeowners over the age of 55 totalled £384.3million in the second quarter of 2015: the largest amount for any quarter since records began<sup>10</sup>. Record lending in quarter 2 meant the total value of equity released in the first six months of 2015 hit £710 million, with the total number of new customers reaching just over 10,000 for the first half of 2015.

Figure 2.2 Equity release total lending by quarter (£): 2012 – 2015



Source: Equity Release Council Data, received in personal communication.

The value of lending, via lump sum lifetime mortgages, increased by 10 per cent year-on-year in the first half of 2015 to reach £285.3 million; this is the highest total for lump sum activity in the first half of any year since H1 2007, when the value hit £355.9 million. The value of lending via drawdown lifetime mortgages showed the highest growth, rising 12 per cent year-on-year from £379.2m (H1 2014) to £423.5 million (H1 2015) and faster from Q1 to Q2 (21 per cent vs. 14 per cent for lump sum products).

Table 2.1 Growth of lending via lump sum and drawdown lifetime mortgages

	Q2 2015		HI 2015
	Quarterly growth	Annual growth	Annual growth
Lump Sum	36	6	916
Drawdown	41	10	2,333

Source: ERC Press Release, July 2015: ‘Equity Release Lending Surges to All-time High in Q2 Following Pension Freedoms’.

It is noteworthy that this uplift comes despite savers gaining greater access to their pension pots since the launch of pension freedoms in April 2015. While the growth in drawdown may reflect the ongoing income needs discussed in Chapter One, the increase in lump sum sales could also be linked to debt clearance, including paying off outstanding mortgage debt. Key Retirement Solutions have reported that 23 per cent of their equity release customers in 2015 used equity release to repay mortgage debt, up from 17 per cent in 2010; and a marked increase in those utilising the funds in their home to repay unsecured debt, from 26 per cent for the first quarter of 2014 to 31 per cent for the same period of 2015. This may reflect the growing appeal of using property wealth as a source of retirement income as house prices began to rise. On the one hand, changes to pension regulation might have been expected to offer an alternative means of obtaining lump sum funds; but, on the other, recent tax changes – which allow untapped pension savings to be passed on tax-free if the pension-holder dies before the age of 75 – may incentivise earlier use of housing equity and later use of pension wealth.

This market growth follows a report published by the House of Lords’ Select Committee on Public Service and Demographic Change which emphasised the importance of ‘an effective equity release market to unlock the housing assets held by older people’ (House of Lords, 2013). The Committee noted that equity release products are underused relative to potential, and suggested that this is linked to ‘quite considerable’ market failures:

<sup>10</sup> ERC Press Release, July 2015: ‘Equity Release Lending Surges to All-time High in Q2 Following Pension Freedoms’.

*We have heard that older people lack confidence in the products that are available and that as a result commercial products have poor take-up. This has knock-on effects for both the market in suitable housing for older people, and older people's ability to adapt their homes for older age.*

Possible strategies identified by the Committee included state support for social lending (building on the commitment to universal deferred payment schemes for care costs); and more communication about 'the positive beneficial implications of using equity in retirement planning'. Recognising the 'urgent need for greater consumer confidence in the equity release industry', the Committee proposed that 'the Government should work with the financial services industry to encourage the growth of a safe and easy-to-understand equity release market', for example, by promoting reliable equity release products that offer 'no negative equity guarantees' and companies that have signed up to the Equity Release Council's Code of Conduct.

### 2.5.2 Supply side barriers to equity release market growth

While some of the barriers identified by the House of Lords (2013) report are being addressed, our research has indicated that, from an industry perspective, there remain some significant perceived barriers to wider up-take of equity release. In 2014, we conducted an in-depth analysis of the views and experiences of retirement borrowing stakeholders, including financial advisers, providers, consumer organisations, charities and law firms involved in equity release. We asked stakeholder participants about their views on the barriers to, and drivers for, market growth (Overton & Fox O'Mahony, 2015). Stakeholders identified a number of supply side barriers to market growth, the most common of which related to equity release products and equity release providers.

#### 2.5.2.1 Products: Greater flexibility and innovation

Following the market downturn in the wake of the Global Financial Crisis, the equity release industry set out to achieve market growth by introducing greater product flexibility. Flexible product features include drawdown lifetime mortgages allowing borrowers to obtain an agreed, maximum amount of money as and when required; inheritance guarantees enabling consumers to protect a proportion of their property value from the outset; and impaired life schemes (otherwise known as enhanced lifetime mortgages), which take into account the health and lifestyle of the consumer, working on a similar principle to enhanced-rate annuities. One provider who re-entered the market in 2011 now offers lifetime mortgages which permit consumers to pay off some of the interest during the life of the loan, thus reducing the overall cost of the loan and increasing the amount left for inheritance at the end of the loan term.

Despite these developments, many stakeholders suggested that current product offerings do not meet the changing needs and preferences of successive generations of retirees. Stakeholders expressed fairly widespread agreement on the need for greater product flexibility and innovation. Alternative product offerings were considered necessary not only to meet a wider range of consumer needs, but also to ensure the long-term affordability of equity release given demographic shifts such as increasing life expectancy and an increase in the average age of first time buyers. One stakeholder suggested that:

*Unless the products change so that interest can be paid in some way, shape or form, or part-paid, part-rolled, or something like that, then I just don't think that they'll be affordable. All the interest rates will be so huge that it wouldn't make sense, it wouldn't make financial sense because people would be in negative equity within a very few years... There's a product that fits most needs, I suppose, but there isn't a huge amount of consumer choice and I think that needs to change... (Private Sector, Adviser)*

Many stakeholders also suggested that, while Equity Release Council Standards and safeguards play an important role in consumer protection, these standards restrict product choice and flexibility. One requirement in the ERC code of conduct is that customers have a No Negative Equity Guarantee, which means that they will never owe more than the value of their homes and no debt will ever be left to the estate. Some stakeholders questioned the necessity of this blanket approach to consumer protection, considering it to be one of the factors contributing to limited demand:

*The market will grow if better products come on the market... Millions of consumers would access this, if there was a simple, straightforward product that they could understand... The protections that the Equity Release Council put forward are great, but if they're stifling the market then that's not great... As long as the risks are properly and clearly explained, some consumers may opt for a technically riskier product or forgo some of the protection in order to get a more flexible product. (Not for profit sector)*

*They're [Equity Release Council safeguards] nice to have, but the reality is I think they restrict innovation a little bit because we're almost forcing every client to have it. So for example if you had a client with a £400,000 house and she's borrowing £10,000 to replace the roof for example, does she really need a no negativity equity guarantee because you'd have to have something pretty extreme to happen for the £25,000 she may owe in 20 odd years' time to erode the £400,000 value of her house. But because we have those protections built in as a norm, you're forced to have it therefore you're forced to carry a higher interest rate or higher set up charges to have each of those, so I think there needs to be a tiered approach to it so that different products that offer different levels of protection, you pay accordingly as to the level of protection that you need or that you choose to have... (Not for profit sector)*

A further consequence of the ERC standards is that all ERC-compliant lifetime mortgages carry a fixed (or capped) interest rate for the life of the loan. Originally, interest rates on lifetime mortgages were not fixed, and so in the adverse financial and economic conditions of the late 1980s where interest rates rose and property values fell, some customers found that they were in negative equity (Appleton, 2003). The move to fixed or capped interest rates therefore reflected a concern, on the part of the industry, to introduce greater consumer protection, but it may be that this particular product feature, which contrasts with the conventional mortgage market where there is limited demand for fixed interest rates in excess of 10 years, is also a potential barrier to greater product flexibility and increased customer demand.

The one-size-fits-all approach to consumer protection in the current equity release market has also been a source of frustration for some equity release consumers. In another recent study (Fox O'Mahony & Overton, 2014b), some consumers expressed frustration over the FCA requirement that all non-professional/non-high-net-worth consumers receive (costly) independent financial advice. Although none of these consumer participants questioned the desirability of the NNEG, or indicated that they were dissatisfied with having to pay for the (indirect) costs that this incurs, it would be useful for further targeted research to explore more fully what consumers want from equity release products, and what they are prepared to pay for particular features and safeguards.

Any industry responses to consumer demand for greater product flexibility and innovation should, however, be tempered by the risk that a tiered approach to protective product features, without additional, alternative measures to ensure consumer protection, might have an adverse effect on consumer outcomes, since equity release consumers are not always in a position to take account of the risks involved, even if they are fully and clearly explained (Fox O'Mahony and Overton, 2014b).

### 2.5.2.2 A negative image

'Equity release' is also sometimes perceived as continuing to suffer from the negative image it gained during the late 1980s and 1990s. During this time, certain products/providers employed investment strategies which, with increasing interest rates and poor stock market performance at the end of the 1980s, left customers with large debts and negative equity; in some cases this led to repossession (Appleton, 2003). Although these practices no longer exist within the regulated equity release market, concerns about a poor industry reputation have lingered, prompting one stakeholder participant (Overton & Fox O'Mahony, 2015) to suggest that a name change might be the only way to shed the negative perception that many people still associate with equity release:

*We sometimes can't get clients beyond the fact that I don't want to talk about equity release, I know I don't want it. And if you ask them what is it you don't want, they say, I don't know but I know I don't want it, I know it's not safe... I think it's just the label... we need to switch more towards retirement lending, retirement mortgages as the badge of what we do... (Not for profit sector)*

This negative image is particularly salient in light of the impact of negative perceptions of equity release in creating an atmosphere of stigma and secrecy relating to retirement borrowing. Although the next generation of retirees may have a different set of attitudes to borrowing, debt and outright ownership in later life, recent research suggests that, for the current cohort of older owners, reluctance to talk about borrowing money in retirement remains a potentially significant barrier (Fox O'Mahony & Overton, 2014a).

In our 2013 equity release consumer study, we asked all participants if they knew anyone else with an equity release plan. The overwhelming majority reported that they did not. Reflecting on the possible reasons for this, participants repeatedly pointed towards the silence that surrounds equity release. Some explained this by noting that older people belong to a generation where money matters are not openly discussed; other participants also acknowledged that to 'admit' to having taken out an equity release plan might represent failure for some people – failure to achieve economic success and the perceived 'norm' of debt-free old age as an outright owner. Our findings revealed a distinction between 'respectable' acquisition mortgage debt, on the one hand, and more socially-unacceptable equity release debt on the other (Fox O'Mahony & Overton, 2014a).

*I don't actually let on I've taken it out, I think that's like saying you've got another mortgage again. There is no end to this sort of mortgage unless I pay it all back... then I would be in dire straits... I didn't have a mortgage when I took out equity release. So I suppose in some ways I feel a bit ashamed because I've got another one again when I'm getting on in life. My aim was always not to have a mortgage when I retired. (Female, age 74)*

*Almost everybody has a mortgage, regardless of your age bracket. And there's great rejoicing when older people clear off their mortgage... And so because it's so general, mortgages are acceptable conversation. But somehow, with equity release, it's, 'Oh, you poor thing. You know, you had to do this because you can't manage, you're so poor'. And so there's a very slight stigma about it, unless you can make it abundantly clear it's purely because you intended going on a world cruise, then that's acceptable. But to actually go in for it because you won't otherwise be able to manage, that's rather looked down upon. (Female, age 81)*

The silence and stigma that surrounds equity release has a number of important implications. Firstly, it has implications for 'peer-to-peer learning' as a route to increased financial capability for older people with respect to equity release transactions. This is particularly acute for those who are less experienced in financial transactions more generally, and for those who are less well off. The likelihood that older people will only have one opportunity to select an equity release product to cash-in their housing equity also means that there is little opportunity for individuals to learn from their own experiences. A culture of silence and stigma is also likely to inhibit the wider take-up of equity release, with adverse implications for some older owners for whom it might present an appropriate financial solution.

### 2.5.2.3 Lenders

Half of our stakeholder interviewees also considered the limited number of equity release providers to be one of the key barriers to market growth. Among these participants, the perceived benefits of a ‘big player’ or household name entering the market included greater consumer choice; greater competition among existing providers (with the effect of greater product innovation and more competitive pricing for consumers); and greater trust and respectability for equity release (Overton & Fox O’Mahony, 2015).

*I can see a big player coming in...if it gains that new found respectability then that to me would be the biggest trigger for equity release growth going ahead. Because then it would become High Street, it would have a brand and it would be something that the consumer can relate to, probably has some foundation of trust in, and makes them think, hey, this is quite respectable actually. (Private Sector Adviser)*

Since we carried out these interviews, Legal and General – a well-known company that consumers are familiar with in relation to other financial services – have entered the equity release market and have stated that they expect to write over £100 million of business in 2015. It remains to be seen whether their presence will make a significant difference to equity release sales, as some stakeholders in the study predicted.

### 2.5.3 Demand side barriers to equity release growth

While the recent increase in equity release sales suggests that there is growing interest in these products, as a form of retirement borrowing or equity withdrawal it remains relatively unpopular. As the table below shows, just 4 per cent of homeowners in 2009 would have considered borrowing against the value of their homes or selling a share of their property to an equity release company to provide income while the most popular option was moving to a smaller home or to a less expensive home or area (59 per cent).

Table 2.2 Views on using housing equity to help fund retirement, 2006 and 2009

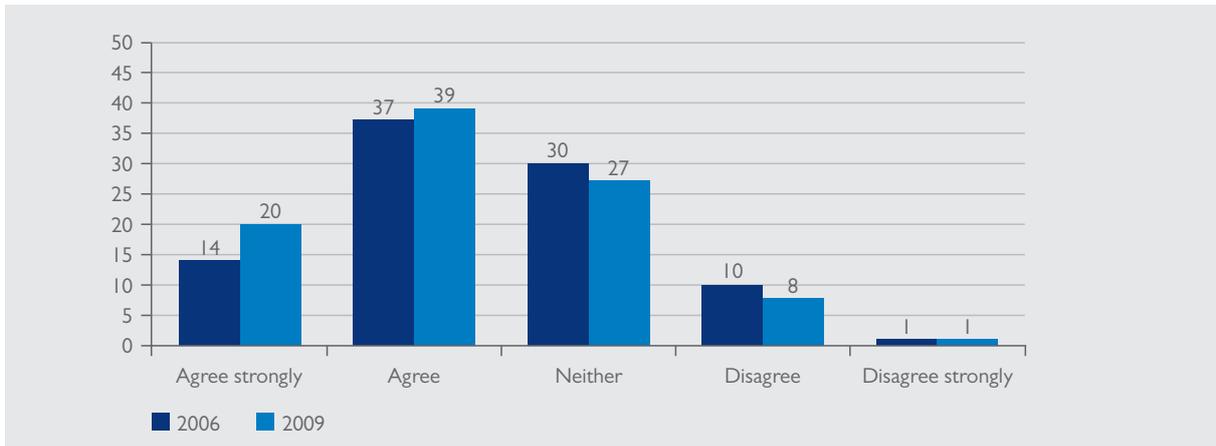
Options for using housing to help fund retirement	2006 All %	2009 All %	2009 Home owners only %
Not a home owner	33	35	
Home owners who wouldn’t consider any of these options (base=all)	23	21	32
<b>Any of the following (multiple answers permitted) of which:</b>	44	44	
Moving to a smaller or less expensive home or area	38	39	59
Selling your home and renting	4	7	4
Borrowing against the value of your home	5	4	2
Selling a share of your home to an equity release company to provide income	5	4	2
<b>Base</b>	<b>1,950</b>	<b>1,654</b>	<b>1,072+</b>

Source: Clery et al (2009) p.72.

This relatively low level of interest in equity release products tends to be associated with concerns relating to security and value for money (Rowlingson, 2006; Ong et al, 2013). Croucher (2008) found that many people were highly suspicious of equity release products, and that they associated them with other ‘scams’ such as endowment mortgages and problems with pension funds that had failed to deliver the returns that people were expecting. Jones et al (2010) also found that older people tended to be suspicious of equity release products and financial services in general.

The *Attitudes to Pensions Survey (2009)* suggests that public perceptions of the extent to which these products offer good value for money have become more negative over time (see Figure 2.3), although it is possible that the increase in negative attitudes towards equity release products reflects an increase in negativity towards the housing market in general.

Figure 2.3 Agreement with view that equity release schemes provide poor value for money, 2006 and 2009



Source: Clery et al (2009) p.74.

The most recent *Attitudes to Pensions Survey (2012)* did not collect equity release data, so we cannot track changes in attitudes since 2009, but it is conceivable that, as the housing market begins to recover, it would be economically rational for attitudes to equity release to shift in a more positive direction. Against this, however, negative (and sometimes misleading) media portrayal of equity release products is likely to continue to dampen demand for these products; compromising their potential to provide a valuable solution to bridging some of the shortfall between income and needs/preferences in later life. Research often shows that while there is a high level of awareness of these products among older people, negative attitudes towards them remain stubbornly hard to change. Just Retirement (2012), for example, found that attitudes to equity release were largely unfavourable. While most people had heard of equity release, there was a considerable lack of understanding about how the products work. For the industry, the challenges range from product innovation – with a view to meeting consumers’ needs through terms and conditions and product features as well as addressing concerns about value for money – to advertising and promotion to address the continued reluctance of most older owners to use equity release as a vehicle for retirement borrowing.

## 2.6 Other barriers to accessing retirement borrowing options

This chapter has highlighted the particular impacts of the ‘credit crunch’ that was triggered by the global financial crisis from 2007 for the UK’s retirement borrowing market. Reduced lending and stricter criteria have reduced the opportunities for older people to avail of mainstream borrowing options. While the industry and the regulator are agreed that this is not an outcome that they welcome, the sector has not yet overcome the barriers (including regulatory restraint and concern about conduct risk) to re-invigorating a post-GFC retirement borrowing market that can effectively and appropriately cater to the needs, preferences and circumstances of a highly diverse later life consumer population.

In addition to the product-specific barriers and opportunities for market growth outlined above, the development of an effective and appropriate market for retirement borrowing must also be sensitive to contextual factors that are likely to affect how consumers access financial services in later life. ‘Older owners’ are a widely differentiated population, with widely varying levels of health, wealth, income and assets, and financial and legal capabilities, and – in terms of age – spanning several decades from the ‘over 50s’ to a growing cohort of centenarians. Across this sizeable and diverse consumer population, there are some important questions to bear in mind when considering the opportunities and limitations of the retirement borrowing market.

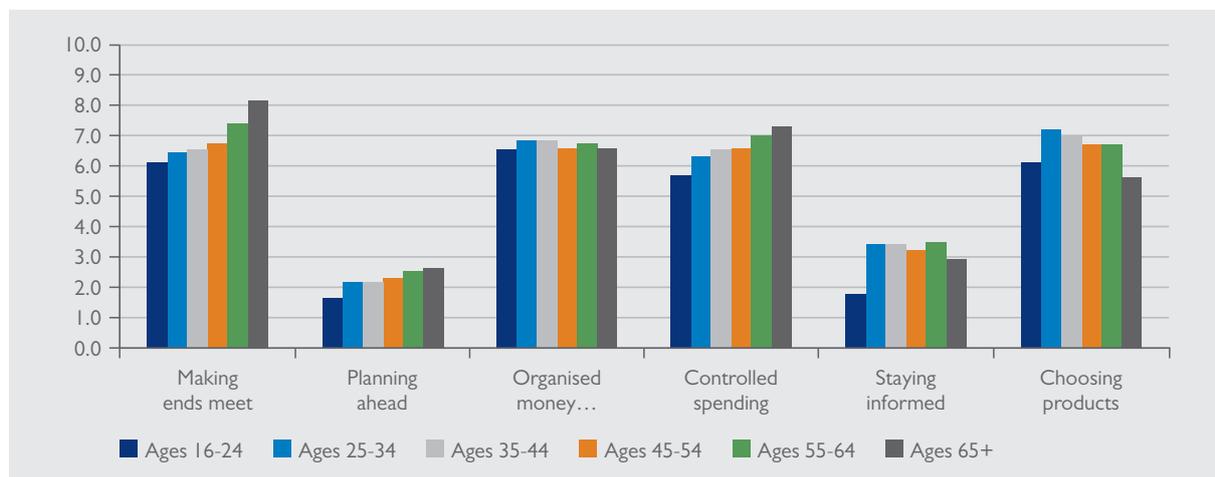
### 2.6.1 Financial capability and vulnerability

The complex nature of the terms and contractual details of many financial products mean that even consumers with good levels of literacy and numeracy struggle to understand them. The FSA’s 2006 baseline survey found that the over-70s were much weaker than the general population at choosing financial products (FSA, 2006: 8); although this survey also noted that the over-60s were particularly strong at ‘making ends meet’ (10), another measure of overall ‘financial capability’ which perhaps informed the FSA’s decision not to focus on older people as a ‘vulnerable group’ for follow-up work.

The Wealth and Assets Survey measures financial capability against 6 dimensions: making ends meet, planning ahead, organised money management, controlled spending, staying informed, and choosing products. ‘Planning ahead’ is based on the extent to which someone makes provision for future expenditure from current income’ while ‘choosing financial products’ refers to the sources of information (if any) someone uses when buying a financial product that most influence their purchase decision, and which deems a consumer to be ‘highly capable’ where he/she has bought a financial product within the last 2 years after shopping around, consulting best buy information or using a comparison website (Finney and Hayes, 2015). The impact of reliance on online consumer information as an element in consumer capability to choose financial products is also significant in light of digital exclusion amongst older people. According to Ofcom, in q1 2014 significant proportions of older people did not have access to the internet at home: 33 per cent of the 65-74 age group and 68 per cent of the 75+ age group (cited by Age UK, 2015). Given that many forms of communication concerning financial products and services is delivered online (with many of the best deal options only available online), digital exclusion is likely to reduce financial capability, as well as directly resulting in older people’s exclusion from products and services that they could benefit from.

All six measures in the Wealth and Assets Survey are scored on a scale of 0 to 10, and – echoing the FSA baseline survey’s findings, the 2010/12 wave found that ‘planning ahead’ was a particularly weak area across the general population, generating a mean capability score of just 2.3. ‘Choosing products’ ranked fairly highly across the general population with a mean score of 6.6, but, again, older people scored poorly in terms of this measure (Figure 2.4).

Figure 2.4 Mean Financial Capability Scores by Age: Great Britain 2010 to 2012



Source: Wealth and Assets Survey 2010-12 – Office for National Statistics.  
 Base: All adults interviewed in person (n=32,092), except for choosing products (n=16,379).  
 Notes: Means are rounded to one decimal place.

Given the increasing necessity for older people to navigate complex choices and decisions about retirement income and assets, especially in the new pension liberalisation climate, persistent evidence of low financial capability in choosing products is particularly concerning, compounded by the ‘impact vulnerability’ of older consumers who have less opportunity than younger people to recover from financial loss resulting from sub-optimal product choice.

### 2.6.2 Advice and guidance

Lower capability in choosing products amongst older populations has implications for how the sector supports their financial decision-making. This includes provision of clear, simple and straightforward information, and access to good quality independent financial advice; while recognising that consumers with lower levels of financial capability, who may be most in need of financial advice, are least likely to be able to afford it (Ring, 2003; Thoreson, 2007; 2008). Furthermore, our equity release consumer study (Fox O'Mahony & Overton, 2014b) found that, while financial advice was viewed as worthwhile and helpful by many consumers, it was most useful for those (predominately better-off) consumers who were 'prepared' or 'ready' to receive advice, who had already researched the options and who knew what questions to ask. We also found that equity release decisions were informed by a range of psychological biases and contextual factors including personal and financial circumstances, embeddedness within particular communities and networks and the nature of the relationship between consumer and financial advisers. This implies that the reliance on information and advice within the current FCA regime for equity release is of limited and unequal value in delivering consumer protection: calibrated to the needs of less-vulnerable consumers (those who are able to research, plan, and know what questions to ask, either because they are financially capable themselves and/or have friends or family who can help them to prepare), it is least effective in protecting the most vulnerable consumers.

The challenge of mediating different needs within a highly diverse consumer population has been a key priority of the newly-constituted FCA, following the emphasis on 'differentiated consumers' in the Mortgage Market Review and under the Financial Services Act 2012, section 6(1)(1C)(2). Yet, the MMR's emphasis on financial advice as the vehicle through which to protect equity release consumers – and, particularly, the suggestion that more vulnerable consumers are likely to benefit *most* from advice (FSA, 2011 (MMR): 5.78) – was not supported by our equity release consumer study findings. More recently, the FCA's (2015b) Occasional Paper on consumer vulnerability has signalled recognition of a broader conception of vulnerability, taking into account the interplay of individual circumstances, situations and the part played by market or firm behaviour. Within this, there is a focus on the need to improve inflexible products designed for the standardised perfect consumer, with the FCA noting that 'a frequent consumer complaint related to products taken out in good faith before the onset of vulnerability – which at a later date turned out to be unsuitable in some way for the situation they found themselves in. Consumers often feel that the details of exclusions and exceptions are not properly explained'. This resonates with the situation that some older people have found themselves in when requesting flexible arrangements to support the effective management of outstanding mortgage debt (see p.17, section 2.2.2.1).

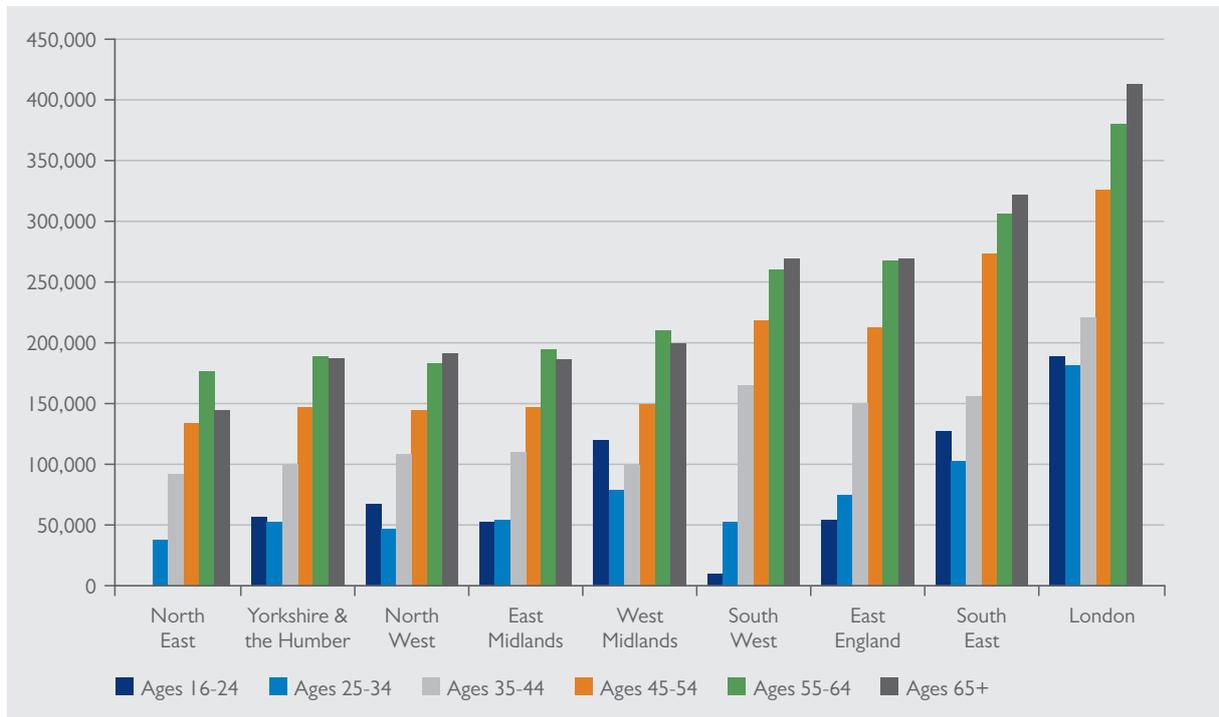
The FCA has stated that it will soon publish a discussion paper to explore how the FCA and the industry can work together to deliver information to consumers about the products or services they have bought or are thinking of buying in smarter and more effective ways.

### 2.6.3 Uneven distribution of housing wealth

Another important factor differentiating older consumers is that, notwithstanding significant regional variation in housing wealth, housing wealth tends to be positively correlated with other wealth (i.e. pension wealth). This has important implications for the distribution of housing wealth in relation to need as well as for the future growth of the retirement borrowing market: if housing wealth is distributed unevenly, benefitting a smaller proportion of the UK population – and there are fewer home owners overall – this will reduce demand for secured borrowing products into the future.

We noted in chapter one that housing wealth is largely concentrated in the hands of older people; although this aggregate pattern masks significant differentiation and wealth inequality across and within generations. While older generations, particularly the baby boomer generations, have accumulated considerable housing wealth, and certainly larger amounts than younger cohorts, there is substantial inequality within older age groups. One source of differentiation is location- and house-price-dependent variation in prospects for house value gains (See Figure 2.5).

Figure 2.5 Mean home equity by region and age group



Source: National Housing Federation (2014), p.10, based on wealth and assets survey 2010-12, available at <http://www.housinglin.org.uk/Topics/browse/Housing/Commissioning/?&msg=0&parent=3693&child=9541>

Significant regional variation in house prices is reflected in sales of equity release products, where the South East saw the highest number and value of plans sold in 2015, accounting for 23 per cent of all UK equity release plans and 28 per cent of total lending. Total lending in the region increased by 35 per cent during the first half of the year compared to the same period of 2014, whilst plan numbers grew by 20 per cent. The average property value for those releasing equity in the South-East region was £329,624, outweighed only by London. These regional differences in house price growth are a significant factor in shaping the equity release landscape, as well as a source of exclusion for those who have not benefitted from a house price windfall, and who are – with limited housing wealth likely to correlate with lower pensions and savings – likely to have fewer options in the retirement borrowing market.

#### 2.6.4 Debt aversion and ‘going without’

Finally, it is important to remember that older people still have more negative attitudes towards using credit, and are less likely to have debts than younger age groups. Age UK’s 2014 evaluation of problem debt among older people found that increasing age is still associated with more negative attitudes towards debt; with women having more negative views about debt than men. Married or cohabiting people were also more negative about debt than those who were single; and older people from ethnic minorities, those who had lower incomes and people living in rented housing were particularly unlikely to resort to credit. It is not currently known whether the impact of reluctance to use financial services leads to other forms of debts, or to some older people living without essential services or items<sup>11</sup>.

<sup>11</sup> Problem Debt Among Older People – Age UK’s summary of research by the International Longevity Centre UK: [http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk\\_iloc\\_debt\\_report\\_summary\\_040613.pdf?dtrk=true](http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk_iloc_debt_report_summary_040613.pdf?dtrk=true)

# Sharing Risk and Responsibility for Lending in Retirement

## 3.1 A joined-up approach

The House of Lords *Ready for Ageing* report indicated that, while the Government cannot carry all the risks and costs of an ageing population, there is much the Government can do to help people prepare for meeting their own financial needs in retirement, including by: ‘...mak[ing] it easier to harness the value in people’s homes to support some of the costs and risks of later years...’ (p.38). As responsibility for financial security has been shifted from the state to the individual, there is an increasingly important role for personal assets, including housing, in later life provision. In this chapter, we reflect on the potential role of the state in creating a suitable environment for the operation of a financial services market that enables older people to better manage their resources in retirement.

The effective implementation of policies geared towards housing equity decumulation as a source of retirement finance depends on the availability, suitability and attractiveness of products, with the financial services industry expected to play a key role here. In pension provision, and particularly following the end of compulsory annuitisation, the industry is facing the significant challenge to develop new products and services that will meet the retirement income needs of individuals throughout retirement. Similarly, with respect to finance for long-term care, the Care Act 2014 has sought to create a framework which stimulates consumer demand, as the backdrop for a new environment in which financial services companies can develop new care products. And in its ‘Ready for Ageing’ report, the House of Lords’ Select Committee on Public Service and Demographic Change specifically emphasised the importance of ‘an effective equity release market to unlock the housing assets held by older people’ (*Ready for Ageing*, 2013), and proposed that ‘the Government should work with the financial services industry to encourage the growth of a safe and easy-to-understand equity release market’ (see Chapter 2).

While the Government has clearly articulated its expectation that the financial services industry will play a central role in facilitating retirement finance, questions remain about the extent to which the industry is fully equipped to deliver what is expected of it, and the role that the state should, or could, play, in better enabling both the industry and consumers to meet retirement needs more effectively. There are a range of examples to illustrate the problems that flow from a gap between policy-making and implementation, whereby policy parameters are set without sufficient consideration for deliverability, including whether appropriate vehicles for delivery exist, and the extent to which the agents of delivery (for example, financial services providers, advisers and regulators) are equipped to deliver new policy expectations. In Chapter 2, we highlighted some of the unintended consequences resulting from post-GFC mortgage market regulation, which has left some older people unable to access borrowing that they could afford, with adverse and unnecessary exclusion implications for consumers, and prudential risks for lenders. Similarly, in the case of care funding, the government has called on the industry to respond to the new policy environment by developing appropriate products, but without working through the necessary detail of implementation, taking account of the broader context in which they must operate.

The industry has signalled its willingness to innovate in order to bring new products to market, while calling on the government to support them, for example, by raising public awareness and providing information and advice on the likely need and costs of care. Consumer engagement is crucial to the success of these policies, to generate demand for the types of products that could enable the delivery of policy outcomes; yet, the financial services industry has expressed concern that a lack of public understanding and awareness, for example, regarding the

new landscape for care funding, could disincentivise consumers from making provision for future care needs, so inhibiting demand for appropriate financial products and stifling industry innovation. Indeed, a lack of existing and past demand has meant that the market for pre-funded long term care plans has disappeared, with no currently active providers in this market, or in the market for long term care bonds (SOLLA Handbook). The long term care market is currently focused on immediate needs annuities from three main providers, but these products are designed to pay for care costs at the point of need, rather than planning ahead for the possibility of needing care.

In order to be able to bring new products to market, the financial services industry has called for action from the government to enhance public awareness and support the provision of information and advice<sup>12</sup>. A YouGov Poll carried out in December 2013 (on behalf of Just Retirement) found that nearly one third of those aged 55 and over believe that councils pay most of the cost while around 40 per cent believe that individuals pay most of the costs (with councils topping up the rest). Evidence also suggests that people significantly underestimate the scale of residential care costs; in stark contrast to the actual average cost of a residential home being £29,016 per year rising to £38,376 for a nursing home (ILC UK, 2014).

In the pension sector we have seen how the transfer of pension risk to consumers has left many people struggling to navigate the highly complex risks involved in pension planning. Paul Johnson, Director of the Institute for Fiscal Studies (IFS) has noted that: “We have moved from a world where the state, which is pretty good at bearing these kinds of risks...was bearing most of the risk, through a period when employers were bearing most of the risk, to a situation for the current working generation where individuals are bearing most of the risk, and they are probably least well set up for bearing that risk” (cited in House of Lords, 2013). In the pension context, the decline in state responsibility was initially balanced against final salary employer pensions which carried the longevity and investment risks of guaranteeing fixed pension outcomes. However, the difficulties for employers to bear these risks eventually overwhelmed firms’ capacity or willingness to provide such pensions, triggering a seismic shift to defined contribution pensions, with less predictable outcomes for consumers.

This has compounded financial uncertainty for consumers, adding to the already difficult task of planning ahead. In 2012, the Institute for Fiscal Studies reported that a third of those approaching retirement were unable to estimate how much income they will receive from their private pension; 40 per cent approaching retirement have given no thought to how to finance retirement; and 70 per cent of those purchasing annuities on retirement from non-employer direct contribution (DC) funds do not shop around for the best rates (Crawford and Tetlow, 2012). This contributes to market failures, when consumers are unable to effectively navigate the choices held out by the market. This, in turn, undermines the goals of policy-makers, which rely on active participation from consumers in practices of saving and managing their own resources to meet their retirement needs.

Planning for older age now requires the careful negotiation of a range of risks and uncertainties, from personal life events over which consumers have limited control (including health and disability risks, longevity risks), to the market risks associated with financial transactions, especially in respect of complex, non-discrete products (investment risk, inflation). The pensions example illustrates some of the barriers to strategies that place risks solely, or largely, on the financial services industry or on consumers that cannot effectively be managed. It highlights the importance of understanding the distribution of risk across the state, the industry, and consumers, taking account of the nature and extent of the risks that each can realistically bear, to create an environment in which the effective delivery of policy initiatives becomes feasible. Research exploring the long-term experiences of equity release consumers has also highlighted the difficulties people have in planning ahead and anticipating their changing needs and circumstances, highlighting the importance of forward looking advice to support people in meeting their long-term needs (Fox O’Mahony & Overton, 2014a).

Drawing on examples from overseas and, in light of the analysis set out in Chapter Two, the next section considers how other jurisdictions have approached the question of risk-sharing between the state and the market for meeting people’s retirement borrowing needs in the context of housing wealth decumulation.

<sup>12</sup> Just Retirement, Care Act 2014 – Overview, Technical Bulletin.

## International Case Studies

### 3.2 Sharing risk and responsibility in equity release: International comparisons

The continued debate over income security in later life and, particularly, the potential role of housing wealth in underpinning retirement borrowing is an important policy issue in many other advanced homeownership regimes, including the US, Australia, and South Korea, where the state plays a range of roles in supporting individuals and financial services industries in managing the changing financial landscape of retirement.

In some countries, Governments have provided greater support for equity release products that better enable individuals and the financial services industry to manage the risks and costs of equity borrowing. For example, as we noted in Chapter Two, one factor that is perceived to inhibit equity release market growth from a consumer perspective is concern over pricing and value for money. Yet, a 2006 study for the Financial Services Consumer Panel of lifetime mortgage products then available in the UK concluded that – taking account of the risks to providers, particularly the potential costs of the ‘no negative equity guarantee’ – across the market as a whole products were priced on a fair basis<sup>13</sup>. Indeed, there will always be constraints on what is commercially viable given the risks that providers face. For lifetime mortgages, these include: (1) termination risk: that is, how long the lender will have to wait to recover the capital through sale of the property (which depends on factors including longevity and future health of the borrower), and, the risk that by the time this happens, the value of the property will be insufficient to discharge the debt, interest and costs (presuming that the lender has given a ‘no negative equity guarantee’); (2) interest rate risk, including the uncertainties of variable interest rates for insurers, since higher-rates may increase the likelihood of non-repayment on termination; and (3) future house-price risk.

While the FSCP’s report suggested that – taking account of the risks to lenders – lifetime mortgages were, generally speaking, fairly priced, consumers’ perceptions that these products offer poor value for money remains a barrier to market growth. As we noted in Chapter Two, one way of approaching this gap between what consumers expect and what the industry can provide would be to conduct further research exploring the importance of features that drive up the price (for example, the no negative equity guarantee), to evaluate the relative importance of mandatory terms and conditions and build consumer awareness of how pricing is determined, based on the distribution of risk between lenders and borrowers. Another way of approaching this question is to consider alternative frameworks for managing the risks for providers. For example, in some countries, the state has played a stronger role in supporting the development of the equity release offer, so contributing to market growth.

In the US, lifetime mortgages sold under the Home Equity Conversion Mortgage (HECM) programme are insured by the Federal Housing Administration (FHA), which protects lenders against the risk that the loan balance may eventually exceed the value of the property. In order to qualify for the HECM, borrowers must be at least 62 years of age, they must own their property outright or have only a small mortgage left to pay on it and the property must meet FHA property standards (HUD, 2011). As with the UK’s lifetime mortgages, no repayments are required on HECMs during the borrower’s lifetime and/or for as long as the property remains their principal residence. Lenders recover their capital plus interest when the property is eventually sold (HUD, 2011). However, in contrast to the lifetime mortgages

<sup>13</sup> Financial Services Consumer Panel, *Report on the value of equity release products to UK consumers*, Prepared by Watson Wyatt Ltd (November 2006); available online at [http://www.fs-cp.org.uk/publications/pdf/report\\_value\\_equity.pdf](http://www.fs-cp.org.uk/publications/pdf/report_value_equity.pdf)

offered by lenders in the UK, the US government (the FHA) will pay the lender the necessary amount to cover the shortfall if the sale proceeds are not sufficient to cover the amount that is owed. The FHA collects a Mortgage Insurance Premium (MIP) from all borrowers in order to provide this coverage. The insurance premium also guarantees that if the lender goes out of business, the government will ensure that borrowers still have access to their loan funds (Huan and Mahoney, 2002; National Reverse Mortgage Lenders Association, 2011).

The HECM programme has been available since 1989 and is the most popular reverse mortgage (or lifetime mortgage) in the US accounting for approximately 95 per cent of the total market (National Reverse Mortgage Lenders Association (NRMLA), 2011). Government-backed insurance has almost certainly helped to encourage a large number of US lenders to enter the reverse mortgage market, which has in turn increased competition and driven down interest rates.

A similar programme was developed in South Korea, which introduced the Jootaekyeonkeum (JTYK) reverse mortgage under the Korea Housing Finance Corporation (KHFC) Act in 2007. The KHFC's rationale for introducing JTYK was to enable older people to use their own resources to meet both their housing and their financial needs, thus enabling the government to provide a social safety net at minimal public cost (KHFC, 2008). Owners can take a monthly income, which they can opt (under changes introduced in 2008) to increase or decrease by a maximum of 3 per cent per annum. Alternatively, they can take lump-sum payments with some restrictions on how this can be spent (including bans on gambling, speculative investments and extravagant consumption).

Following the US example, the scheme is supported by government guarantees which effectively reduce risk to the mortgage provider, thereby increasing the return for older owners. Borrowers also benefit from a number of tax concessions: they are exempt from registration, education and special rural taxes; they receive a 25 per cent reduction in property taxes, subject to income and wealth limits; and a reduction in income tax liability. When it was introduced, JTYK was limited to people who were at least 65 years-old, living in their own (and only) home, valued to a maximum of 600 million won. A year later, the age limit was lowered to 60 years and the maximum value increased to 900 Million won. In 2008, the first full year of the scheme, 695 applications for reverse mortgages were approved, and although the numbers remain small they increased rapidly to 2,016 in 2010 and 2,081 in the first 9 months of 2011 (KHFC, 2011).

The state-backed guarantees offered in the US and South Korean markets enable lenders to offer lower interest rates and relatively large payments compared with the non-state-backed products offered in the UK and Australia (see Table 5).

Table 3.1 International Comparison of lifetime mortgages

	Product	Government-insured?	Approximate Maximum loan (% of house value)*	Interest rate type
U.S	HECM	Yes	58%	Fixed; Variable
South Korea	JTYK	Yes	60%	Fixed; Variable
UK	Lifetime Mortgage	No	41%	Fixed only
Australia	Lifetime Mortgage	No	22%	Fixed; variable

\*For a borrower age 72. Notes: These figures are approximate based on a standard, lump sum, lifetime mortgage. Source: Munnell and Sass (2014); Ma and Deng (2013); Deloitte (2013); Just Retirement<sup>14</sup>.

14 Lump Sum Plus Lifetime Mortgage <http://www.justadviser.com/Documents/15949%2020JR%20Lump%20Sum%20Lifetime%20Mortgage%206541%20v7.pdf>

Although the global financial crisis threatened the long-term sustainability of the HECM programme, the US Federal Government signalled its continued commitment to support this sector, through the Reverse Mortgage Stabilisation Act 2013, which intervened to prevent its collapse. The changes brought by the 2013 Act have lowered the total amount that older owners can borrow, but loan-to-value ratios nevertheless remain considerably higher than the UK equivalent (see Table 6).

Table 3.2 New HECM Programme and the HECM Standard and Saver Programmes it replaced

Programme	Maximum loan* (% of house value)	Insurance premiums	
		Up-front (% of house value)	Ongoing (% of loan balance)
New Programme	57.5	0.50	1.25
Programmes replaced:			
HECM Standard	67.7	2.00	1.25
HECM Saver	55.4	0.01	1.25

\*Maximum loan for a borrower age 72 on a 5 per cent interest rate loan. Source: Munnell and Sass (2014), p.3.

In a number of other ways, East Asian countries such as Japan and Singapore have sought to strengthen the contribution of home ownership to meeting older people's income needs (Doling and Ronald, 2012). In Japan, for instance, recognition of considerable reluctance among older people to trade down led to the establishment of the 'house moving support scheme for the elderly' in 2006. Under this scheme, a government agency rents houses from home owners over 50 years old. The properties are then sub-let to younger family households with children. With contracts lasting their lifetime, the older households receive a rental income which can be put towards re-housing in smaller dwellings. In order to support the smooth running of the leasing system, and to offset risks of non-repayment and vacant properties, the government provides a contingency guarantee (Doling and Ronald, 2012, p.482). Such schemes, if developed elsewhere, could potentially address the twin challenges of deficient pension incomes and insufficient housing new build.

In Singapore, the Housing and Development Board (HDB) has built and sold apartments to eligible Singaporeans such that they are now owned by around 80 per cent of the population. This programme has been underpinned by an assumption that owning a home reduces living costs in retirement, thereby allowing older people to get by on smaller pensions. In March 2009, the HDB launched its Lease Buyback Scheme (LBS) enabling owners of homes with three or less rooms to sell some of the remaining years of their lease to the HDB in return for a lifelong supplement to their income. Minimum age restrictions apply (youngest lessee at least 62 years) as well as a number of others such as a household income of S \$3,000 or less and no equity having already been released via downsizing. Under the scheme, the HDB buys back any remaining years of a lease in excess of 30 years at market value. The HDB provides a subsidy of S \$10,000, together funding a S \$5,000 lump sum with the remainder being used to purchase an annuity from the Singaporean Central Provident Fund Board. The scheme therefore allows for a lifetime supplement to income while also allowing older people to continue living in their homes. If they die before the end of the 30 year lease then the proceeds of the sale of the remaining years of the lease are passed on to their estate. If they are still living after 30 years; the HDB will make alternative arrangements such as sourcing a place in a nursing home (Doling and Ronald, 2012, p. 483).

In addition to underwriting risk and enabling and encouraging housing equity decumulation via other means, such as the house moving schemes available in some East Asian countries, another way for governments to support housing wealth decumulation is via tax laws. Released equity in income form may be subject to income tax, as in the UK, and this has played a part in stifling the development and innovation of income-based equity release products or equity loan schemes. In response to this barrier, one leading provider of equity release products, Just Retirement, developed the drawdown lifetime mortgage. Lifetime mortgages taken out with a drawdown facility allow the borrower to obtain an agreed, maximum amount of money, as and when required. This facility can reduce the effect of compound interest by allowing customers to take out smaller amounts of money at different periods rather than accessing a single, larger lump sum. Though this has proven a popular development, and drawdown lifetime mortgages now account for a greater proportion of sales than the more traditional lump sum lifetime mortgage (see Chapter 2), it is still a compromise, and the market does not currently meet the needs of those who might want or need a scheme producing a regular income. If housing equity released as an income stream benefitted from the same tax exemptions as mortgage payments and payments into private pension schemes, the industry may be more inclined to fill this gap. In some other European countries, such as Poland, released equity in income form is not subject to income tax (depending on Product type)<sup>15</sup>.

These tax-based restrictions may reduce the potential for housing equity to play a role in meeting everyday living expenses for house rich, income poor households, and for the market to reach a wider consumer population. Similarly, for those in receipt of means-tested benefits, opportunities for drawing on the value of the home to bridge the gap between income and needs in later life are limited. This has traditionally been seen as a potentially significant barrier to wider take up of equity release in the UK, since those in receipt of means tested benefits may lose substantial amounts of entitlement by entering into a plan (Terry and Gibson, 2006). It is possible to retain entitlement during an Assessed Income Period (AIP), but if and when the AIP comes to an end, an individual's entitlement will be reassessed and the income or capital from an equity release plan will be taken into account.

Third and private sector partnerships have gone some way to overcoming this barrier by offering products that are more suited to the needs of poorer groups. The Home Cash Plan, for example, was developed in collaboration with the Joseph Rowntree Foundation and Just Retirement. The product allows small sums to be released on demand at least once a year, a wide range of properties can be offered as security for a loan, and the set-up fees are lower than on most other lifetime mortgages (Terry and Gibson, 2010, p.5). Additionally, and, unlike most commercial products, the minimum initial draw-down is sufficiently small that it will not increase the home owners' savings beyond the threshold for Pension Credit. The scheme was initially piloted in three local authorities, and while a welcome development, early evaluations indicated low take up noting 'that it is difficult to bring equity release to the attention of older home-owners on low incomes in a way that encourages them to consider it, even though it may be a very useful option for them' (Terry and Gibson, 2012, p. 7). These challenges raise questions, once again, about the need for a more joined-up, holistic approach to borrowing in retirement.

<sup>15</sup> Information provided by EPPARG in personal communication.

In summary, this chapter has drawn attention to a number of overseas programmes and practices in housing wealth decumulation to provide a useful illustration of the potential role that the state can play in supporting the retirement borrowing sector through greater risk sharing and facilitation. In the UK, the state plays a significant role in subsidising mortgage borrowing for working age people (for example, under Right to Buy schemes, Help to Buy, Funding for Lending scheme, Key Workers scheme, and so on). However, to date, the UK Government has relied largely on the financial services industry to manage the risks and costs of equity lending in retirement. With policies geared towards encouraging more people to make use of the equity tied up in their own homes, to support themselves and remain financially secure after retirement, there is a case to be made for the state to rethink its role in sharing some of the risks associated with housing finance for older people.

Following recent proposals for a state-backed Equity Bank developed in collaboration with ILC-UK, there has also been renewed discussion about the role of the UK government in equity release. This proposal suggested that the UK Government set up an 'equity bank', where homeowners exchange some of the equity in their property for income or cash provided by a state-run bank (Mayhew and Smith, 2014). However, since this would amount to direct provision, in an environment where the state has clearly indicated that it prefers to play an enabling rather than providing role, it seems unlikely that it will be taken up. However, as the US, East Asian (and some European) examples demonstrate, there are a number of alternative roles for the state to play, in better enabling the industry and consumers to manage retirement finance risks.

Nigel Waterson, Chair of trade body the Equity Release Council, has also argued for the state to play a stronger awareness and education role: 'There is undoubtedly a role for government to play, but instead of taking on a provider's responsibilities and the associated risks, we urge government to throw its support behind the industry and work to raise awareness and promote better understanding of and access to equity release'. While there is merit in this proposal, we would propose that, given that perceptions of poor value for money, rather than a lack of awareness, appear to be a major contributing factor to relatively low take up of equity release products (Chapter 2), an information-based strategy alone is unlikely to enable the sector to realise the full potential that this market holds.

# Key Findings and Recommendations for Future Research

## 4.1 Retirement borrowing: demand

Demand for retirement borrowing in the UK is driven by demographic, political and socio-economic factors. The UK's changing retirement landscape poses considerable challenges for older people to meet their own financial needs by effectively managing their income and assets over a longer period of time. Our findings illustrate the enduring impact of changes to the financial security of older people (for example, changes to pension funding), and emerging risks such as the maturing of interest-only mortgages, growing responsibility for social care and welfare needs in later life, as well as growth in consumer debt.

The development of, and demand for, innovative and flexible approaches to retirement products has been inhibited by a range of factors, including the uncertainties resulting from the global financial crisis, economic recession and credit crunch, changing government policies in pensions and long-term care funding, and the reform of financial services regulation. The current and future impact of this changing environment on consumer behaviours is not yet fully understood: while there are early indications as to how people will respond to the removal of the default retirement age, the end of compulsory annuitisation, and changes to the tax structures affecting inheritance of pensions and housing equity, only time will tell how these developments will alter asset and income management in retirement in the medium term. Changing patterns of debt accumulation and saving before retirement will also have a significant impact on future demand for retirement borrowing, with current evidence indicating general trends towards increased borrowing and decreased saving. Financial well-being amongst the current working-age population will be an important factor in driving future demand for retirement borrowing.

## 4.2 Retirement borrowing: supply

Our findings demonstrate that the current industry and regulatory environment for retirement borrowing does not adequately meet the needs of our ageing population. There is an important role for the financial services industry in meeting consumer demand (appropriately informed by consumer needs), and for effective coordination between the industry, regulators and Government.

### Housing needs

Improving the supply of suitable housing for older people remains a key policy challenge. Meanwhile, the lack of feasible options for older people to downsize within the current housing market points to a continued need for borrowing options on existing properties to meet growing income needs and preferences.

### Regulatory considerations

While the FCA is urging lenders to look more closely at their interpretation of MMR rules to ensure they are delivering the right outcomes for consumers, the industry remains cautious about the risk of breaching the conduct rules around affordability criteria.

Although the MMR made a strong steer towards proof of pension income as a key element in stress-testing affordability for lending into retirement, the centrality of pension income to overall financial wellbeing in later life has been overtaken by events, including the end of compulsory annuitisation and increased flexibility in the form that wealth and asset holding in retirement can take. In addition to the potential prudential risk of excluding credit-worthy borrowers based on age, the IMLA has pointed to the impact of refusing business based on pension income alone, rather than an holistic assessment of affordability, with potentially adverse implications for the overall risk profile of the loan book.

### Wider barriers to retirement borrowing

Product-specific and regulatory barriers (as outlined in chapter two) have contributed to a considerable decrease in conventional mortgage borrowing in retirement. However, the development of an effective and appropriate market for retirement borrowing must also be sensitive to contextual factors that are likely to affect access to financial services in later life such as: different levels of financial capability and vulnerability; digital exclusion among older people; the effectiveness of advice and guidance as the main source of consumer protection for different types of consumer; and debt aversion preventing take up of potentially beneficial solutions to income needs.

### The role of equity release in meeting drivers of demand for retirement borrowing

In a context of growing demand, the exclusion of older borrowers, especially older borrowers with lower incomes, from mainstream lending highlights the important role for specialised retirement borrowing options. At present, specialised lending provision is dominated by equity release, and within this, by lifetime mortgage products.

While the equity release sector has grown significantly in recent years, it remains small relative to mortgage lending, and there is a widespread view that the equity release market holds considerable untapped potential as a source of retirement borrowing. Our findings identified the main supply-side and demand-side barriers to wider take-up and market growth. These include:

- **A perceived need for greater flexibility and innovation in equity release products.**  
For example, most equity release products carry a 'no negative equity guarantee' and other safeguards. Stakeholders have questioned the desirability of a 'one-size-fits-all' approach to safeguards. However, further research would be needed to better understand consumers' attitudes to equity release product features, and the extent to which they would be willing to trade off certain safeguards for lower costs.
- **The negative image associated with equity release.**  
It has been suggested that a legacy of poor products and mis-selling continues to fuel widespread distrust of equity release, with some stakeholders proposing a new approach to branding and advertising. It has also been suggested that a limited number of providers, and particularly the lack of high-street names that consumers relate to and trust, has adverse implications for consumer confidence, as well as reducing competitiveness. Research has shown that while consumers like the idea of equity release in principle, many remain concerned that products are risky and offer poor value for money. An enduring demand-side barrier to equity release is a perception of poor value for money. Although much of the concern is based on a lack of understanding of how the products work, efforts to counter this seem to have made relatively little difference so far.

### The evolution of equity release?

With many older people unable to access conventional borrowing, the current equity release offer provides limited choice, with providers tending to offer limited flexible options for repayment, or to service interest, during the lifetime of the loan. This can reduce the scope for borrowers to deploy their assets and income for multiple purposes over the longer term of retirement, although a small number of lenders have started to offer hybrid products (part-paid, part-rolled). We have also raised questions in relation to the decline of the reversion market, with possible adviser and provider bias towards lifetime mortgages being one possible factor. Any discussion of the evolution of the equity release market should therefore give due consideration to the role of reversions or other such equity loan schemes in meeting the needs of those with a preference for non-mortgage based products.

### Lack of suitable financial products to enable people to plan ahead to manage their care costs

There are currently no products within the UK market to enable people to plan ahead for the costs of social care, and very few options for meeting immediate care needs. The financial services industry has expressed a desire for government support to raise awareness of the need for financial planning to cover care costs, but there remain significant gaps in understanding of consumer preferences when it comes to care funding.

Following the Care Act 2014, the Government undertook to implement a new framework of universal deferred payments to help people with covering social care costs without having to sell their homes in their lifetime. However, following concerns expressed by local authorities with regard to implementing the changes, the reforms proposed in the Care Act have now been delayed for the life of the current Parliament, to 2020. Notwithstanding these delays, there may well be a growing need for the development of housing equity product options to help pay for care costs.

### The role of the UK Government and regulators in working effectively with the financial services industry to develop a suitable retirement borrowing market

The financial services industry has become firmly embedded as a key player in funding later life, but in Chapter 3 we questioned the extent to which the industry is fully equipped (on its own) to deliver what is expected of it. We provided several examples of policy parameters being set without sufficient consideration for whether those responsible for delivery are capable of doing so, or indeed whether they are being fully supported by the state to deliver policy goals effectively. In the UK, the state plays a significant role in subsidising mortgage borrowing for working age people (for example, through Right to Buy, Help to Buy, Funding for Lending and Key Workers Schemes), but it plays less of a role in supporting retirement borrowing than some other countries do, for example, in equity release risk-sharing.

Similar questions can be raised with respect to the capacity of the third sector and local government in this arena. In previous years, local authority partnership models such as the Home Improvement Trust were set up to provide equity-based loans for older homeowners, enabling them to repair, improve and adapt their homes. However, the recent, and considerable, imposition of local government spending cuts forced the Trust to cease operating in 2013.

Situations like these, and the overseas examples outlined in Chapter 3, raise questions about what more the UK government, could, or should, do to enable individuals, the market, local authorities and the third sector to meet older people's income, housing and care needs more effectively. Successful programmes operating in one country cannot always be easily transferred to the UK context, but there seems little to lose, and potentially much to gain, from an exploration of the options and lessons that might be learned.

## 4.3 Gaps in the knowledge base

### How are older people meeting their borrowing needs and preferences in retirement?

- There is relatively little evidence regarding what people do when excluded from conventional secured borrowing. Are people turning to:
  - equity release;
  - higher-cost, higher risk, options;
  - or are they going without?

### Product development

- What do consumers want and need? Is it better access to conventional mortgage borrowing, equity release, or something in between? There has been some development of so-called hybrid products that offer a bridge between traditional lifetime mortgages where the debt rolls up over the course of the loan, and those that allow interest to be part paid/part rolled, but we currently lack knowledge and understanding of the appetite for these products. Are there other options? And what are the challenges with regard to funding and distribution?
- What are the particular features that would make retirement borrowing products more attractive, and what are people prepared to pay for?

### Advice

- How do people make decisions about retirement income and assets, particularly in the pension freedom environment?
- What are the challenges in providing advice aligned with the changing pattern of spending in retirement?
- How can holistic advice be given in a way that makes sense to the customer and engages them into thinking about their future tax, care costs and legal needs?

### Greater risk sharing and a more joined up approach to borrowing in retirement

- What do stakeholders (i.e. government, regulators, and lenders) think about a more joined-up approach to retirement lending? Is there an appetite for risk-sharing options, to support better outcomes for consumers and to reduce costs and risks to lenders?
- What lessons can be learned from other countries where the state plays a more active role in encouraging and enabling the use of housing equity in later life?

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