Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Retirement interest-only mortgages

Lead regulator: FCA

Date of assessment: 26 February 2018

Commencement date: 23 March 2018

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of the UK

Brief outline of proposed new or amended regulatory activity

'Retirement interest-only mortgages' are loans for older consumers where the lender will not seek repayment of the loan until a specified life event (usually the customer's death or move into residential care). At that point the loan is repaid through the sale of the property.

When implementing the Mortgage Credit Directive, we reclassified loans such as these as lifetime mortgages, in order to give lenders the benefit of the equity release exemption in the Directive. This meant that retirement interest-only mortgages became subject to our equity release conduct requirements rather than our requirements for standard mortgage sales. Firms that carry out standard mortgage lending – historically the firms that have lent retirement interest-only mortgages – subsequently told us that this decision was a barrier to them selling these loans due to the systems changes and staff training needed to comply with our equity release standards.

We proposed to bring retirement interest-only mortgages back into our standard rules while also adding a small number of requirements we consider appropriate for their sale. These are:

- Disclosure of any restriction on other people living in the property, such as family members or a new spouse or civil partner;
- Disclosure that using a retirement interest-only mortgage to draw down capital may affect the consumer's tax position and entitlement to benefits and the consumer should consider seeking advice before taking out that mortgage;
- For advised sales where the retirement interest-only mortgage is to be used to draw down capital, the suitability assessment must address the tax and benefits implications, or the customer be referred to a source of information on this, for example Her Majesty's Revenue and Customs; and

- Disclosure that a lifetime mortgage may be available and more appropriate for the customer.

Few standard mortgage lenders were selling retirement interest-only mortgages prior to MCD implementation. However, demographic and economic changes mean that demand for retirement interest-only mortgages may be increasing.

Several recent industry publications have highlighted factors likely to increase demand for mortgage borrowing among older consumers.[1] These include, the increasing number of consumers taking debt into retirement, interest-only mortgages maturing without adequate savings to fully repay, and pension savings shortfalls. For older consumers with borrowing needs and good pension income, a retirement interest-only mortgage could be an appropriate solution. Making it easier for standard mortgage lenders to meet this demand could increase the number of sales of this type of mortgage significantly.

Which type of business will be affected? How many are estimated to be affected?

The types of firms affected will be residential mortgage lenders and intermediaries. We expect only a small proportion of mortgage lenders will look to sell Retirement Interest-only products. We expect that those with a significant interest-only backbook[2] will be most likely to sell these products. Using internal FCA sector knowledge of the mortgage sector, we estimate that there are 12 mortgage lenders with a significant interest-only backbook or an interest in lending to older borrowers.

There are approximately 10,000 mortgage intermediaries who could sell retirement interest-only mortgages. Although not all intermediaries are likely to focus on this market, the main focus of this impact assessment is the number of sales regardless of whether it is made by a lender or through an intermediary.

Price base year	**Implementation date**	**Duration of policy (years)**	**Business Net Present Value**	**Net cost to business (EANDCB)**	**BIT score**
2017	2018	10	283.9	-33.0	-164.9

Please set out the impact to business clearly with a breakdown of costs and benefits

The regulatory changes we have introduced enable firms to sell retirement interest-only mortgages where before our rules operated in such a way as to deter them from doing so. Relaxing our rules gives firms the choice of whether to sell these products, and, if they decide to, incur the costs of complying with our new rules on retirement interest-only mortgages.

[1] BSA, Lengthening the Ladder, 2017. https://www.bsa.org.uk/media-centre/press-releases/lengthening-the-ladder-bsa-launches-report-that-s; CML, Later life borrowing: new mindsets old siloes, 2017. https://www.cml.org.uk/news/cml-research/the-advice-framework-for-older-mortgage-customers-an-assessment/; ERC, Equity release rebooted, 2017, http://www.equityreleasecouncil.com/document-library/equity-release-rebooted-white-paper-april-2017/.

[2] Interest-only backbook consumers are consumers that currently hold an interest-only mortgage. These consumers may not have a repayment strategy at the end of the mortgage term, or they may wish to extent their interest only mortgage past the end-of the mortgage term and into retirement.

We asked 12 lenders with a significant interest-only backbook or an interest in lending to older borrowers whether they would be likely to sell retirement interest-only mortgages if we made the changes proposed in our consultation. These 12 lenders cover almost the entire interest-only mortgage sector and, therefore, would be the firms most likely to enter this new market.

Five of these indicated that they would sell retirement interest-only mortgages if we changed our rules. Others said that it was too early for them to decide so it is possible that additional firms outside our sample will sell interest-only mortgages. However, we are taking a conservative approach to the size of the market and limiting it to five lenders. We take this approach to the number of firms likely to enter the new market (and do not extrapolate to the other mortgage providers) as this means we take a conservative approach to the benefits of our rule change.

The firms interested in lending indicated that they would make increasing amounts of sales up to 2021/22 with around £1.7bn in sales. In our analysis, we assume that only these firms sell these products up to 2026/27 and sales remain at £1.7bn per year after this date. This means we are likely to underestimate the true size of the market, especially later in the period as more firms are likely to begin selling these products.

We would expect around 21,000 sales per year of retirement interest-only mortgages from 2021/22. We estimate this based on the total retirement interest-only mortgage sales, the average loan size for new lending and remortgages (£95,600 and £71,000 respectively[3]) and the proportions of new and remortgages lending reported to us by the five lenders.

The benefits to firms of our regulatory change are the additional profits they make from selling retirement interest-only mortgages. One firm provided information on the profits that they would earn on the sales of these products but the remaining firms did not. We would expect that firms would have a Net Interest Margin of these products of at least 0.6% and likely more (i.e. the difference between the rate at which they borrow and the rate they lend on these products). We estimate this using internal FCA sector knowledge of the mortgage industry. The Net Interest Margin overstates the profit these firms will make on these loans as there are other costs in providing such a mortgage. However, in reality the Net Interest Margin will be higher than this and therefore the 0.6% is a good proxy of the profits firms will make on this lending.

Given the sales and using our profit rate we need to amortise these profits over the life of the mortgages. We then only include profits that are received in the period of the reporting period in our calculations. We do this by assuming that profits are spread over a period of 25 years, taking into account the fact that firm will have discounted these profits at their cost of capital. Given that the mortgages are interest-only, there is no repayment of capital until the end of the contract period but we would expect that mortgages are terminated at different points after initiation. Using internal FCA data on the mortgage market, we assume that on average 5% of the initial value of the mortgage book is paid off each year. This implies that all mortgages are repaid after 20 years. This assumption also accords with FCA data on lifetime mortgages, which similarly end when the customer dies or moves into care.

Given we do not expect any growth in sales from 2021, and firms gave us the estimates of sales in nominal terms, we deflate profits using the GDP deflator. We, therefore, estimate profits to increase to £67m in 2026/27.

We would expect that the vast majority of retirement interest-only mortgage sales will be made through intermediaries. Intermediaries will also make a profit on these sales. In situations where lenders sell retirement interest-only mortgages direct, we would expect the lender to make additional profits similar to those made by intermediaries. Using information from mortgage intermediaries on the profit, total revenue, mortgage revenue and mortgage sales, we calculated the average profit per mortgage sale of £115. Using the information on the number of mortgage sales, we calculated the expected profits for mortgage intermediaries. In 2026/27, we estimate that intermediaries would make £2.4m in profits on these sales.

Lenders and intermediaries will also incur costs from the requirements placed by our new rules on retirement interest-only mortgage sales. Firms told us that there would be no systems

[3] FCA analysis of Product Sales Data from firms

changes needed. The disclosures we are requiring are similar to existing disclosures that are required and could be easily accommodated by their current systems. Therefore, there are no one-off costs envisaged. Based on the analysis of firms' survey data and conversations with firms, we would expect that the additional disclosures per sale would take a maximum of five minutes. We would expect these disclosures to happen more quickly than this in practice. We use an average salary of £32,000 for banking branch sales (taken from Willis Towers Watson 2016 Financial Services Survey) for our estimates. This is the upper bound of salary estimates from the Towers Watson survey of who would likely sell mortgages. Using a 30% uplift for employer overheads, there will be an additional cost per mortgage sale of £2.24. Therefore, we estimate that the total (ongoing) costs of the additional disclosure would range from £14k in 2017/18 to £47k in 2026/27.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

QCP Retirement interest-only mortgages,
https://www.fca.org.uk/publication/consultation/cp17-32.pdf