Setting the standard in equity release

Equity release rebooted: the future of housing equity as retirement income

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www.equityreleasecouncil.com

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The views expressed in this report are those of the authors unless otherwise specified and do not necessarily represent those held by the Equity Release Council or its members.

"...WITH INCREASING PRODUCT INNOVATION, COMPETITION AND FLEXIBILITY, WE ARE SEEING THE EQUITY RELEASE SECTOR 'REBOOTED'..."

Foreword from the Equity Release Council

The equity release sector passed two significant milestones during the writing of this paper. December 2016 not only saw the 25th anniversary of the first industry standards being introduced to begin a transformation of industry practices in 1991; it also brought an end to a year where the landmark of £2 billion annual lending was passed, with the yearly growth rate doubling from 16% in 2015 to 34% and lifetime mortgage customer numbers growing faster than any other mortgage market segment.

In the past, equity release was often viewed as a niche area of lending, treated with caution by consumers and advisers alike despite its considerable untapped potential. More recently, concerted efforts to establish a safe and reliable market for consumers have helped to attract growing interest from the UK's ageing population in housing wealth as a fresh source of funds for later life, at a time when many of the old rules of retirement have been re-written.

With increasing product innovation, competition and flexibility, we are seeing the equity release sector 'rebooted' with the Financial Conduct Authority (FCA) among the growing audience of influencers and policymakers keen to see this trend continue to the benefit of more older consumers. Plans revealed by the Treasury in February 2017 for the new Pension Advice Allowance included advice on the potential use of housing wealth within scope: amounting to recognition from government that housing wealth has an important role to play when people make their retirement plans.

These developments have occurred against a backdrop of major socio-economic and regulatory change, with the end of the Default Retirement Age in 2011, the implementation of the Mortgage Market Review (MMR) in 2014 and the advent of the pension freedoms in 2015. At the same time, low interest rates have exacerbated the challenge of saving for later life, weighing down on pension incomes, while cuts to public funding for social care are already putting added pressure on personal finances.

Growing support and advocacy for the equity release sector recognises that housing wealth has considerable potential to form part of the solution to tackle these financial challenges and help people enjoy a comfortable and rewarding retirement. This report takes stock of where we are today by inviting outside perspectives on progress to date and the challenges ahead to build on current momentum:

In Part 1, **Rob Thomas**, Director of Research at Instinctif Partners and formerly an economist at the Bank of England and senior policy adviser to the Council of Mortgage Lenders, begins by considering the changing role of wealth and savings in the post-pension freedoms era and the implications for older homeowners' property wealth.

In Part 2, **Dr Louise Overton**, Lecturer in Social Policy and member of the Centre on Household Assets and Savings Management (CHASM) at the University of Birmingham, goes on to look in more detail at the progress and challenges for the equity release sector to meet consumer demand.

We conclude by considering what actions are necessary for housing wealth to make an even greater contribution to the retirement funding landscape and make a positive difference to more individuals' lives.

Equity release has come a long way in the last 25 years. We now look to the future with the confidence of a well-established and growing market, able to take constructive criticism robustly in its stride. And we will continue to work tirelessly with our members, industry, regulators and policymakers to ensure consumers are well served with advice and products that steer them towards good outcomes in later life.

Nigel Waterson
Chairman of the Equity Release Council

Executive summary

The UK is facing a retirement income crisis

Inadequate pension saving through defined contribution (DC) schemes means millions of workers will face severe reductions in income when they retire.

DC pensioners with contributions of 8% throughout their working life can expect to retire with a pension of only 15% of their final salary – only one fifth of the pension of an identical worker in a defined benefit (DB) scheme. Most DC pensioners have not contributed enough to achieve even this modest amount.

Yet housing wealth has never been higher

Against this backdrop of reduced pensions, total homeowner equity in England reached £2.6 trillion in 2016, of which £1.8 trillion belonged to households with a homeowner aged 55 years old or over – a figure forecast to double by 2036.

Wealth accumulated through mortgage repayments has also increased sharply in recent years with regular and lump sum repayments of mortgage capital totalling £62.7 billion in 2016, up from £40.7 billion in 2005.

Property is often the greatest asset

Housing has the advantage of being a widely-held asset with 17.7 million owner occupiers in the UK compared with 10.3 million employees with pensions.

With an average worker potentially repaying twice as much in mortgage capital each year as they save into their pension, it would be increasingly illogical to ignore the potential to unlock the wealth people have accumulated in their homes to help fund retirement.

Outdated social norms act as a barrier to equity release

In the UK, outright home ownership carries high level status and a sense of pride. As a result, for some consumers there is a lingering stigma attached to debt, leading to a reluctance to release housing equity even though it may be the best financial solution for them.

Pension freedoms challenges traditional retirement and inheritance planning

Pensions are now fully realisable assets rather than income streams, and fully inheritable just like property and personal finance assets. In this new world, pensioners can now plan their retirement finances regarding all their assets: their pension pot, other financial assets and their home.

Rather than opt for a guaranteed, secure income for life, retirees may choose to use invest their pension lump sums in the first few years of retirement, resulting in the need to find alternative sources of income or capital in later years. Housing wealth is likely to play a key role here among a wide range of other potential uses.

Advisers and consumers need in-depth understanding of later life finance options

While freedom and choice in pensions provides new opportunities for retirees, it further complicates an already complex range of options available to consumers.

The creation of a new, single body for public financial guidance has the potential to provide a more joined-up approach across the equity release industry and other key players in the market. This should make it easier for consumers to consider their income and asset portfolio together, and to access the help they need to make sound financial decisions.

Advisers will require a high level of knowledge of products and services related to retirement income and assets, or be able to signpost to other experts at an early stage, so that consumers are offered suitable options.

For many homeowners, following such a structured approach to financial planning in retirement with all assets taken into consideration will lead to outcomes including the release of housing wealth.

'Soft skills' support positive consumer outcomes

While many suggestions for 'smarter consumer communication' involve the use of online and interactive tools, these are not always appropriate or desirable, particularly for older people. Greater emphasis on the role of 'soft skills' training in supporting a positive relationship in which the consumer feels able to ask questions, and where they can take time to absorb and reflect upon the information and advice that they have received, may prove advantageous in supporting good consumer outcomes.

Innovation can add to the 'future proofing' of equity release products

Recent product developments in the equity release industry, such as downsizing protection, voluntary repayments without early redemption charges and interest servicing, suggest significant opportunity for addressing some of the key issues and concerns associated with traditional offerings. This trend can help unlock the potential for wider uptake among an increasingly diverse consumer population, with 'future proofing' enhanced by new product features alongside financial and legal advice and product safeguards.

PART 1

Funding retirement: housing wealth in the post pension freedoms era

About the author:

Rob Thomas is a Director of Research at Instinctif Partners with a specialist focus on financial services and the mortgage and housing markets. He previously served as an economist at the Bank of England from 1989-1994, a high-profile analyst at the investment bank UBS between 1994-2001 and as senior policy adviser to the Council of Mortgage Lenders from 2005-12. He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme.

The UK faces a retirement income crisis in the coming decades as inadequate pension saving through DC schemes leaves millions of workers facing severe reductions in income on retirement. The shift from defined benefit DB to DC pensions that has been taking place since the 1990s in the private sector has serious implications for the standard of living of future generations of pensioners.

An individual who works for 45 years until retiring aged 65 with average contributions to a DC pension of 8% throughout their working life can expect to retire with a pension of only 15% of their final salary if wage inflation and returns stay around current levels. This is only one fifth of the pension of an identical worker in a DB scheme.

But most DC scheme members have not contributed enough to achieve even this modest income in retirement. In 2012-14 the average value of a DB pension for 55-64 year olds in the private sector was £170,200 while the average for DC pension holders was only £30,200[1]. Such a DC pension holder looking to retire now would receive a guaranteed index linked income of less than £1,000 per annum (pa).

At the same time, the amount of wealth UK households have tied up in their homes has never been greater while saving through repayment of mortgage capital hit a record £63 billion in 2016. Total homeowner equity in England reached an estimated £2.6 trillion in 2016, of which £1.8 trillion[2] belonged to households with a 55 year old or over. It is forecast that housing wealth held by the over-55s will nearly double to £3.6 trillion by 2036 based on demographic projections and modest house price growth.[3]

Houses are not just a source of equity, they are also a vehicle for accumulating wealth. In 2016 UK households amassed £62.7 billion through regular and lump sum capital repayments on their mortgages[4]. This figure has increased sharply in recent years (being only £40.7 billion in 2005), far exceeding personal pension savings outside of the workplace and comparing to estimated total contributions to UK private pensions of £70 billion in 2012[5].

An employee on average earnings of £28,000 with total pension contributions of 8% of earnings to their DC pension with a capital repayment mortgage of four times salary would 'save'[6] an average £4,480 pa through via mortgage repayments: exactly twice their pension contributions of £2,240 pa.

The pension freedoms of 2015 are a game changer. Potentially the greatest effect of pension freedom is that it makes pensions a fully realisable and inheritable asset alongside other financial assets and houses. Leaving your pension to your children (tax-free) could become just as important as leaving your house.

Perhaps the greatest obstacle to the growth of equity release in the UK has been psychological. People see homes as the main asset to leave to the next generation. They have looked to pensions to provide their main retirement income. But in the post-2015 'pension freedom' era these distinctions should, logically, start to fall away. A pension could be just as valuable to retain and pass on to children as a home. Through equity release, a house can be a source of income in retirement where pensions and investment income are inadequate.

1. ONS Wealth and Assets Survey
2. Instinctif Partners estimate
3. Instinctif Partners projection
4. Bank of England data
5. Institute for Fiscal Studies Green Budget, February 2014
6. 'Save' in this context refers to the accumulation of equity in a property by reducing the mortgage debt

Estimating future pension income

The pensions market has changed out of all recognition since World War II, as the appendix – A brief history of pensions – sets out. The huge expansion of company pensions from the 1950s to 1960s was followed by the decline of the DB pension and rise of the DC pension – a trend that has been evident since the 1990s but has been accelerating in recent years and even more marked in the private sector. 2015 brought another watershed moment when government reform in the shape of 'pension freedoms' did away with any requirement to purchase an annuity and allowed people complete access to their DC pension savings, subject to income tax being payable on any withdrawn funds beyond the first 25%.

The decline of the DB pension and rise of the DC pension has shifted investment risk from the employer to the employee and followed the fall in interest rates in the 1990s which, coupled with rising longevity, dramatically increased the cost of providing a guaranteed income in retirement. The implication of this move to DC pension schemes, with their much lower contributions and correspondingly reduced wealth, is obviously going to be lower incomes for the increasing number of people who work in the private sector and have known only DC pensions. But how large might the income shortfall be?

For people in DB pension schemes, estimating their expected pension income in retirement involves a straightforward calculation using the number of years in work and final or average salary (depending on the scheme). For DC pension scheme members the calculation is more complex.

To estimate the expected income in retirement for DC scheme members you need to know the length of time the member will work, the level of contributions that will be made, future investment returns, future wage increases and annuity rates when they retire. Of course, the future is highly uncertain with wage growth, investment returns and annuity rates all likely to be subject to future shifts. But these variables are all linked.

If we remain in a low inflation environment of the kind seen in recent years, wage growth, investment returns and annuity rates are also likely to remain low. Indeed, historically there have been fairly consistent longer term relationships between these variables. Over the longer term, wages have on average grown around 2% faster than prices[7], reflecting productivity growth across the economy, while investment returns have exceeded inflation and interest rates, as investors require a premium to offset uncertainty.

We have produced a calculation for an employee who works continuously for 45 years until their retirement aged 65, with earnings equal to the average full time male income for each corresponding age group as they get older[8]. We have also upgraded incomes by 2% a year to reflect the general rise in nominal wages.

We have assumed that this employee has 8% of salary contributed to their pension pot throughout their working life (reflecting the minimum level of contributions required in workplace pensions from 2019). Finally, we assume that the pension is invested in assets that produce an annual return of 4% after all charges and we have taken current annuity rates to turn their pension pot into a guaranteed income at age 65 rising in line with the Retail Price Index (RPI).

Table 1 shows the results of our calculation. This very average worker will make pension contributions over their working life of just under £176,000. By the time they retire at 65 their pension pot should be worth over £380,000. But if annuity rates remain broadly in line with current rates, this will buy them an inflation linked income of only £12,000 a year[9], less than 15% of their salary at

7. ONS data on real UK full time wages shows an average increase of 1.9% per annum between 1975 and 2013
8. Based on ONS average earnings data by age group
9. We have converted lump sums into a guaranteed income in retirement using an index linked annuity. This is for illustrative purposes only to show what kind of guaranteed income could be available.

retirement. An identical employee who happened to be in a typical DB scheme could expect to retire at 65 on 75% of their final salary, five times as much.

Table 1 - Worker saving in DC pension (from age 20 to 65)

Starting salary	£16,900
Final salary	£80,622
Total pension contributions	£175,896
Pension pot at age 65	£380,650
Guaranteed income in retirement	£12,006
Retirement income as % of final salary	14.9%

Assumes: Wage growth 2% pa, investment return 4% pa

Even if this individual continued to work for another five years, they would still face a large shortfall in income, with an expected pension of £15,700 (17.7% of final salary). Of course, it is possible that inflation rises in the future, pushing up nominal wage growth, investment returns and annuity rates. So in Table 2 we show the calculation with 4% pa wage growth, investment returns of 6% pa and annuity rates 1 percentage point higher than today. But even in this more inflationary environment the employee still faces a dramatic decline in income on retirement, with an expected pension equal to only 19.4% of final salary.

"...THE SHIFT TOWARDS DC PENSIONS CARRIES THE RISK THAT MANY MILLIONS OF WORKERS WILL FACE DRAMATIC FALLS IN INCOME ONCE THEY REACH RETIREMENT..."

Table 2 - Worker saving in DC pension (from age 20 to 65)

Starting salary	£16,900
Final salary	£189,459
Total pension contributions	£305,937
Pension pot at age 65	£887,052
Guaranteed income in retirement	£36,848
Retirement income as % of final salary	19.4%

Assumes: Wage growth 4% pa, investment return 6% pa

Although the individual in our example can also expect a full state pension from the age of 68 (the full new state pension currently offers £159.55 a week or £8,296.60 a year, although many people only qualify for less than the full amount), it is clear that the shift towards DC pensions carries with it the risk that many millions of workers will face dramatic falls in income once they reach retirement. But although these results appear alarming, they are still likely to understate the scale of the looming crisis because they appear to overstate the amount of money that is likely to be accumulated in DC pension pots.

We can compare the size of pension pot that our model would predict for each age group with the actual level of pension held by people of this age. As Table 3 shows, based on the assumptions outlined above and taking account of previously lower wage levels you would expect the average 35-44 year old to have accumulated a pot of over £29,000. But the actual median average pot in this age group is only £14,400.

Moving up the age scale the shortfall in pension pot becomes larger. Our model would predict that the average 55-64 year old should have a pot of around £123,000, but ONS data shows that they have only £30,200 on average. It is likely that this median figure is influenced by the fact that

many people did not contribute to their pension consistently in the past, because for example they were in a job with no pension provision.

Table 3 – Actual DC pension pots compared to our projected pots

Age	Expected DC pot	Actual DC pot	Actual as % of expected
25–34	£9,652	£5,000	51.8%
35–44	£29,150	£14,400	49.4%
45–54	£64,751	£20,600	31.8%
55–64	£123,140	£30,200	24.5%

Source: ONS and our estimates

Of course, some people would have been in DB schemes in earlier years, which will provide them with a separate income in retirement but, nonetheless, these figures suggest that many older employees will be facing an extremely challenging financial situation in retirement. For a 55-64 year old looking to retire now, £30,200 would purchase a guaranteed index linked income for life of less than £1,000 pa.

In conclusion, even if an employee spends an entire working life of 45 years with contributions to a DC pension pot running at a rate of 8% – the total minimum contribution for auto-enrolment pensions that will apply from April 2019 – they are likely to face a dramatic shortfall in income in retirement. In reality ONS data suggests that the average DC pension holder has an even smaller pot, suggesting an even more severe shortfall in retirement income.

The implication of this analysis is that, as DB schemes fade into history, many more people will be retiring on wholly inadequate pensions. We now turn to see the extent to which the other assets of future generations of pensions (other financial assets and property) are capable of helping to fill this looming retirement income gap.

The wider wealth and savings picture

We can compare the wealth held in pensions outlined above to households' other wealth using data from the ONS Wealth and Assets Survey. In 2012-14 the median household headed by a 55-64 year old with a current DB pension in the private sector had total pension wealth of £170,200 while the median household with a current DC pension had pension wealth of £30,200. By comparison, the median household headed by a 55-64 year old also had net financial savings of £14,500, and savings held in the form of property (other than their main residence) of £0. Of those households that owned their own home, median housing wealth was £153,000.

It is clear that other financial assets of the median household, at £14,500, are going to prove insufficient to make a substantial difference. In terms of a guaranteed index linked income, they would provide only £38 a month, even ignoring the need for households to keep some cash balances for emergencies. Buy-to-let should provide a healthy income for most of those that invested in this asset but these are a small minority of households.

This leaves the main residence. With housing wealth of £153,000 the median household headed by a 55-64 year old could for example take out a lifetime mortgage of around £46,000 (30%) from age 65 if they chose to take the product then – boosting their finances in later life with a sum worth more than three times their net financial savings (excluding pension wealth). And they may be able to release a higher amount through either a lifetime mortgage or home reversion depending on their exact circumstances.

We can also look further into the future as we did with pensions to see how a typical household can accumulate wealth via housing and see how

this compares to the pensions data shown in Tables 1 and 2. Starting from today's average property price of £219,000[10], assuming the same individual starting out at 20 and assuming that property increases by an average 3% a year, we can see that if our worker buys an average property at 30, it will cost £294,000 (see Table 4).

Table 4 - Household purchasing average property

Purchase price at age 30	£294,318
Value of property at age 65	£804,048
Amount saved in property	£294,318
Capital gain	£509,730
30% equity release	£241,214

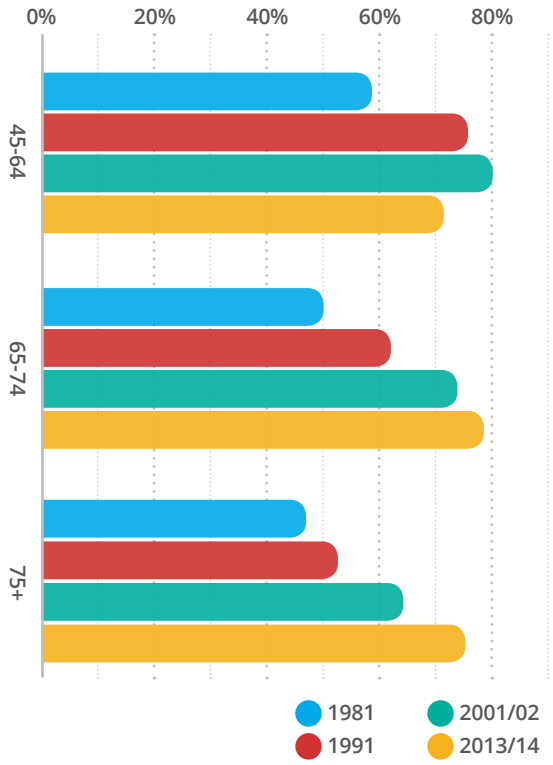
Assumes: Wage growth 2% pa, house price growth 3% pa

At age 65 the property would be worth £804,000 if prices continued to rise by an average 3% pa[11]. Assuming the homeowner chose to release 30% of the equity through a lifetime mortgage, they would have £241,214 to draw on, either as a lump sum or in multiple instalments over an extended period of time. Compared with a potential pension income of £12,000 per annum shown in Table 1 and their state pension entitlement, this sum would clearly make a significant difference to many people, whether it is used to supplement income or meet other expenses and financial needs.

Of course, these figures can vary greatly through even small changes in the assumptions, as Table 2 illustrates. But the comparison provides a feel for how accumulated housing wealth is capable of providing a useful enhancement to – or in some cases, transforming – retirees' financial outlook.

Housing also has the advantage of being a widely held asset. On the latest figures, there are 17.7 million owner occupiers in the UK and, as Chart 1 shows, homeownership is the majority tenure among older households and has been rising over the past three decades in these older age groups. And although there has been a slight reversal of this trend in the 45-64 year old age group since the early 1990s even in this group over 70% of households are still homeowners.

Chart 1 – Homeownership rates by age group (England)



Source: English Housing Survey 2013-14

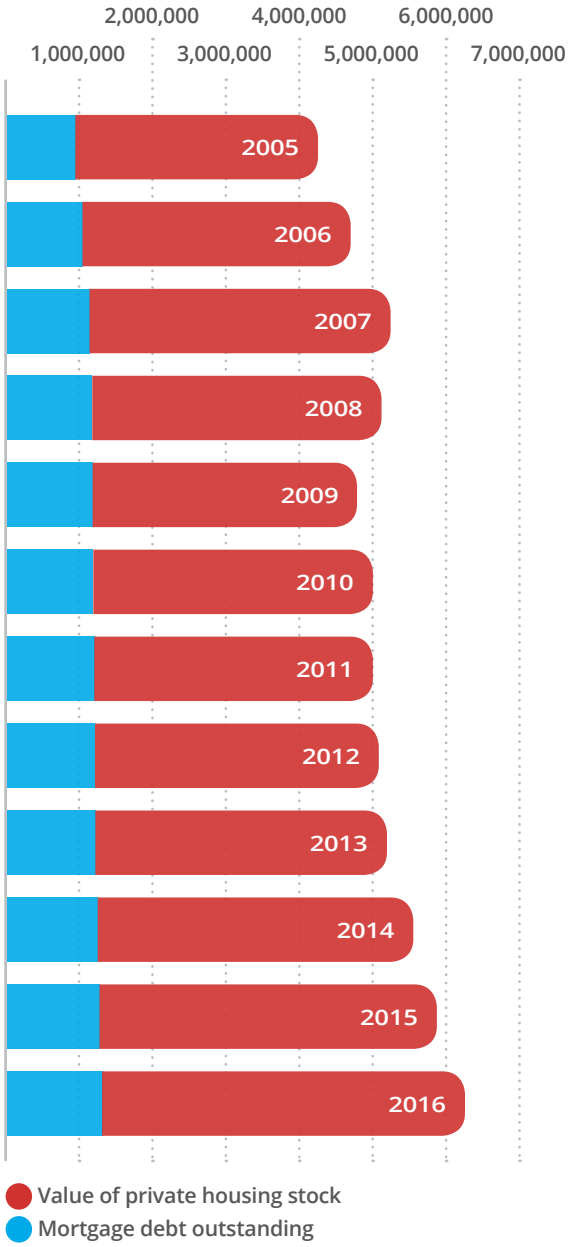
Thus while the proportion of pensioners paying into DB schemes fell to 1.6 million by 2014 and the total number of employees with pensions reached 10.3 million, a greater number of households can still potentially fall back on housing wealth when they retire.

Using house price and tenure data we can estimate the total value of UK housing. We calculate that the whole private housing stock (owner-occupied and private rented sectors combined) was worth £4.9 trillion at the end of

10. Based on Land Registry data.
11. House prices increased by an average 6.7% pa between Q4 1995 and Q4 2016.

2016, up from £3.3 trillion in 2005. Of the total, owner occupied properties in England had a total value of £3.4 trillion and total equity of £2.6 trillion. Within this total, households with a 55 year old or above held total housing equity of £1.8 trillion, 69% of the equity held by all owner occupiers.

Chart 2 – Value of the private housing stock and outstanding mortgages (£ millions)



Source: Land Registry and Bank of England

This concentration of housing equity in older households owes less to the decline in homeownership in younger generations and more to two other factors. Firstly, households typically move to more expensive homes over their lifetimes and secondly, as households head towards retirement they are paying off mortgage debt and thereby accumulating equity. It is this second phenomenon we turn to now.

Accumulating wealth in our homes

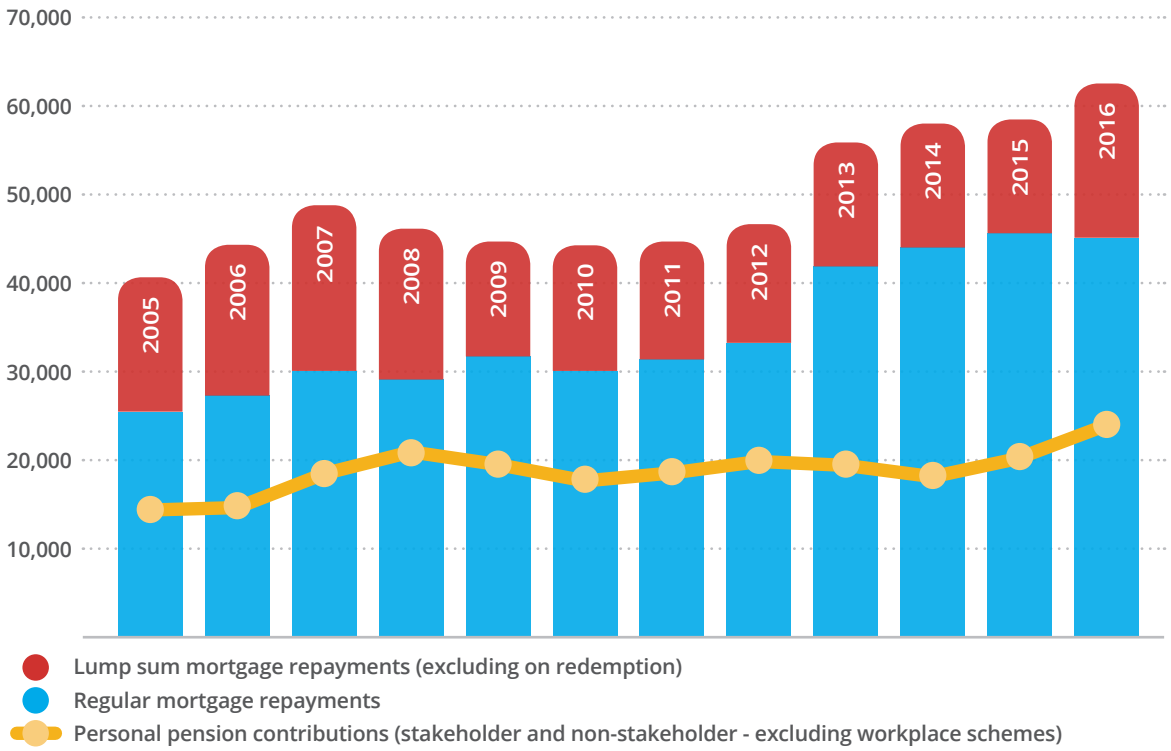
If you asked members of the public what forms of saving they undertake they are likely to mention their pension and cash savings for items such as holidays or household improvements. Some will have channelled savings into the stock market or buy-to-let property. But there is a form of investment which totalled £62.7 billion in 2016, which few people will even think to mention. It is the wealth we accumulate as we pay off the mortgages on our homes over our working lives. Although exposed to property market risks, this form of 'saving' has proved popular and successful for over 30 years.

In 2016 regular repayments of mortgage debt total £45.2 billion with an additional £17.5 billion in lump sum repayments (excluding redemption of capital on sale of a property) – see Chart 3. This total saving of £62.7 billion compares to total contributions to all private pensions of £70 billion in the latest available year[12] (2012) and far exceeds the £24 million of personal pension contributions made in 2015/16 outside the workplace.

Moreover, while employees' average pension contributions have been falling as the balance of DB and DC schemes moves in favour of DC, mortgage capital repayments have soared, having risen from £40.7 billion in 2005.

12. Estimate from The IFS Green Budget: February 2014 Carl Emmerson.

Chart 3 - Accumulating wealth via mortgage repayments (£ millions)



Source: Bank of England, repayment of mortgage principal by type of lender/HMRC, personal pensions: contribution and tax relief statistics

Another way to illustrate just how much we typically save via our properties is by a simple example. A worker earning the average full time wage of £28,000 a year in a DC pension scheme with total pension contributions of 8% (including their employer's contribution) will have annual contributions of £2,240. If this worker has borrowed four times their salary (£112,000) to buy their house, with a repayment term of 25 years, they will make an average repayment of mortgage capital of £4,480 a year over the life of the loan. In other words, they are saving twice as much via their home as they are in their pension.

Moreover, with tightened mortgage lending rules under the FCA's Mortgage Market Review (MMR), it has become much more difficult for borrowers to get interest-only mortgages. So the extent to which people are in effect required to save through their property is likely to be higher still in the future.

The potential value in our homes

In conclusion, with inadequate rates of saving through DC pension schemes or via other financial assets, the largest form of saving that many households are now undertaking is increasing the equity in their home as they pay off their mortgage. As a growing proportion of the population reaches retirement with DC instead of DB pensions, given the limited level of saving that most households undertake through other assets, it is increasingly odd to ignore the potential to unlock the more substantial savings people have made through their homes to help fund retirement.

One option retirees have to release value from their home is to downsize but for some there are practical reasons that make this unpopular. Many retirees wish to accommodate returning offspring, while some want to remain in a neighbourhood where they have built up friendships and contacts. For others, the lack of appropriate property to

trade down to is the main barrier. A report by the International Longevity Centre – UK published in January 2016[13] suggested that nearly half of older households would consider downsizing but far fewer had put these plans into action.

Equity release is the obvious solution for those who want to remain in their homes but there are powerful psychological barriers to overcome. People understand that they save through a pension over their working life and then use those savings to provide an income in retirement. But even though, as we have shown above, they have saved through their home in a similar way through mortgage repayment and home improvements over their working lives, they have not viewed their home as a store of savings in the same fashion.

The psychological barriers to equity release take two main forms. Firstly, some people have an aversion to taking out debt on their home having spent their life paying it off which creates an aversion to lifetime mortgages. And secondly the family home is usually viewed as the main asset to be passed on to children. However, this barrier may already be diminishing. According to a July 2016 report from Aviva[14], 46% of over 45 year old homeowners see the wealth built up in their property as a key part of their retirement income plans, and this figure rises as high as 58% among 45-54 year olds. We conclude by illustrating why pension freedom should accelerate the changes to these psychological barriers.

New retirement choices: the implications of pension freedom

What do the pension freedom changes of 2015 mean for those entering retirement now and in the future?

Whereas previously DC pension pots had to be turned into an income through the purchase of an annuity, now they are fully realisable and inheritable assets just as other financial assets and property are. This should be expected to drive a move towards a more holistic approach to financial planning in retirement where individuals consider all elements of their wealth including pension pot, other financial assets and home equity together.

Leaving your pension pot to your children could now become just as important as leaving your house. This is likely to reduce the psychological barrier to equity release posed by the focus there has been to date on leaving the family home to the next generation. And whereas in the past professional financial advice for retirees tended to come in silos, with advisers specialising in pensions or equity release but not both, the new environment should support more joined-up advice which increasingly looks at all of the retiree's assets, advising on how best to utilise each of them to meet their financial objectives.

This in turn could help retirees to think in a more structured manner about their financial objectives. For example, rather than just deciding they will leave the family home to their offspring, faced with advice that seeks to optimise outcomes taking all assets into account, the retiree might think more carefully about how much of their wealth they want to leave to their children, what income they need now, how much investment risk they want to take during their retirement and how they can balance these objectives.

For many homeowners such a structured approach to financial planning in retirement with all assets taken into consideration will lead to outcomes that include the use of either a lifetime mortgage or a home reversion plan. To demonstrate how pension freedom has changed how retirees may look at their circumstances and become more proactive about using their property wealth within that, we provide a series of examples as follows:

13. Generation Stuck – Exploring the reality of downsizing in later life
14. Aviva Real Retirement Report, summer 2016: Six million over 45-homeowners see property as key to their retirement income plans – but is there enough house to go round? 27 July 2016

Example 1 – Mr Taylor

Mr Taylor is retiring at age 65 with a house valued at £200,000, a DC pension pot of £100,000 and £10,000 of other financial savings. If he uses his pension pot to purchase a conventional level annuity he can provide an income for life of approximately £5,000. But he is concerned that if he dies within a few years, the annuity will have been poor value and he will have forgone the chance to leave his pension to his children.

Alternatively Mr Taylor could take out a £50,000 lifetime mortgage to provide himself with an income of £5,000 a year for 10 years and leave his pension invested. In 10 years he will be 75, and should therefore benefit from the higher annuity rates available for older pensioners. A higher annuity rate coupled with the likely growth in the size of the pension pot should probably allow Mr Taylor to purchase a guaranteed £5,000 pa income while keeping some of his pension invested and available to his children when he dies, as well as any remaining value in the property.

Example 2 – Mr Russell

Mr Russell is 65 years old. He has a DC pension pot of £300,000, a property worth £600,000 and £50,000 of other financial assets. His children want to get on the housing ladder and he wishes to help them with their deposits. He wishes to pass on a total of £150,000 now. He could withdraw this sum from his pension but would incur income tax as it exceeds 25% of his pension fund. If he releases equity from his home via a lifetime mortgage he can avoid this additional income tax.

He chooses to release £150,000 via a lifetime mortgage. His children will ultimately inherit less from his property – and if he dies within seven years of the transfer there may be the potential for an inheritance tax bill on the gifted sum – but he believes that getting them on the property ladder now is more important. With the pension still invested, they stand to inherit funds from the pension as well as any remaining value in the property.

Example 3 - Mr and Mrs Patel

Mr and Mrs Patel are both 70 and have just retired. Mr Patel has been a successful amateur investor for many years and now has a self-invested pension pot of £250,000 as well as a house valued at £230,000. His pension generates an income of 4% a year (£10,000) which he plans to draw, but this is not sufficient for them to live on.

Mr Patel is pessimistic about future property values but optimistic about the outlook for the equities he has invested in. They want to ensure that their children receive a good sized inheritance after their deaths and therefore enter into a home reversion scheme to provide a lump sum that can generate the extra income they need. This allows the Patels to keep their pension invested and they hope its value will rise considerably over time, ultimately providing their children with a large inheritance.

Example 4 – Mrs Sterling

Mrs Sterling is a 57 year old widow. She has a DC pension pot of £50,000 and a property worth £120,000. She has only a modest amount of cash in the bank. She is concerned that she might outlive her pension if she draws down funds so decides to take a guaranteed income by purchasing an annuity with her pension funds. However, the best annuity she can find will only pay her only £2,100 a year. Although she wants to pass money onto her children, she needs additional income so decides to take out a lifetime mortgage on her property, using the drawdown facility to provide regular instalments of additional funds as she needs them.

Example 5 – Mr and Mrs Scott

Mr and Mrs Scott (both 65) have a house valued at £150,000 and a DC pension pot of £100,000. They also have other savings of £10,000. They have no children and want to use their assets to enjoy their retirement to the full. They have worked out that they need a guaranteed inflation proof income of £6,000 a year. This will require them to use the whole of their DC pot to purchase an index linked annuity. They then plan to take out a lifetime mortgage providing them with an additional pot of cash which they want to use on items including travel and a new kitchen – the latter increasing the value of their home. They plan to keep the £10,000 in cash in case of emergencies.

These illustrative examples are not designed to present 'best outcomes' but rather to show how property wealth can be accessed and integrated into wider financial solutions. Advisers, working with their clients, will be able to determine the appropriate shape of such planning to achieve suitable outcomes.

PART 2

Meeting consumer demand: progress and challenges in the equity release sector

About the author:

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Drivers of demand for equity release products

As individuals take on greater responsibility for securing their financial security and well-being in later life, mechanisms designed to support the conversion into retirement income of UK households' greatest asset – housing wealth – will continue to grow in importance. While greater access to Defined Contribution (DC) pension savings may alter the role and relevance of housing wealth, there are a number of factors that suggest the continuing need and preference for additional sources of retirement finance.

Retirees opting against a secure, guaranteed, income for life

As the previous chapter has illustrated, inadequate income from DC pension savings may well be the most significant driver of future demand for access to equity release products. But we also know that since the pension freedoms were introduced, there has been a considerable decline in annuity sales now that purchases are no longer compulsory[15]. This suggests that retirees are opting against a guaranteed, secure income, for life, with potentially serious implications for their future financial resilience. 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 capital later on, and housing wealth is likely to play a key role here.

Conversely, and in light of the recent increase in lifetime mortgage sales coming after savers have been given greater access to their pension pots, it may be that rather than delaying the use of equity release to later in retirement, the reforms might incentivise earlier use of housing equity.

Restrictions on access to 'mainstream' mortgage finance

In the wake of the 2008-9 financial crisis, the MMR implemented significant changes to the FCA's rules governing the sale and approval of mortgages to residential consumers[16]. Key changes included the implementation of an affordability assessment, to ensure borrowers will be able to afford repayments both now and into the future of the loan (though this does not apply to lifetime mortgages where repayment by instalment is not required but is an optional extra on a growing number of products). While the (then) Financial Services Authority (FSA) explicitly stated that it did not wish to encourage an excessively cautious approach on the part of lenders, restricting availability and increasing the cost of mortgages into retirement[17]; in practice, lenders have responded cautiously, and older consumers have experienced difficulty gaining access to conventional mortgage borrowing[18].

These restrictions are part of a wider trend towards responsible lending, but for the increasing number of older people carrying mortgage and non-mortgage debt into retirement, either as a deliberate asset management strategy or through little choice, this shift has placed greater, unnecessary, strain on household budgets as income declines. Even when consumers have adequate resources to service mortgages into retirement, requiring borrowers to have a private pension, regardless of their other savings and assets, has meant that some, perfectly credit-worthy, consumers have been refused access to 'conventional' mortgage borrowing.

A number of providers, notably building societies, have since loosened some of these restrictions, primarily by increasing the maximum age for lending money on a mortgage. However, at the beginning of 2017, the Financial Ombudsman Service indicated that more still needs to be done, with a significant minority of older people

15. Pensions Policy Institute (2014) How complex are decisions that pension savers need to make at retirement? http://www.pensionspolicyinstitute.org.uk/publications/reports/transitions-to-retirement---'how-complex-are-the-decisions-that-pension-savers-need-to-make-at-retirement
16. FSA (2011), Mortgage Market Review: Proposed Package of Reforms (CP11/31); online at www.fsa.gov.uk/library/policy/cp/2011/11_31.shtml
17. FSA (2011), Mortgage Market Review: Proposed Package of Reforms (CP11/31)
18. Overton, L. and Fox O'Mahony, L. (2015) Consumer Demand for Retirement Borrowing, London: CML

continuing to experience (perceived) unfair treatment and discrimination from mortgage providers relying on strict, inflexible rules.[19]

These trends position retirement borrowing towards more specialist equity release providers, who do not operate such restrictions. Indeed, the difficulties facing older people in the 'mainstream' mortgage sector may well account for some of the recent increase in lifetime mortgage sales. However, the FCA's requirements have also had implications for new 'hybrid' equity release products that give customers the option to make interest repayments initially with the option to revert to roll-up interest at any point. Within the last year, the FCA has recognised that its responsible lending rules could have contributed to restricted development and take-up of hybrid mortgages, and has subsequently modified the affordability rules so that they do not apply if the customer wants to service the interest but has the safety net of roll-up in the background[20]. This will allow firms to more readily offer this type of product.

Looking to the future and at how older consumers can make the most of their overall wealth, the challenge now is for the FCA, and the industry, to look at where there may be remaining barriers to mortgage product innovation, while at the same time ensuring any moves towards facilitating greater innovation do not run the risk of compromising appropriate protection for more vulnerable consumers.

Intergenerational financial support

In addition to using housing wealth to meet individual needs and preferences, there is evidence to suggest that older people will increasingly look to mechanisms that enable them to use their housing wealth to support their children and grandchildren. Indeed, many already are, with a quarter of equity release customers taking out plans to support family and friends in 2016[21].

Previous qualitative research with equity release consumers showed that among those who had used equity release for this purpose, the funds were used in whole or in part to relieve their children's financial difficulty. Typically, adult children were in debt due to divorce and relationship breakdown, the cost of higher education, or labour market instability. These findings suggest that the older generation are 'giving something back'; contrary to the now infamous David Willetts claim[22] that the baby boom generation have stolen their children's future and should give it back.

However, while these private financial transfers of housing wealth can be seen as positive on the one hand (and even a means through which to address increasing intergenerational wealth inequalities)[23] there is concern that familial support for children's welfare potentially compromises parents' welfare needs, or at least the ability to pay for them. But as people enjoy longer lives, they may increasingly decide to pass on a 'living inheritance'. The difficulties young people now face in gaining access to home ownership, particularly without parental assistance[24], are likely to continue to drive demand for intergenerational financial support, and instruments such as equity release, to support this.

Ageing in place

In theory, one option for older people wanting to access the equity tied up in their homes is to trade down to a lower value property, but there are limited opportunities for this in the current UK market. The government's recent White

19. http://www.financial-ombudsman.org.uk/publications/ombudsman-news/139/139-mortgages-and-age-whats-in-a-year.html
20. FCA, Feedback Statement, Call for Inputs on Competition in the Mortgage Sector, May 2016, Quarterly Consultation No.14, September 2016 and Handbook Notice 40, January 2017
21. UK Equity Release Market Monitor, Full Year Review, 2016 https://www.keyretirement.co.uk/MediaLibrary/KeyRetirement/images/Equity%20release/Market-Monitor-FY.pdf
22. Willetts, D. (2011) Pinch: How the Baby Boomers Took Their Children's Future-and Why They Should Give it Back. Atlantic Books.
23. Rowlingson, K., Joseph, R. and Overton, L. Intergenerational Giving and Inequality, Hampshire: Palgrave Macmillan (forthcoming in March 2017)
24. ILC UK (2014) Mapping Demographic Change - A factpack of statistics from the International Longevity Centre-UK; Council of Mortgage Lenders (2015) The challenge facing first-time buyers. 8https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/590043/Fixing_our_broken_housing_market_-_housing_white_paper.pdf

Paper, Fixing our Broken Housing Market, points to a number of options for making it easier, and more attractive, for older people to move. But the paper stops short of offering detailed plans, or indeed fiscal incentives, for realising these policy goals[25].

Furthermore, moves to improve the supply of accessible housing will be welcomed by those able and willing to move, but they will do little to overcome the emotional and psychological attachments many older people have to their homes. Research has shown that to access equity tied up in housing, people opt for equity release, instead of moving, because the house is valued for the space it offers to accommodate people (family and friends) and possessions, and the locale for maintaining a sense of connection and belonging[26]. These factors point to the continuing need for options allowing equity release in situ.

"...RECENT PRODUCT DEVELOPMENTS... SUGGEST THE POTENTIAL FOR WIDER UPTAKE AMONG AN INCREASINGLY DIVERSE CONSUMER POPULATION..."

Product development and innovation

The trends outlined above point to the growing need for innovative and flexible approaches to lending in, and into, retirement. As older people have to manage their income and assets over a longer period than past generations, there is greater necessity for financial products that meet people's changing needs and circumstances *throughout* retirement. Coupled with lower interest rates, recent product developments in the equity release industry, such as downsizing protection, voluntary repayments without early repayment charges and interest servicing, suggest significant opportunity for addressing some of the key issues and concerns associated with traditional offerings, and the potential for wider uptake among an increasingly diverse consumer population.

Overcoming consumer concerns about debt and insecurity

Unlocking the potential in the equity release sector has proven difficult to realise for some time. However, record lending in 2016, with sales surpassing £2 billion for the first time, suggests progress is being made in overcoming some of the demand-side barriers to this long-awaited market expansion.

Research with equity release consumers revealed the unease and anxiety that some owners feel as a consequence of the progressive impact of accumulating interest and dwindling equity[27]. This study showed that the fear of 'ending up with nothing' was particularly prominent among less well-off consumers, and based variously on inheritance motives, anxiety about future financial needs, fears concerning negative equity (notwithstanding the 'no negative equity guarantee' offered by members of the Equity Release Council) and a dislike of debt. In a very small number of cases, participants felt so uncomfortable about the level of debt that was owed that they decided to repay the loan.

25. Fox O'Mahony, L. and Overton, L. (2015) 'Asset-based welfare, equity release and the meaning of the owned home', Housing Studies, 30(3), pp.392-412
26. Overton, L. and Fox O'Mahony, L. (2015) The Future of the UK Equity Release Market: Consumer Insights and Stakeholder Perspectives, http://www.birmingham.ac.uk/research/activity/social-policy/chasm/publications/index.aspx
27. Fox O'Mahony, L. and Overton, L. (2015) 'Asset-based welfare, equity release and the meaning of the owned home', Housing Studies, 30(3), pp.392-412.

In this context, historic product features and provider practices (such as relatively low loan-to-value (LTV) ratios combined with relatively high interest rates and start-up costs) have tended to benefit better off consumers with higher house values; while those with more modest means have found it difficult to release housing equity without compromising their ability to leave an inheritance, or their overall sense of (material and symbolic) financial security[28].

With traditional product offerings, consumers could expect the debt to double every ten years, and this hasty erosion of equity has a greater impact on those with lower value properties, especially if modest house price rises do little to offset the accumulating debt. The advent of drawdown lifetime mortgages, allowing borrowers to obtain an agreed, maximum amount of money as and when required, went some way towards limiting the total amount owed over the lifetime of the loan, but more recent product developments and flexibilities look set to make equity release more attractive, and better suited to the needs and preferences of a wider range of consumers. Interest rates of 4.5% or lower are also becoming more commonplace, extending the period of time before the debt doubles to 17 years or more.

With an increasing range of providers offering options for paying interest on the loan and the flexibility of making voluntary repayments without penalty, more consumers will be able to feel financially secure for longer. These emerging flexibilities have the potential to allow more, older, owners to 'have it all' – to realise the asset value of the house without having to give up many of the other meanings and functions of the owned home.

Better value products and younger borrowers

Consumers in the 65-74 age group remain most likely to take out an equity release plan, but the share of new customers aged 55-64 is rising (from 17.2 per cent in the first half of 2014 to 21.3 per cent in the second half of 2016[29]). This shift may be a sign that people are starting to look at housing wealth as a potential asset earlier in the retirement planning process, or that more find themselves with existing borrowing to pay off as they move into later life.

Increasingly, this existing borrowing includes residential interest-only mortgages that are reaching maturity. Experian research for the FCA predicted several peaks in the years ahead (2017/18, 2027/28 and 2032) and suggested approximately 40,000 residential interest-only mortgages will mature each year between 2017 and 2032 where the consumer will be past 65 when the mortgage reaches the end of term[30].

Equity release can offer a very valuable solution here, but there is a risk that more people drawing on the value of the home early on in retirement will mean fewer resources to draw on for unanticipated needs and expenses later on, particularly as life expectancy rises. In the consumer study referred to above, a number of participants were concerned about the extent to which equity release had depleted their stores of housing wealth, and how this might affect their ability to meet future care and income needs. Against this backdrop, the recent trend towards better value and more flexible products is increasingly essential.

While recognising that housing wealth is a limited resource, new product features and flexibilities may also help to establish a more effective equity release market, 'enabling more people to use their assets to help pay for the cost of their social care, to adapt their homes, and to support their incomes'[31]. A key challenge for the industry has been to develop products that cope well with changes in consumers' needs and circumstances, and some of the features that are now being introduced (e.g. interest-served products, early repayment without penalty) signal a step in the right direction.

28. Equity Release Council (2017), Equity Release Market Report Spring 2017
29. Experian (2013), Residential interest-only mortgages volumes, concentrations and maturity horizons
30. House of Lords Select Committee on Public Service and Demographic Change (2013) Ready for Ageing? London: The Stationary Office (p.138)
31. See http://www.equityreleasecouncil.com/ship-standards/statement-of-principles/

Future proofing equity release products

The Equity Release Council product standards, contained within its Statement of Principles, state that customers have the right to move their plan to another suitable property without financial penalty.[32] This has been the case for products sold by Council members since the standards were first introduced in 1991 and remains a particularly important safeguard in the current retirement landscape, where the ability to anticipate future changes in needs and circumstances over a long period of time will grow increasingly difficult.

However, consumer research on the long-term experience of equity release revealed that some customers find themselves unable to move to a more suitable property when the need arises[33]. Deteriorating health, isolation, and/or having too much space to manage were among the main reasons consumers wanted to transfer their equity release plan to a different property, typically an apartment or specialist retirement property. At the time of enquiry, consumers either found that this had never been possible, or that changes in provider policy meant such properties were no longer in the 'acceptable' category.

These findings – despite being weighted towards historic home reversion products, which account for a very small share of today's market – nonetheless raise important questions about the extent to which products can be considered fully 'future proof', and indeed whether warnings about risks and costs during the advice process (which includes financial and legal advice in the case of products sold by Council members) constitute sufficient consumer protection. Alongside the provision of such advice, future proofing can also be thought of in terms of the suitability and regulation of product features, and enhanced by options such as downsizing protection and fixed early repayment charges.

The findings also resonate with recent work by the FCA on consumer vulnerability[34], which signals a shift from a narrow, product-based, conception of vulnerability (i.e. that a particular product makes all its consumers vulnerable by default, regardless of who the consumer is and what their circumstances are) to a broader conception of vulnerability, which emphasises the interplay of individual circumstances, the context of the transaction, and the part played by firms in making some consumers vulnerable. Nevertheless, the FCA noted a general need to improve inflexible financial products (not specifically equity release) designed for the standardised perfect consumer. They reported 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.'

"...CONSIDERABLE PROGRESS IS BEING MADE TO PROVIDE GREATER FLEXIBILITY..."

While considerable progress is being made to provide greater flexibility, further efforts in this area would help to ensure that equity release products have genuine long-term suitability and avoid limiting their potential as a vehicle for later life finance in the new retirement landscape. Restrictions on lending against some types of retirement properties are not confined to equity release providers, and are also barriers for residential mortgage providers, due to factors including the limited resale value of these properties. However, the equity release sector might usefully see this as an opportunity to explore ways of working with retirement housing developers to overcome these restrictions, and establish itself as the most suitable and attractive option for retirement borrowing.

32. Overton, L. and Fox O'Mahony, L. (2015) The Future of the UK Equity Release Market: Consumer Insights and Stakeholder Perspectives
33. FCA (2015) Consumer Vulnerability – Occasional Paper No. 8, London: FCA
34. FSA (2006) Financial Capability in the UK: Establishing a Baseline, London: FSA; Wealth and Assets Survey 2010-12 – Office for National Statistics

Equity release advice and guidance

Greater product flexibility and innovation in the equity release sector is certainly something to be welcomed, but greater choice brings the potential for greater risk of financial loss resulting from suboptimal product choice. This is particularly significant in light of the evidence that older age groups, particularly the over 70s, are less proficient than the wider population at choosing financial products[35].

This has implications for how the equity release industry, and wider advice and later life planning sector (including the FCA), supports consumers' financial decision-making – a recurring challenge across many areas of financial services. Findings from research with equity release consumers[36] demonstrate that information about equity release can appear complex, overwhelming, and difficult to process, while equity release stakeholders suggested that firms feel restricted in their ability to present simpler information by current regulatory requirements.

Smarter consumer communication

In light of these findings, and the wider issue of communicating information on a range of financial products in a simpler, clearer, and more effective fashion, there is a pressing need to consider the opportunities for, and potential barriers to, new and more innovative ways of helping consumers to overcome 'information vulnerability'[37]. Recognising this, the FCA has embarked on a programme of work with the financial services industry and other key stakeholders to look at consumer vulnerability, alongside its ageing population strategy, to consider the most effective ways of communicating information about financial products and services.

It is hoped that effective communication (i.e. when consumers pay attention to the information, have the capacity to interpret it, and are willing to incorporate it in their decision-making process[38]) will produce better consumer outcomes. With the FCA also removing firms' requirements to provide unnecessary, non-meaningful disclosures, the challenge now is for the equity release and wider financial services industry to develop innovative approaches to communicating information about product terms and features (including exclusions) in a way that is sensitive to the particular needs and circumstances of the older consumer population(s). As a result of lifetime mortgages being excluded from Mortgage Credit Directive (MCD) requirements, the equity release sector has a great opportunity to deliver this.

A more joined up approach to support better consumer outcomes

There are currently three government-backed financial guidance providers which all aim to help individuals navigate financial decision-making, but there is some evidence of low awareness and uptake of public guidance services[39]. Given that this kind of financial information, ahead of taking regulated financial advice, can have a positive effect on consumers' ability to interact effectively with the adviser, the creation of a new, single body, for public financial guidance[40] has the potential to provide a more joined-up approach across the equity release industry and other key players in the market. In turn, this should make it easier for consumers to consider their income and asset portfolio holistically, and to access the help they need to make sound financial decisions.

Given the increasing necessity for older people to navigate complex choices and decisions about retirement income and assets, particularly in the pension freedom environment, there are also

35. Overton, L. and Fox O'Mahony, L. (2015) The Future of the UK Equity Release Market: Consumer Insights and Stakeholder Perspectives; Fox O'Mahony, L. and Overton, L. (2014) 'Financial Advice, Differentiated Consumers and the Regulation of Equity Release Transactions', Journal of Law and Society, 41(3), 446-469.
36. Cartwright, P. (2015) Understanding and protecting vulnerable financial consumers. Journal of Consumer Policy, 38(2), pp.119-138.
37. FCA (2016) Feedback Statement - Smarter Consumer Communications, London: FCA
38. The Financial Capability Strategy for the UK, October 2015
39. HM Treasury and DWP (2016) Public Financial Guidance Review, London: HM Treasury
40. Overton, L. and Fox O'Mahony, L. (2015) The Future of the UK Equity Release Market: Consumer Insights

important questions to be addressed concerning the knowledge base required for advisers to be able to offer a suitable range of product options for meeting their customers' aims and objectives, or signposting to other experts where necessary.

In this context, recent FCA moves to consider upskilling pensions and investment advisers on equity release could be advantageous, on the one hand, by enabling more advisers to offer a holistic approach, and considering all the customer's assets as part of their retirement planning. On the other hand, this also included a proposal for a potential move to a standalone equity release qualification which would not require advisers to become qualified in other areas of conventional mortgage advice. This has been challenged by many of the key stakeholders in the market, as there is a risk that clients would not receive advice on the range of retirement secured borrowing options and alternatives to a lifetime mortgage that may be better suited to their needs, objectives and circumstances.

The role of soft skills in the advice framework

While many of the recent suggestions for 'smarter consumer communication' involve the use of online and interactive tools, equity release consumer research has indicated that verbal communication, in particular, communication with a personable, friendly adviser, can play a key role in determining how clear and helpful consumers find information and advice, and how that advice influences their subsequent choices[41]. These findings suggest that greater emphasis on the role of 'soft skills' training in supporting a positive relationship in which the consumer feels able to ask questions, and where they can take time to absorb and reflect upon the information and advice that they have received, may prove advantageous in supporting good consumer outcomes.

It also raises questions about the suitability of moves towards greater use of 'robo-advice' (a catch-all term used to refer to a range of online advice and investment) for this consumer population. One of the points the Financial Advice Market Review[42] considered was how advances in technology, particularly the increasing availability of online services, could be used to fill 'advice gaps' for investments, pensions (accumulation and decumulation) and protection. This is also significant in light of digital exclusion among 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 65-74s and 68 per cent of the 75+ age group[43]. Given that many forms of communication concerning financial products and services is delivered online, digital exclusion could reduce financial capability, as well as directly resulting in older people's exclusion from products and services they could benefit from.

"...GREATER EMPHASIS ON THE ROLE OF 'SOFT SKILLS' TRAINING... MAY PROVE ADVANTAGEOUS IN SUPPORTING GOOD CONSUMER OUTCOMES..."

41. and Stakeholder Perspectives,
42. FCA, Financial Advice Market Review Final Report, March 2016; FCA Call for inputs on competition in the mortgage sector, 2016
43. Cited by Age UK (2015) Response to FCA scoping study of access to financial services, London: Age UK,

The social acceptability of equity release

This chapter has identified many areas where progress is being made to offer more attractive and suitable equity release options, enabling more people to make the most of their housing wealth in later life. It has also identified where challenges remain. This final section concludes with arguably the greatest challenge facing the equity release sector going forward: increasing the social acceptability of equity release.

Our research suggests that one of the consequences of the positive status attached to home ownership in the UK and, in particular, outright ownership in later life, is that those who engage in equity release are reluctant to 'admit' that they have taken out a plan, and are more likely to feel a sense of shame and/or guilt, rather than pride in their decision[44]. Though this sentiment was slightly less common among some of the better-off participants, perhaps because they were not relying on the money to get by but had instead chosen to release equity to enhance their lifestyle and/or support family, there was nevertheless widespread agreement on the difference between 'acceptable' debt, for example, mortgage acquisition debt, and 'unacceptable' debt – the debt accumulated under equity release. This notion that surrounds equity release perpetuates a (false) belief that later life debt is 'abnormal', and has a number of important implications, not least preventing wider up-take of equity release, with adverse implications for those who might benefit most, and for market growth in this sector.

It is possible that future generations of retirees will have a different set of attitudes, enabling them to feel more 'at home' with housing equity consumption and secured debt in retirement. In the meantime, enabling more people to benefit from what equity release has to offer will require more than raising awareness and getting the products right (greater flexibility and innovation): it will also require specific strategies to normalise equity release as a socially accepted vehicle for retirement finance. Both industry and government can play a role in taking on this challenge.

"...THIS NOTION THAT SURROUNDS EQUITY RELEASE PERPETUATES A (FALSE) BELIEF THAT LATER LIFE DEBT IS 'ABNORMAL'..."

44. Overton, L., Fox O'Mahony. L. & Gibson, M., 'The emotional dimension of trading on home in later life: Experiences of shame, guilt and pride' in Thinking Home (eds. Bahun, S. and Petric, B.), Home Studies series, Palgrave Macmillan, forthcoming 2017

Recommendations

This paper has provided a comprehensive background to the socio-economic landscape of today, particularly in the context of changing pension provision.

As we have seen, the UK faces a number of challenges including an ageing population, rising social care needs with declining public resources and inadequate pension funds.

Equity release can play a key role in helping older people meet those challenges. With its Statement of Principles at its heart, The Council will continue to actively engage with all stakeholders, including government and regulators, to promote the opportunities that equity release can provide.

1 Equity release is a viable option

Equity release is an option available to people over 55, but for some homeowners there is currently a reluctance to release housing equity. This is partly driven by cultural norms of the desirability of home ownership in the UK, and partly by attitudes to debt preventing equity release being considered as an option.

Rising house prices means that many people have effectively 'earned' much more through home ownership than saved through other means such as pensions. At the same time, an increasing number of customers are moving towards retirement with outstanding interest-only mortgages. There are estimated to be 40,000 interest-only mortgages reaching maturity each year between 2017 and 2032, with around 10,000 of these either having a shortfall or no strategy for paying off the mortgage.[1]

For many consumers, equity release may be the most appropriate solution because property will be their greatest asset. Government and industry can play a role in both changing prevailing social attitudes to debt and raising awareness of the potential of housing wealth so that equity release is simply regarded as one of the tools that can help fund later life.

2 Communications must be clear and accessible

The concept of equity release needs to be clearly understood so that consumers can make informed choices. That means using simple, jargon-free language and making customers aware of the various free guidance tools available.

A range of advice is also increasingly available at relatively low cost. The UK government's new Pensions Advice Allowance will now enable consumers to seek advice on retirement options including housing wealth. It is vital that customers are aware that this facility exists and are encouraged to utilise this resource.

Equity release guidance and advice should be available across both digital and more traditional platforms to ensure that it is accessible to all.

3 Greater understanding of equity release customers is needed

Equity release customers come from a variety of backgrounds and take out plans for various reasons, to meet a wide range of needs. These needs can and do change over time. Features such as lower interest rates and partial early repayment without penalty, aim to provide a range of products to meet these differing requirements.

1. https://www.ftadviser.com/mortgages/2017/04/04/for-fa-interest-only-time-bomb-raises-standards-questions/

Further research is needed to gain greater insight into consumer lifecycles so that equity release products and services can continue to adapt to best support the needs and priorities of all consumers. Government and regulators should also actively facilitate a supportive environment to help industry meet those needs.

Focused, well-directed training on mental capacity is crucial. Although individuals may have mental capacity issues at any age, given the demographic of equity release customers, this is an area in which the sector must develop a much greater understanding. Consumers must be well-protected and able to make informed decisions, free of undue influence. Operational systems must be sufficiently robust to enable appointed third parties to make decisions on behalf of others, while ensuring the necessary safeguards.

4 Equity release can help meet socio-economic challenges

As has been well-documented, the UK has an ageing population, with increasing pressure on social care services with ever tighter resources. At the same time, with pension provision in decline and this trend looking set to continue in the future, the reality is that housing will most likely be the greatest asset available to homeowners.

Equity release can be one part of the solution to meet such socio-economic challenges, by, for example, providing consumers with access to resources to finance social care needs. For politicians of all parties, a major attraction of equity release is that it does not involve extra taxation or increased government borrowing – the housing wealth is already there.

To enable the equity release industry to realise its potential in this area, government must actively acknowledge the role that the sector can play. That is why we welcomed HM Treasury's view that retirement advice should not only consider pensions but also include other assets such as housing.[2]

But government can, and should, go further. It should abandon its 'semi-detached' attitude to equity release and establish a dedicated policy team committed to promoting equity release as a safe product that should be on everyone's retirement checklist. Government should also ensure the removal of regulatory barriers to the growth of the sector, particularly those that might constrain either existing or new funding streams.

5 Adaptability and flexibility is essential

The equity release sector has shown its capacity to innovate and offer flexible products to meet consumer demand. With existing and future socio-economic challenges as they develop, the industry must to continue to demonstrate the tenacity and skill to adapt to changing consumer needs.

Adaptability and flexibility are requirements of services as well as products. The report identifies the importance of a 'soft skills' approach to advice, as even in an increasingly digital age, consumers still value face to face contact with knowledgeable and patient industry professionals, ahead of making important financial decisions.

The Council's consumer safeguards which are already in place for equity release customers are a guiding example to the wider financial services sector on how to interact with older consumers.

Equity Release Council
April 2017

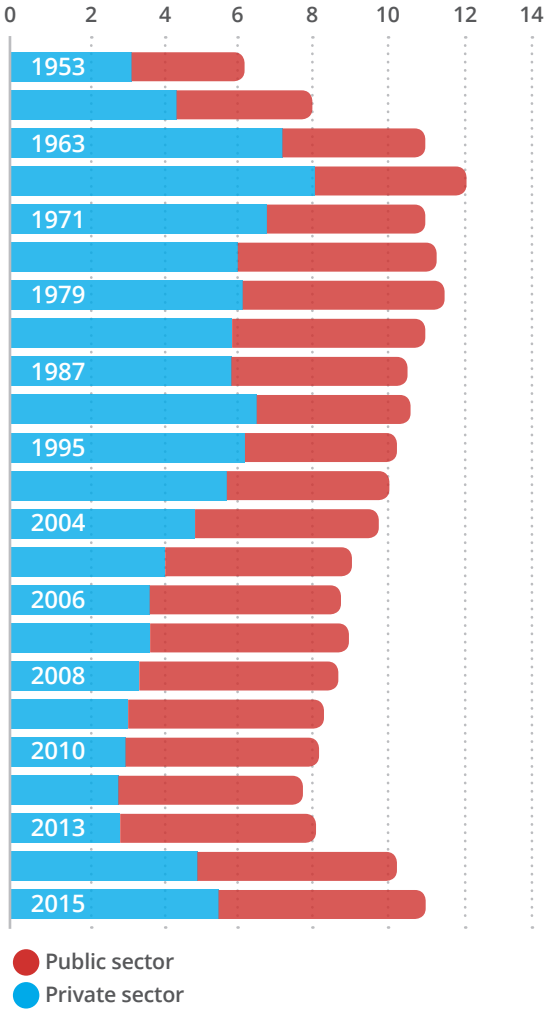
2. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589163/Pensions_Advice_Allowance_response_to_the_consultation_web.pdf

Appendix

Context: A brief history of pensions

The pensions market has changed out of all recognition since World War II. 70 years ago the average male in the UK had a life expectancy of 64 years[45]. So, it is perhaps understandable that pension provision was not a high priority for many people. Many workers did not have an occupational pension but instead relied on the state pension (which was first introduced in 1909), personal savings or their offspring to maintain them financially in their retirement.

Chart A – Number of employees in a pension scheme (millions)



Source: Office for National Statistics (ONS) Occupational Pension Schemes Survey, UK 2015

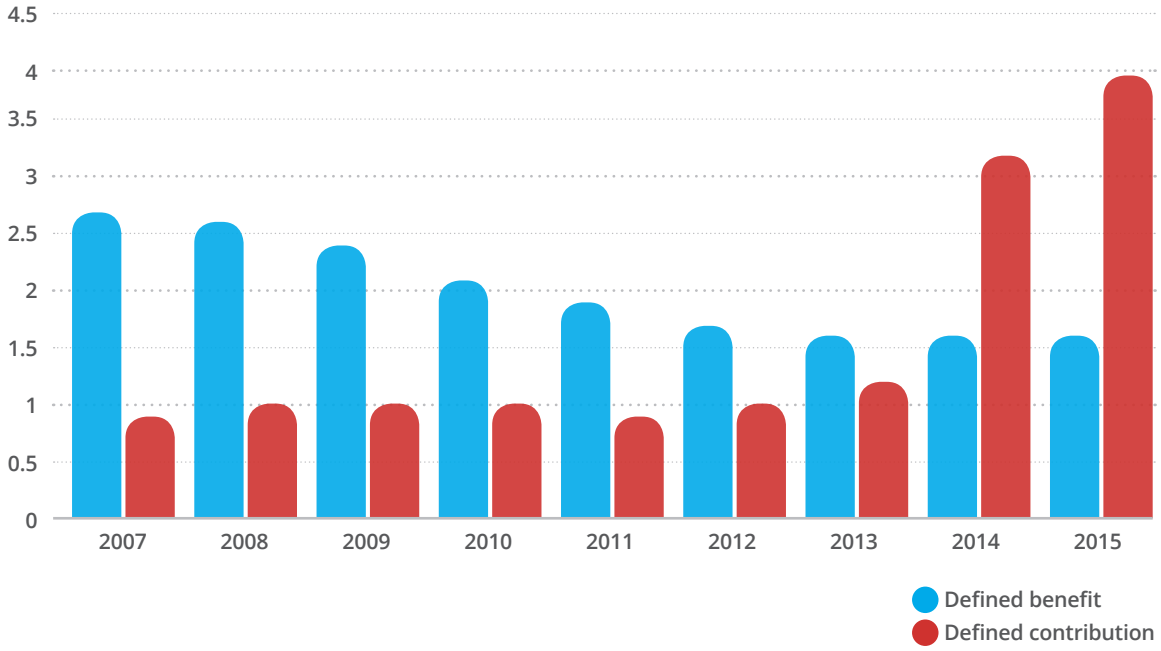
Over the next two decades there was a huge expansion in the provision of company pensions so that by the mid-1960s over 12 million people were enrolled in a pension in their workplace (see Chart A). The vast majority of these workers were in a final salary or DB pension scheme. This gave people the certainty of knowing that their income in retirement would be directly related to their salary at retirement with the employer obliged to meet these payments regardless of subsequent investment performance. However, with high nominal investment returns from the late 1960s to the 1980s, employers found the cost of running such schemes reasonably affordable.

The next major shift in pension provision came with the decline of the DB pension and rise of the DC pension. This trend has been evident since the 1990s but, as Chart 2 shows, it has been accelerating in recent years and the trend has been even more marked in the private sector, so that today most of the remaining DB scheme members are in the public sector. Note that the spike in pension membership in 2014, which resulted from the introduction of compulsory workplace pensions via auto-enrolment, was concentrated entirely in DC schemes.

In DC pension schemes, rather than guaranteeing a particular percentage of salary in retirement, employers contribute to an investment pot, which is expected to grow over time to provide a lump sum which can be used to purchase an income for life on retirement. The move from DB to DC pensions has shifted investment risk from the employer to the employee and it followed the fall in interest rates and a significant change in tax rules in the 1990s which, coupled with rising longevity, dramatically increased the cost of providing a guaranteed income in retirement.

45. Government statistics

Chart B – Number of employees in DB to DC pensions (millions)



Source: ONS Occupational Pension Schemes Survey, UK 2015

In contrast to employees in DB pensions, those in DC schemes could actually see an asset building up in their pension pot over their working lives but, because government rules required that pot to be converted into an income for life on retirement through the purchase of an annuity, the asset was illusory. The move from DB to DC pensions thus saw retirees still receiving a fixed pension income, but now with the uncertainty of not knowing until retirement exactly how large that income would be.

As annuity rates followed interest rates down in the wake of the financial crisis peaking in 2008-9, the income retirees could receive from a given size of pension pot diminished further. This led to pressure on the government to relax the rules around compulsory annuitisation and in 2011 the government abolished the requirement that pensioners purchase an annuity by the age of 75. But the real watershed in UK pensions policy came in 2015.

The 2015 watershed moment for savers

In his March 2014 Budget, then-Chancellor George Osborne announced plans to overhaul the treatment of pensions with a policy that became known as pension freedom. This did away with any requirement to purchase an annuity and allowed people complete access to their DC pension savings, subject to income tax being payable on any withdrawn funds beyond the first 25%.

The real revolution of the 2015 pension changes was that pensions became fully realisable assets rather than income streams and these realisable assets became fully inheritable just like property and personal finance assets. In this new world, pensioners can plan their retirement finances with regard to all their assets: their pension pot, other financial assets and their home.

Implications of the shift from DB to DC pensions

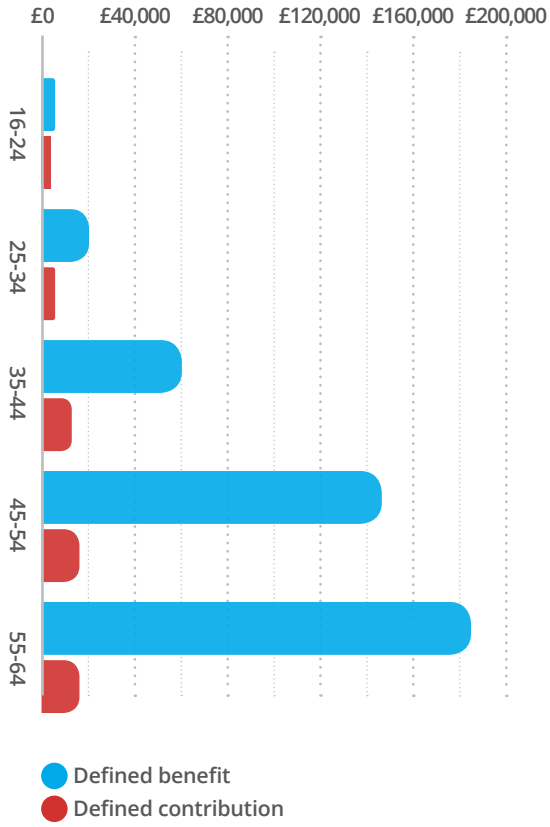
Over the past half century, the majority of households have looked to employer pension schemes to provide the bulk of income in retirement. The generations that were in DB schemes, which were the norm until the 1990s in the private sector (and remain the norm in the public sector), had the certainty of knowing in advance what income they could expect from their pension. But with the switch to DC schemes employers have not only passed the investment risk onto employees but have also taken the opportunity to sharply lower the contribution they make compared to DB schemes as seen in Chart C.

Chart C – Average pension contributions (% of pensionable earnings – private sector)

Source: ONS Occupational Pension Schemes Survey, UK 2015

As a result of the much lower contributions being made into DC pensions, the wealth held in such pensions is far lower than in DB schemes. The latest ONS data can be seen in Chart D. For example, in 2012-14 the median average 55-64 year old in a current DB scheme (one where contributions are still being made) had a pension valued at £184,200 against only £17,000 for those in DC schemes. For the private sector alone the equivalent figures were £170,200 and £30,200.

Chart D – Median average wealth held in pension



Source: ONS Wealth and Assets Survey, 2015

As part 1 of this report sets out, these trends have serious implications for the standard of living of future generations of pensioners and might be expected to drive a move towards an increasingly joined-up approach to financial planning in retirement, where they consider all elements of their wealth – including housing equity and other financial assets – alongside their pension pot.

About the Equity Release Council

www.equityreleasecouncil.com

The Equity Release Council is the industry body for the equity release sector, which represents over 500 members including providers, qualified financial advisers, solicitors, surveyors and other industry professionals.

It works to ensure a safe equity release market for consumers, by operating rigorous Standards for the provision of advice and products which guarantee security of tenure and financial protections. 2016 marked the 25th anniversary since the first industry Standards were created for equity release in 1991. Since then, more than 380,000 consumers have taken out an equity release plan from Council members, drawing on over £19 billion of housing wealth.

The Council also works with consumers, industry and policy makers to improve awareness and understanding of equity release and the potential for housing wealth to help solve many of the financial challenges facing people over the age of 55 across the UK.

Key facts and figures

- The first equity release Standards were introduced in December 1991, when the predecessor body Safe Home Income Plans (SHIP) launched. **This evolved to become the Equity Release Council in 2012.**

- The Council today represents over **500 individual members and 150 member firms**, including providers, qualified financial advisers, solicitors, surveyors and other industry professionals

- All members are **committed to support the equity release Standards, Principles, Rules and Guidance set out by The Council**, in addition to their regulatory responsibilities

- Since 1991, more than **380,000 people have taken out an equity release plan** from a Council member, drawing on **over £19 billion of housing wealth**. Growing consumer demand means 37% of lending and 28% of new plans have been advanced in the last five years (2012-2016).

- Annual lending has **grown from £29 million in 1992 to over £2 billion in 2016**. The market's post-recession recovery has seen it almost treble in size **from £788 million in 2011 to £2.15 billion in 2016**: over 75% more than the pre-financial crisis peak of £1.21 billion in 2007.

Contact details

Find out more about the Equity Release Council, its members and the products and services they provide by visiting www.equityreleasecouncil.com

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