ASIC

Australian Securities & Investments Commission

REPORT 59

Equity release products

November 2005

Executive summary

In the last year Australia has seen the rapid development of a range of 'equity release' products, where consumers can obtain current financial benefit by trading equity in their homes.

The three types of products currently or soon to be available in Australia are:

- *Reverse mortgages*—the consumer borrows money against the equity in his or her home and the principal and interest is not repaid until the home is sold (usually when the consumer dies or voluntarily vacates the home).
- *Home reversion schemes*—the consumer sells part or all of his or her home to a reversion company. The home is sold for less than its market price (typically between 35% and 60%), but the consumer can remain in the property until they die or voluntarily vacates the home. There are at least two types of home reversion schemes – a sale and lease model and a sale and mortgage model.
- *Shared appreciation mortgages (SAMs)*—the consumer gives up the right to some of the capital gain on the property in return for paying reduced or no interest on that part of his or her borrowings.

Note: Internationally, the three products described above have been grouped together under the title 'equity release' products. This term could technically be understood to encompass a broader class of products including lines of credit secured over a home. However, in this paper it will be limited to reverse mortgages, home reversion schemes and shared appreciation mortgages.

Increase in equity release products

These products have previously had limited acceptance in Australia. However, this position has changed dramatically in the last 12 months, during which time the first two home reversion scheme products have been introduced and two commercial shared appreciation schemes have been announced, although not yet launched (with at least another one currently in development).

There has also been an increase from three to at least 15 reverse mortgage products—currently the most popular equity release products in Australia. Whilst remaining only a tiny fraction of total consumer lending, the reverse mortgage sector has grown significantly in the 12 months to March 2005, going from $468 million to $770 million, with 8,899 new loans provided. A recent industry report estimates that the potential opportunity market for reverse mortgages could increase to $12 to $15 billion by 2010[1].

Reverse mortgages and home reversion schemes are increasingly used by elderly people who are asset rich but cash poor to, for example, supplement their incomes or pay for renovations or medical needs. And shared appreciation mortgages, when launched, will be able to be used by younger Australians who do not have enough savings to be able to enter the housing market.

What are the issues for consumers?

In the United Kingdom and the United States, where the market is more established, there have been negative consumer experiences with each type of product having been missold to vulnerable consumers at some stage. For instance, in the UK there was heavy promotion of reverse mortgages to retirees in the 1980s. However, when prices moved against consumers and their debt exceeded the value of their properties, many were evicted. As a result, in both the UK and the USA, there has been some specific regulation of equity release products.

More recently, in Australia, the Australian Securities and Investments Commission (ASIC) has commenced proceedings in relation to Money for Living—a sale and lease home reversion scheme that has gone into administration and ceased making ongoing payments to consumers—on the basis that its advertising was misleading and deceptive. We have also obtained court orders requiring the promoters of Money for Living to surrender their passports and our investigation is ongoing.

As Money for Living was the only scheme of its type, no other products currently available in Australia raise the same specific risks for consumer. However, all equity release products are complex and, if used inappropriately or with poor advice, there are significant risks for consumers. This is because:

- Both target customer groups—the underfunded aged and aspiring first homeowners—will include many who are vulnerable to making poor decisions, whether from financial inexperience, emotional attachment to the idea of owning their own home, or constrained financial circumstances.
- Each of the three types of equity release products has a complex legal structure in which the ownership and management of the property is shared between the provider and consumer over an extended period of time.

[1] Trowbridge Deloitte, 'The Equity Release Opportunity for Financial Planners' July 2005 (Trowbridge report), 3-6; Sweeney Research, 'Research Report Prepared for Australians Seniors Finance', February 2005.

- Used at the end of consumers' working lives, the products have significant implications for consumers' overall financial positions because consumers must appropriately manage their existing equity and income to fund their housing, care and other needs for the rest of their lives.

There are also complex issues surrounding equity release products that consumers should consider including:

- projected movements in interest rates and property prices,
- variations in consumers' life expectancies and old age caring and housing needs, and
- intergenerational tensions and conflict between the desire to leave an inheritance and the need for money to live on in older age.

Finally, there are obligations and consequences specific to some products which consumers should be aware of including:

- negative equity, if the debt exceeds the value of the property (this was the problem in the United Kingdom in the late 1980s),
- terms and conditions that can trigger the immediate repayment of the loan and loss of key rights,
- differences between products as to which party is obliged to undertake necessary repairs to the property and who obtains the financial benefit from any renovations completed,
- the impact of capitalising of interest with reverse mortgages, particularly if interest rates increase significantly, and
- potentially disadvantageous pension and taxation implications.

Key messages for consumers

The key message for consumers is that it is important that they fully understand the product and their obligations. We recommend that consumers obtain independent legal and financial advice and that they consider the following issues before entering into equity release arrangements.

Question	What to look for
Are there protections against excessive costs?	Reverse mortgages may include: • 'no negative equity guarantees' which guarantee that the provider will bear any difference if the debt exceeds the value of the property, and/or

Question	What to look for
	• Fixed interest rates or caps on variable interest rates which may limit the risk of negative equity. SAMs may include: • caps on the amount that providers will be entitled to if value of the consumer's home increases beyond an agreed amount. • a mechanism to measure the price of the SAM, other than the value of the property. Home reversions may include: • rebates if the consumer sells the property earlier than expected.
Who is obliged to maintain the property?	In some home reversion schemes the provider is responsible for maintaining the property but in most equity release products, the consumer is responsible for maintaining the property to a standard that is set by the provider.
What are the terms and conditions?	If the consumer breaches the terms and conditions in the contract (including for example an obligation to maintain the property), they may lose key rights under the contract and the provider may have the right to evict them.
Who gets the benefits from renovations?	Some contracts deliver the financial benefit from renovations to the provider, some to the consumer, and some provide a portion of the benefit to each.
How will it effect consumers' pension and tax?	Payments from reverse mortgages and home reversion schemes can have significant impacts on older Australians' pension entitlements.

Question	What to look for
Does someone else live in the home?	Residents in the consumer's home who do not sign up to the equity release contract may not have any rights in relation to the property. This can arise as an issue if the homeowner dies or moves to aged care accommodation.
Is the provider financially sound and/or prudentially regulated?	If not, there may be an increased risk that the provider may not be able to meet any long term promise to make payments.
What rights does the consumer have if something goes wrong?	If the product provider and issuer are members of an external dispute resolution scheme, the consumer will have better access to resolution of disputes at low cost.
Is this the best option for the consumer?	Other equity release products or non-equity release options may better suit the consumer's needs.

Regulation

Products

The existing regulatory system was not designed to address the issues raised by equity release products, which take the form of a credit arrangement but nevertheless have some of the attributes of an investment product.

At the product level, the principal vehicle for regulation of credit, the Uniform Consumer Credit Code (UCCC), does not provide for disclosure of risk, nor provide a mechanism for disclosing elements of the cost of the product, such as the forgoing of equity, that are not translatable into an interest rate. Finally it will not apply at all where the funds obtained are to be used for investment purposes.

The principal vehicle for the regulation of investment products, the *Corporations Act 2001* (Corporations Act), has limited application to some home reversion and shared appreciation products, depending on their terms, but generally does not apply to reverse mortgage products.

Advice

International research shows that advice on equity release products is often inadequate. For instance, recent research by the Financial Services Authority (FSA) in the United Kingdom shows that more than 70% of product providers, independent financial advisers and mortgage brokers do not gather enough relevant information about their customers to assess their suitability for the product, and more than 60% of advisers do not advise consumers about the downsides of equity release.[2]

Industry statistics indicate that most equity release products are being distributed by mortgage brokers who are, at present, far less regulated than advisers in other sectors of the financial services industry, although there are proposals for further regulation at the state level.

Although shared with the states, ASIC does have clear jurisdiction under the *Australian Securities and Investment Commission Act 2001* (ASIC Act) in relation to any misleading, deceptive and/or unconscionable conduct in the promotion, distribution and sale of equity release products and it will exercise this jurisdiction fully.

Conclusions and recommendations

Although it has been growing, the equity release market remains relatively new in Australia.

Overseas experience suggests that there is a risk of misselling and that consumers may receive poor advice. Whilst the products have clearly been designed to meet consumer needs, the products are complex and, if used inappropriately or with poor advice, there are significant risks for consumers.

The industry has commenced some self-regulatory initiatives and some product issuers are incorporating provisions that mitigate the worst risks for consumers. Nevertheless, some consumer risks remain. The growth of this product sector will depend on establishing and maintaining consumer confidence. That in turn will depend on ensuring widespread negative experiences are avoided, whether through industry promotion of best practice and self-regulatory initiatives, clever product design or regulatory intervention.

ASIC will continue to actively monitor developments in the marketplace and, principally relying on the broad consumer protection provisions of the ASIC Act, will take legal action whenever appropriate.

This report recommends:

- Consumers obtain independent legal and financial advice before entering into equity release arrangements.

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[2] FSA Media Release 24 May 2005, 'FSA warns advisers that unsuitable equity release advice has got to stop'.

- Federal, state and territory regulators monitor closely the development of the market, consumer complaints and any problems they point to and keep under review the adequacy of the regulatory structure to address them.
- Equity release products be considered in any review of the Uniform Consumer Credit Code and in the ongoing development of enhanced regulation of mortgage brokers.
- ASIC work with industry to promote best practice and identify and appropriately deal with risks for consumers.

Further work

We will continue to work in this area by:

- Monitoring advertising and complaints.
- Initiating consumer education.
- Creating consumer tools including illustrations and/or calculators.
- Working with industry and state and territory governments to enforce existing legislation and further develop industry best practice.
- Undertaking legal action (usually under the ASIC Act) where appropriate.
- Undertaking future research into the industry as it develops.