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The UK Equity Release Market: Views from the Regulatory Authorities, Product Providers and Advisors

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Abstract

This study investigates the factors constraining the development of the UK equity release market. The results of a thematic review of interviews with industry stakeholders (product providers, advice providers and regulators) suggest that the attractiveness of the equity market for insurance companies (the main funders of the market), has diminished following a decline in annuity business and complications around the capital maturity matching requirements under Solvency II. Product costs (interest charges, and the cost of financial advice) are high. Trust in the market has improved, but remains fragile. Increased entry into the market by recognised brand names, (such as the traditional mortgage providers) would increase competition, reduce costs and promote trust. The risk of reputational damage limits the appeal of the market to new entrants. The no negative equity guarantee, a cost in terms of lower than otherwise loan-to-value ratios, promotes demand by way of the protection it affords to customers and their beneficiaries. Equity release is unsuitable for funding long-term care and policymakers advocating it as such damage the market.

Keywords: Equity release mortgage, Transaction costs, Trust, Solvency II

JEL classification: G21, G22, J14

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1. Introduction

In the UK, almost 80 per cent of people between the ages of 65 and 74 own their own home and two thirds of these homeowners are mortgage free (ONS, 2016). Improvements in life expectancy and a growth in age-related fiscal costs has led to increasing policy interest in the utilisation of housing equity to support retirement needs and reduce households' dependence on publicly-funded welfare programmes (CPS, 2019). Much of the policy debate in the UK has centred on the possibility of older homeowners using housing wealth to supplement retirement income, support house adaptations and contribute to social care costs (FCA, 2017; House of Commons, 2018; Lords, 2013). Similar types of debate are ongoing in most advanced countries (European Commission, 2018; Fouejieu, Kangur, Martinez & Soto, 2021).

One way that the elderly can release equity in their home is through an equity release product. These are age-specific financial instruments designed to help older homeowners borrow against the value of their home. In many countries, the development and growth of an equity release market has been hindered due to a variety of demand and supply side constraints. Market failures and risk factors have acted as supply side constraints. These include the risk of housing equity falling below the outstanding loan balance, high insurance costs, absence of risk pooling mechanisms and regulatory disincentives (Chatterjee, 2016; Knaack, Miller & Stewart, 2020; Nakajima & Telyukova, 2017). Factors that have constrained demand include transaction costs, bequest motives, the implications for state benefits and product complexity (Davidoff, Gerhard & Post, 2017; Jefferson, Austen, Ong, Haffer & Wood, 2017; Stark, Choplin, Mikels & McDonnell, 2014). Consequently, the market in most countries (if one exists) tends to be dominated by niche institutions with mainstream financial institutions absent.

The UK has the most developed equity release market in Europe and is second in size only to the market in the US.[1] In 2019, 45,598 households aged 55 and over used equity release products releasing over £3.4 billion in home equity (Key Retirement, 2020a). The market is however small when compared to the mortgage market where £281.5 billion was committed in new loans during 2019 (FCA, 2020a). In recent times the UK market has been subject to both change and challenge. During the financial crisis a number of providers (due to funding

[1] In Europe only a small number of countries (Germany, Italy, Netherlands, Poland, Sweden and Spain) have a developed equity release market. Outside Europe the market is relatively well developed in Australia, Canada and New Zealand but all are small in comparison to the US equity release market (EPARG, 2021).

difficulties) exited the market. The market is classed as 'highly concentrated' (FCA, 2018). Market concentration may have implications for transaction costs, interest charges and loan-to-value ratios. Insurance companies are the main supplier of funds into the market, in part because ERMs are fixed income assets used to match their fixed annuity liabilities. However, contraction in the annuity market has weaken the attraction of the market for insurers. Solvency II also threatens insurers' participation in the market. Consumer trust in the market has been damaged due to product mis-selling in the 1990s and as a hangover from problems in the housing market in the aftermath of the Financial Crisis.

The primary objective of this study is to investigate the underlying factors constraining the development of the UK equity release market. A subsidiary objective is to consider the importance of equity release in supplementing retirement income and whether this could (or should) contribute to the funding of long-term social care costs. To inform our analysis a series of semi-structured interviews are conducted between August 2017 and January 2019 with senior representatives from product providers, advice providers, the regulatory authorities (Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA)), and the trade body (Equity Release Council (ERC)). Participants included managing directors, heads of departments (compliance, marketing, business development and public affairs) and senior policy experts from the regulatory authorities. All interviews are analysed by means of a thematic review, producing five major themes and fifteen sub-themes. The major themes are trust, competition and innovation, product cost, access to funds, and supplementing retirement income and supporting care costs.

The study contributes to the literature in two ways. First, by capturing insights from service providers it offers the opportunity to comprehensively assess supply side factors impeding the development of an efficient equity release market in the UK. Previous work on supply side issues has tended to centre upon modelling exercises (see, Alai, Chen, Cho, Hanewald & Sherris, 2014; Andrews & Oberoi, 2015; Hosty, Groves, Murray, & Shah, 2008; Shao, Hanewald & Sherris, 2015). Second, it is the first study to consider the views of the UK regulatory authorities (FCA and PRA). Decisions made by these regulatory bodies can be expected to influence both the demand for and the supply of equity release products.

A number of insights emerge from the analysis. These insights should prove of benefit to those seeking to expand the UK equity release market and are transferable to other countries establishing (or growing) an equity release provision. The attractiveness of the equity release market for insurance companies, the main suppliers of funds into the market, has lessened due to a decline in annuity business and complications around the capital matching requirements

under Solvency II. Funding effects have greatest impact on providers that are externally funded. Product costs (interest charges and the cost of financial advice) were considered high and viewed as deterring product demand. The no negative equity guarantee (NNEG), a cost in terms of lower than otherwise loan-to-value ratios, was considered as enhancing product demand by way of the protection it provided to customers and their beneficiaries. Participants considered it inappropriate for the Government to intervene in the market to underwrite the NNEG, even if this resulted in improved loan-to-values. The importance of consumer trust was recognised by all participants. Attracting more recognised brand names was seen as a means of underpinning trust although the risk of reputational damage limited the attractiveness of the market to new entrants. Major equity release providers and advice firms are often part of the same group raising the perception (at least) of a conflict of interest with adverse consequences for trust and product demand. Participants considered there was a role for equity release in allowing the elderly to stay in their homes longer, albeit such arrangements were unsuitable for funding long-term care given the widespread perception among homeowners that it is 'unfair' having to use accumulated housing equity to meet long-term care needs.

2. Equity Release Market

In the UK, high rates of homeownership, high house prices and a sophisticated financial system provide strong foundations for a market that supports housing equity withdrawal in later life. The UK equity release market originated in the late 1970s, with basic products provided largely by building societies. The market suffered reputational damage in the 1990s due to the mis-selling of shared appreciation mortgages leaving many borrowers with high levels of debt (Fox O'Mahony & Overton, 2014).[2] The market recovered and grew steadily until the financial crisis when many providers exited the market leaving it to a few insurers and niche equity release providers. Since 2012, new lending in equity release has grown annually by more than 25 per cent. The five most popular reasons for taking out an equity release mortgage (ERM) are home and/or garden improvements, to go on holiday, pay debts, treat or help family and friends and clear an outstanding mortgage (Key Retirement, 2020b). The figures do not reveal any evidence of housing equity being released to pay for care costs (although the category home and/or garden improvements could include those choosing to adapt their home so that they can remain

[2] Shared appreciation mortgages share house price risk between the borrower and the cash provider.

in it longer). There are over 200 product options now available (Key Retirement, 2020a).[3] This growth has been driven by a wider range of consumers adopting equity release and by new funders joining the market.[4] However, the market remains concentrated. FCA (2018) estimate a Herfindahl-Hirschman Index (HHI) of 2284 (above 2000 indicates a highly concentrated market). Take-up rates of ERMs are also considered low (FCA, 2020a; Mayhew, Smith & O'Leary, 2017).

Lifetime mortgages (also known as ERMs) are the main type of equity release products in the UK. Lifetime mortgages are designed to convert accumulated housing equity into regular income. Cash can be drawn down when required or lent as one lump sum at the start of the contract. In 2019, 65 per cent of new customers opted for a drawdown lifetime mortgage while 34 per cent purchased a lump sum lifetime mortgage.[5] The average age for new customers of drawdown and lump sum ERMs is 70 and 68 years respectively. The average house price for draw down customers was £348,466 compared to £313,028 for new lump sum customers. The average house price in the UK was £230,292 indicating that the market is attracting customers who may have above-average housing wealth. The average loan-to-value in 2019 (2015) of a lump sum mortgage was 30.6 (32.0) per cent while for a drawdown mortgage it was 28.5 (26.0) per cent, 18.0 (15.4) per cent as the initial advance and 10.5 (10.6) per cent as the future drawdown. The loan-to-value ratio increases with age, translating into shorter duration of the mortgage (longevity risk) and decreases with interest rates because the remaining home equity balance is used to offset the interest costs throughout the life of the ERM. Average interest rates charged have fallen significantly, since 2015, due to a mix of increased competition, wider product availability and low base rates. In July 2019, the average interest rate was 4.91% (5.97%, 2015) (ERC, 2019).

The majority of equity release providers are members of the ERC. One requirement of being a member of the ERC is that the equity release provider offers a NNEG to customers. With an ERM, the customer does not make any repayments until the property is sold. This is usually when the customer passes away or moves into long-term residential care. At this point, the provider reclaims the sum borrowed plus accrued interest. The NNEG protects customers

[3] Product options include, voluntary/partial repayments with no early repayment charge, inheritance guarantee, downsizing repayment options and sheltered/age restricted accommodation.
[4] Legal & General entered the market in 2015 (buying lender New Life) and is now the largest provider of ERMs.
[5] A further 1 per cent of customers chose an alternative form of equity release product known as a home reversion scheme. This product involves part or all of the home being sold to a provider for below market value in exchange for either a regular income or a lump sum with the right to remain in the home until the contract expires.

against this liability exceeding the sale value of the home.[6] The risk management of the NNEG is undertaken by offering 'prudent' loan-to-value ratios and incorporating a premium in the interest rate charged to the borrower (Sharma, French & McKillop, 2020). Premiums are not made public, however it has been argued that the cost of the NNEG has been systematically underestimated. There is lack of clarity about the expected (and then actual) longevity among those taking out ERMs and about the extent of capital gains projected (Dowd, Buckner, Blake & Fry, 2019; Tunaru & Quaye, 2019).

It is mandatory for consumers seeking an ERM to go through a financial advice process. All advisors (and providers) for lifetime mortgages are regulated by the FCA.[7] [8] Once an advisor has determined that equity release is appropriate, the client is typically provided with a report detailing the various options, benefits check and the advisor's recommendation on the most suitable scheme.[9] For this advice report, firms charge a fee of between 1.5 per cent and 2.0 per cent of the amount of equity released. The client is under no pressure to proceed with any recommendation and as a consequence the advisory firm can be said to maintain its independence. However, some advisory firms are part of a group which includes an equity release provider which raises the potential at least for the perception of a conflict of interest. FCA (2020b) in a review of equity release case files noted *"... cases where lifetime mortgages were working well, unlocking equity for consumers who would not have been able to afford traditional mortgages or other sources of borrowing. However, we also saw cases where it was not clear that the advice was in the best interests of the consumer."*

The main supplier of funds to the UK equity release market are the major insurance companies.[10] This occurs either through insurance companies, such as Legal and General and Aviva, providing these products in their own right or by insurance companies, such as (Phoenix Life Limited and Pension Insurance Corporation), providing funds to specialist equity release

[6] With the exception of Germany, all countries with a sizeable equity release market require a NNEG to be provided to customers (EPARG, 2021).

[7] There are three main providers of equity release advice - Key Retirement, HUB Financial Solution (a subsidiary of Just Group Plc) and Age Partnership. There are over fifty smaller firms that also provide advice (see, https://register.fca.org.uk). This compares with 5,210 directly-authorised mortgage intermediary firms.

[8] It is also a requirement in Canada, New Zealand, Spain and the US that equity release customers seek independent financial advice (EPARG, 2021).

[9] FCA (2019a) advice rules state that the role of the advisor is to establish whether the consumer requires an ERM, determine the appropriate product type, and explain the product and its implications depending on the consumer's circumstances. This includes whether the benefits to the consumer outweigh any adverse effect on: (a) the customer's entitlement (if any) to means-tested benefits; and (b) the customer's tax position (for example the loss of an Age Allowance).

[10] In the US, the main funding source for equity release mortgages is by way of securitization. In Australia and Sweden securitization is an important source of funding as is that by banks. In the Netherlands and Spain the main funders are banks and insurance companies while in Canada funding is through banks and whole portfolio sales (EPARG, 2021).

providers such as Just Retirement, Liverpool Victoria, or Pure Retirement.[11] The dominance of insurance companies in the market is because ERMs are fixed income assets that can be used to match their fixed annuity liabilities. The annuity market has, however, contracted in recent years causing some ERM providers to withdraw from the market. [12] [13]

The Solvency II supervisory framework for insurance and reinsurance companies, directed by the European Insurance and Occupational Pensions Authority (EIOPA), came into force on January 1st, 2016. Solvency II rewards the matching of assets and liabilities through a reduction in Solvency Capital Requirement (Rae et al., 2018). A maturity matching adjustment (MA) gives insurance companies relief for holding long-term assets that match their long-term liabilities. Therefore, an increase in the share of lifetime mortgages in an insurance companies' portfolio of assets may result in a reduction in capital requirements. However, Solvency II requires a *perfect maturity match* in the long-term cash flows. This may be difficult to achieve with ERMs due to longevity risk, the NNEG and the option of voluntary early redemption available on some products. The PRA does not specify how to calculate the MA benefit arising from the presence of ERMs, and therefore approaches used by different insurers may differ.

3. Literature Review

Given demographic change towards social ageing, relatively smaller workforces and resultant diminishing public funding and resources, discussions regarding how to make efficient use of private sources of wealth have captured the attention of policymakers (Lennartz & Ronald, 2017; Whitehead, 2016). Housing wealth constitutes the majority of personal savings for old age in most Western countries (Arundel & Hochstenbach, 2020; French, McKillop & Sharma, 2018).[14] [15] Housing wealth accumulation and divestment can be viewed in terms of the life

[11] Phoenix Life Limited and Pension Insurance Corporation are leading annuity providers with investments in the equity release market. Just Retirement and Liverpool Victoria partially depends on outside funds but also fund a proportion of equity release business from their own annuity book. Pure Retirement is solely dependent on external funds.

[12] The value of plans used to buy an annuity was approximately £4.5 billion in 2018/2019 compared to £11 billion in 2013/2014 (FCA, 2019b). Prudential, the UK's largest insurer by market value, withdrew from the UK annuity market in 2015.

[13] A further feature of the market is that some organisations act as referral intermediaries. When a referral results in product purchase the intermediary receives commission determined as a percentage of the loan value. For example, Age UK earns commission of approximately 0.75 per cent of the sum released by homeowners (The Telegraph, 4th May 2019).

[14] In Great Britain, the contribution of net property wealth to total wealth for the median household is 35 per cent (ONS, 2019).

[15] Mandič (2010) observed a high incidence of unfit housing and of economic hardship and deprivation among homeowners in post-socialist societies indicating their limited capacity to store and sustain the wealth contained in their housing. He states that this is particularly pronounced in comparison to West European countries.

cycle theory of consumption. The model assumes a known finite lifetime over which the individual can anticipate spending needs and after passing the peak of life cycle earnings the rational homeowner progressively engages in housing equity withdrawal (HEW) (Ando & Modigliani, 1963; Deaton, 1992). However, the reality is that both the accumulation and divestment process can be complicated by uncertainties regarding life expectancy, capital market imperfections, and by the fact that many homeowners view housing wealth as a form of self-insurance only to be drawn down in response to income and lifestyle shocks (Fornero, Rossi & Brancati, 2015; Haffner, 2008; Skinner, 1996).[16]

Historically, the main channel for HEW has been property downsizing (Banks, Blundell, Oldfield & Smith, 2012). For those wishing to remain in their own homes an alternative to downsizing is the purchase of an ERM (Burgess, Monk & Williams, 2013). Both forms of HEW are identified as more likely in households with difficulties in smoothing consumption due to: debt overhang; having too few liquid assets; and collateral constraints (Klyuev & Mills, 2007; Skinner, 1996). Benito (2009) suggests that housing offers a financial buffer by providing collateral for borrowing and therefore many households consider HEW as risky and a last resort to financial problems (Jones, Geilenkeuser, Helbrecht & Quilgars, 2012). Hoekstra and Dol (2021), in an analysis of attitudes towards housing equity release strategies in six European countries, state that the decision to release housing equity is strongly influenced by context, including welfare state regime, pension system, fiscal aspects, culture and the housing market situation.

Almost all commercial transactions have within them an element of trust (Arrow, 1972). Trust is particularly important for the efficient functioning of financial markets due to product complexity, product opaqueness and consequent information asymmetries (Ghent, Torous, & Valkanov, 2019). Financial markets in many countries have been subject to significant levels of deregulation which further raises the importance of trust as an implicit mechanism that substitutes for regulation and discourages opportunistic behaviour (Aghion, Algan, Cahuc, & Shleifer, 2010; Carlin, Dorobantu, & Vishwanathan, 2009). A significant decline in the level of trust in finance professionals (across all subsectors) relative to a decline of trust in the general population has been documented for the US (Limbach, Rau & Schürmann, 2021). A lack of trust in financial providers, particularly in the post financial crisis period, has adversely affected the decision to withdraw housing equity, (Burgess et al., 2013;

[16] Haffner, Ong and Wood (2015) observe that in Australia, the US and the UK housing equity has increasingly been used to smooth consumption earlier in the life cycle which results in an increasing number of middle-aged homeowners having outstanding mortgage debt as they approach retirement.

CFPB, 2012). The importance of independent financial advice and the development of a bond of trust between the consumer and their financial advisor has been highlighted as vital to the good functioning of the equity release market (Inderst & Ottaviani, 2012). Information asymmetries are also more likely in the case of equity release due to product complexity, effects of purchase (entitlement to benefits, tax liability) and the effects of cognitive aging (Stark et al., 2014).

The bequest motive has often been cited as an important impediment to HEW with the withdrawal of housing equity viewed as 'eating into' dependent's inheritance (Elsinga, Quilgars & Doling, 2012). The desire to bequest has been identified as restricting the uptake of equity release plans (Jefferson et al., 2017; Sass, 2017). However, some studies suggest that the desire to bequest may actually be facilitated through HEW. Equity release plans, for example, are used in different ways by different income groups, with those on high incomes using them to make early bequests and large one-off purchases (Burgess et al., 2013; Redfoot, Scholen & Brown, 2007).

The major deterrent to HEW, however, appears to be transactions costs. Skinner (1996) suggests that housing wealth is in fact a 'sideshow' if transaction costs are high and/or financial markets do not offer products that facilitate HEW. Yang (2009), in a dynamic, general equilibrium model of life-cycle behaviour, demonstrates that transaction costs are crucial in generating the slow downsizing of housing assets. Transaction costs in the form of initial set up costs and ongoing interest rate charges have been identified as inhibiting the uptake of equity release products (Davidoff, 2015; Davidoff et al., 2017; Ronald, Kadi & Lennartz, 2015). A lack of competition adversely impacts on transaction costs (CFPB, 2012). The NNEG also has implications for transaction costs. Lenders mitigate the risk associated with the NNEG by way of the percentage value of the house offered as a loan amount and by charging a NNEG insurance premium (Pu, Fan & Deng, 2014). Nakajima and Telyukova (2017) calculate that the removal of the NNEG would increase demand for reverse mortgage in the US by 73 per cent.[17] Fox O'Mahony and Overton (2015) view transactions costs as impeding the uptake of ERMs in the UK, but find product complexity and limited product innovation to be equally problematic.

[17] Dowd et al. (2019) find valuations of the NNEGs are high relative to loan amounts and subject to considerable model risk.

4. Methodology

The empirical research in this paper utilises semi-structured interviews. Semi-structured interviews are based upon an interview guide, which is a schematic presentation of questions to be explored by the interviewer. Rigorous development of an interview guide contributes to objectivity and trustworthiness and ensures findings are plausible (Galletta, 2013). The interview guide for this study was developed from a review of the literature, prior research by the authors and knowledge gained from our partnership in a European Commission project on using housing capital to support pensions in old age (VP/2014/014). Initial questions sought to elicit the participants' perspectives on demand and supply side factors constraining the development of the UK equity release market and if there was a role for government in underpinning the market. Further questions explored the importance of equity release in supplementing retirement income and whether it could (or should) contribute to the funding of long-term social care costs. All questions in the interview guide benefited from extensive refinement including three pilot interviews. Table 1 provides broad details of the questions asked in the semi-structured interviews.

Interviews were with senior representatives from product providers, advice providers, and regulatory/representative bodies. Table 2 details the organisational types and the positions of those interviewed. Although 17 participants are highlighted, they represent 15 different organisations (in two cases, two individuals represented the same organisation). The organisations are categorised under one of three types – Financial Providers (10 separate companies) designated FP1… FP11, Financial Advice Providers (2 separate companies) designated FA1 and FA2, and Financial Regulators and Industry Representatives bodies (3 separate organisations), designated FRIR1 … FRIR4. As there are only two regulatory bodies and one representative body it was not possible to separately detail their views and continue to protect organisational identity of the industry representative body. Categorisation by organisational type facilitates identification of possible differences of opinion between the three groups but at the same time ensures the anonymity of the individual participants.

All interviews were conducted by phone and recorded with the permission of the participant. Given the potential sensitivities of the matters being discussed and the desire for the participants to be as candid as possible, participants were informed that the interviews would be reported in a manner where statements could not be attributed to specific individuals. Each interview was undertaken by the lead author, with interviews conducted between August 2017 and January 2019. Each interview began with an explanation of the objectives underlying

the research project. Questions were then asked to generate discussion around broad topic areas before probing for further information by exploring sub themes within each topic area under discussion. The interviews on average lasted one hour. The recorded data was transcribed and analysed by means of thematic analysis. This involved searching for themes, reviewing themes and then defining and naming themes and sub-themes.

5. Results and findings

The thematic analysis produced five major themes and fifteen sub-themes. Table 3 illustrates the thematic map for the major themes, the accompanying sub-themes and the factors which influence the sub-themes. The themes are hierarchical in nature in that they are categorised as per their appearance and inferences drawn directly from the dataset. The analysis that follows considers each of the major themes in turn and constructs a commentary that integrates the sub-themes and influencing factors. This analysis is supported by quotations taken from the semi-structured interviews. The themes now considered are trust, competition and innovation, product cost, access to funds, and supplementing retirement income and supporting care costs.

5.1 Trust

The financial crisis, its adverse effect on house prices and the subsequent near closure of the mortgage market severely damaged consumer trust in housing related markets. This was articulated by the regulatory authorities.

> *"I won't say the UK equity release market is mature, but it is a market, which has quite a number of years of experience of operating and those years have not been entirely glorious. There is a backdrop of poor product design and poorly explained products, which creates a long tail of problems.*" (FRIR1)

A majority of product providers and advisors felt that mistrust of equity release was reducing. Financial advisors (not unexpectedly) arguing that if mistrust remains it is due to product misconceptions plus a lack of awareness of the variety in products now on offer.

> *"You know people say that consumers do not trust equity release schemes, but I think it is less of an issue because the number of people visiting us to gather information on the products is huge. So I think trust is less of an issue."* (FA2)
>
> *"I think lack of trust goes back to lack of awareness and misconceptions…"* (FA1)

At the same time, participants also pointed out a lack of involvement in the market by household brand names. They conjectured that their presence would improve consumer trust although (paradoxically) one participant questioned whether a household name would risk their brand in a market without a sound reputation.

> "*If you got more reputed brands selling this product then that would benefit it and we might be able to turn the tide of consumer distrust and get more people thinking about it. "[However] I think some big brands would look at this market and say why would I risk my brand in a market without a sound reputation?*" (FP4)

The regulatory requirement that consumers obtain financial advice before purchasing equity release should foster trust. However, many of the larger advice firms and product providers are part of the same group.[18] This creates the perception of a conflict of interest and may undermine trust. No data is publicly available on the frequency an advisory firm recommends the plans of a particular provider, however, the ERC does have access to this information. The view from the semi-structured interviews was that this sharing of information by the ERC reduces the risk of advisors giving unwarranted preference to specific providers. A typical comment was,

> *"Through the Council's reports, we can see how much business an individual advisor or a broker is doing. We can see how proportionate it is against the whole market and if somebody is giving more business to one firm than another, it sticks out. Unless they have a specific customer base that means that they have to advise that particular lender about that particular type of product. For example, there is only one company that does sheltered housing of retirement home products in which case you have people specialised to advise on that product and they would all be referring customers to a particular lender, which is fine because there is a reason for that."* (FP7).

A mixed message on trust is evident from the interviews.[19] Revitalised growth in the demand for equity release has encouraged the belief that consumer mistrust is no longer as serious a problem for the sector as it once was. To some extent this is true. In the wake of the financial crisis, regulatory and supervisory controls are more stringent on supply side participants (as they are in all markets). It is now mandatory for consumers seeking an ERM to go through a financial advice process. A rapid growth in product types suggests better tailoring of products to customer needs. However, it is also clear that mistrust is still considered an issue and not helped by the potential for conflicts of interest. Entry into the market of brand

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[18] Moreover, the largest provider of ERMs (Legal & General) is now approved (October 2019) to provide in-house financial advice. https://www.ftadviser.com/mortgages/2019/10/04/fca-approves-l-g-s-advice-launch/

[19] Hoekstra and Dol (2021) in a demand side investigation, based upon consumer focus groups form six countries including the UK, suggest that the ERM not only lacks transparent product information, but also suffers from a lack of trust in financial institutions and regulators.

names and greater information disclosure were considered as ways in which trust could be improved.

5.2 Competition and Innovation

The equity release market has evolved considerably over recent years, with choice increasing and rates reducing as a result. The beneficial effect on product pricing of new entrants into the market was highlighted by participants.

> *"... L&G entering the market has impacted the market in a big way. I would say what that did was to reduce prices by about a 100 basis points overnight. So it is not just the prevailing low interest rate environment that we are in – of course that has helped but more competition has driven price down!"* (FP1)

Product innovation and reducing rates has also been driven by competition from the mainstream mortgage market. Mortgage companies had complained that the reclassification of 'retirement interest-only mortgages' as equity release (due to the Mortgage Credit Directive) was a barrier to selling these loans due to systems changes and staff training needed to comply with equity release standards. In March 2018 the FCA brought 'retirement interest-only mortgages' back into their standard rules. By March 2019 there were 38 'retirement interest-only mortgages' available launched by 12 providers, only one of which was not a building society.[20]

> *"... there was room for more competition from the mortgage market but the response to that was saying that we have the regulatory barriers, ... I think we are seeing signs of increased competition and innovation in the market."* (FRIR2)

There are three main providers of equity release advice. That more firms do not participate in the market is due to the potential for reputational damage, the cost of doing business and barriers to entry created by the advertising campaigns of the main advice providers.[21]

[20] 'Retirement interest-only mortgages' allow borrowers to pay monthly interest on their mortgage until they die or go into long-term care, at which point the mortgaged property is sold as a means to repay the loan. The FCA have stated that they envisage retirement interest-only mortgages as an additional option alongside downsizing or equity release, not just as a solution for customers with maturing interest-only mortgages, https://www.ftadviser.com/mortgages/2019/02/19/retirement-interest-only-mortgages-start-to-take-off/

[21] Recent advertisements on national TV have been undertaken by Key Retirement and Age Partnerships with these advisory firms also placing adverts in national papers, https://www.telegraph.co.uk/financial-services/retirement-solutions/equity-release-service/

"Those who do hold equity release advice qualifications, I think a quarter of them advise on the product. I think advisors have caught on to the negative reputation aspect and think that it could be a risk to them and their businesses." (FP5)

"*Most people are attracted to this market through direct marketing, which is expensive and takes a long period of time. If you are an advisor and you are spending £100 in marketing, why would you spend that on equity release when you can get business elsewhere far faster and at a lower cost?"* (FP8)

"*The Daily Mail and the Telegraph provide guides on equity release, which is fantastic, but they are linked to providers …*" (FA2)

The discussion highlights that the product market has become more competitive leading to a decline in interest charges and an increase in product innovation. This is because new providers have entered the market and substitute products are now available from mortgage companies. However, the section that follows demonstrates that interest charges remain relatively high with financial advice adding considerably to overall product cost. The advice market is less competitive with three advice firms dominating this market. Furthermore, each of these firms are part of an organisation which includes a product provider. This scale enables these advice firms to engage in national advertising thus creating a de facto barrier to entry for other firms into the advice market.

5.3 Product Cost

Compared to the interest rates charged on mortgage products of similar risk, interest rates on ERMs were viewed as relatively high. A typical comment to that effect was,

"... the interest rates on these products are quite high about 4.5% to 6%. But the interest rate on a buy-to-let mortgage, which is quite a risky loan is lower - about 3.5%, I think." (FRIR4).

Although not a regulatory requirement, providers of equity release products that are members of the ERC must offer a NNEG to their lifetime mortgage customers. There was strong support for the NNEG but also a recognition (by most) that it increased product cost and reduced loan-to-value ratios.

"*I think the NNEG is a powerful customer benefit and I would be reluctant to see that disappear, but it does ultimately impact on how products are priced and the loan-to-values available."* (FA1)

"I guess the main issue is the NNEG. Whilst it's brilliant, it holds back the ability to do any high loan-to-value products. That's the real killer, I think." (FP5)

However, one provider viewed it as unnecessary protection arguing that the risk of negative equity at contract termination was low,

> *".... if you underwrite the property correctly in the first place and apply maximum loan-to-value, history tells us the real risk is, I am not going to say non-existent, but from our point of view it is negligible."* (FP1).

Participants were probed about a role for government in underwriting the NNEG to reduce product cost and support higher loan-to-value ratios. Most rejected government intervention believing that it would drastically change the current structure of the market which they believed to work relatively well, despite some shortcomings,

> *"I think it would need stronger evidence that the market is not working, which is difficult for us to demonstrate, given that we presently have a viable market."* (FRIR1).
>
> *"I don't think state intervention is a positive thing. I think you should allow the private sector to compete and to develop more types of loans and features*." (FP6).

A further cost is for financial advice. Charges levied for financial advice range from 1.5 to 2.0 per cent of the amount of equity released. Some participants considered that these costs when taken in conjunction with solicitor costs and valuation fees may dampen consumer demand. A typical comment was,

> *"…there can be an application cost, a solicitor fee and independent financial advice costs. So that could be a deterrent for people .... We do try to defer fees where we can but yes there is definitely a cost attached to equity release. I mean a lot of people defer these costs until the case is actually completed. So the money would come out of their completion money. Most independent financial advisors will take their fee after completion as well."* (FP5).

The analysis highlights that the costs involved in purchasing an ERM are considerable. Costs include, interest charges, the cost of financial advice, solicitor fees and valuation costs. Taken together these costs are high and deter product demand. The NNEG is also a cost in terms of lower than otherwise loan-to-value ratios. However, participants stressed the importance of the NNEG in protecting customers and their beneficiaries, boosting consumer confidence in the market and guarding against reputational damage which would be caused by customers with equity shortfalls at contract termination. There was no enthusiasm for

Government intervention in the market (as in the US) to improve loan-to-values by underwriting the NNEG.

5.4 Access to Funds[22]

The main supplier of funds to the equity release market are insurance companies. However, falling gilt yields have made annuities less attractive to retirees, as have new pension freedoms that offer the opportunity for 25 per cent cash withdrawals or income drawdown. Increased longevity has also meant that providers must make more payments over the person's life which places downward pressure on pay-out rates. The adverse effects of these changes on the flow of funds to the lifetime mortgage market were highlighted by product providers and regulatory authorities,

> *"From a supply side, the availability of ... firms that can take on longevity risks and have an appetite for house price risk has been limited. Recently, they tend to be insurance companies that write annuity business but then that's limited in terms of the amount of equity that they write versus the equity release business they can back it with."* (FP3)

> "*Well there are not many annuity providers left in the market… If the annuity markets were to shrink further, then one might think that the attraction to the insurance companies of offering ERMs would reduce*." (FRIR4).

Companies that do not internally fund their provision of lifetime mortgages from annuity books but rather depend on external funds (mostly from insurance companies) were assessed to be at greatest risk of a funding shortfall.

> "*We are currently primarily externally funded, which has made it harder for us to acquire funds for new loans. Some firms with the way their internal are structured, they have not had a hard time*." (FP5).

Implications for the flow of funds of Solvency II capital requirements were discussed. Participants focused on the fact that capital requirements strongly incentivise insurers to match the duration of assets and liabilities with a perfect match in duration resulting in reduced capital requirements,

[22] As part of the semi-structured interviews, participating Financial Providers (FP) were asked to rate (Likert scale 1-5) each of twelve potential barriers to growth in the UK equity release market. Access to funding emerged as the dominant constraint, followed by lack of consumer knowledge, Solvency II, cultural resistance and reputational risk.

> *"If you think about the shape of the cash flow of ERM and annuities they are very different. So you can't back the whole of your annuity book with ERMs because there will be cash flows that don't match… The fact that ERMs need to be restructured is an unfortunate side effect of Solvency II MA rules because they are simply not eligible in their raw form."* (FRIR4)

> "*We have very high capital charges for writing annuity business under Solvency II… Ultimately we are all fighting over the small amount of funds available to this market."* (FP2)

> *"Solvency II says that to have an equity release, it has to be perfect match from a risk perspective to the funds that are coming such as from annuity funds. For example, if I have an annuity that I expect to pay out for 16 years, I have to match it with an equity release loan that I expect to receive for 16 years. There is a matching adjustment piece going on there and they have to be identical, there is no percentage leeway… It is a big issue!"* (FP7)

Companies dependent on external funds were again considered to be most at risk of a funding shortfall. The process of matching the structure of assets and liabilities at the funder's end (insurance company) slows down the equity release transaction for these providers as does the fact that the provider would be expected to seek the funder's approval before processing each lifetime mortgage application.

> "*We are not internally funded, so it can lead to a staggered start. Because for some of the loans we have to wait for our external funders for their approval to come through the PRA. Things like that make it a bit of a harder stretch for us. If we were internally funded, we would have been able to just go with it but we have to rely on someone else. So it puts more constraints in place, I guess*." (FP5)

Solvency II, of course applies to insurance companies not to the equity release market and one of the regulatory bodies made the not unreasonable point that the regulatory requirements stemming from Solvency II were developed without consideration of their effect on the flow of funds to the equity release market.

> *"… we all have to recognise that Solvency II was designed for a much bigger market than the equity release market and I think we are dealing with regulation which didn't really think about the specifics of this market."* (FRIR1)

The discussion emphasises the importance of life insurance companies to the equity release market. They are attracted to the market because of diversification benefits, high risk-adjusted yields compared to other investments and the potential of equity release as a longevity

hedge. A decline in annuity business has, however, diminished the attractiveness of the market for them. Capital requirements under Solvency II have exacerbated the problem. The Matching Adjustment, an important concession won by the PRA for the UK insurance industry and which has proved to be of undoubted benefit, is considered by providers as too restrictive.[23] Any future contraction in funding was expected to be borne most heavily by those providers that rely on insurance companies as third party funders. The market is thus subject to funding vulnerability and would benefit from attracting alternative sources of funds.

5.5 Supplementing Retirement Income and Supporting Care Costs

Participants discussed the potential of equity release for supplementing retirement incomes and paying for old age care costs. There was a general acceptance by participants that property could and should be used to supplement retirement income although it was cautioned that releasing equity from your home may affect your tax situation and any state benefits or local authority support.

> *"People haven't saved enough in traditional pension pots, state support for people will continue to decline and therefore home equity will, well from a societal need perspective, need to be used ... for the elderly to move through their retirement and for society to function in a stable way."* (FP6)

> *"Taking out equity release can have implications for people who are entitled to forms of state support such as benefits and grants and also it can constrain your future options. If you have taken out an equity release product, you may be more limited in terms of your later choices."* (FRIR1)

There was also a view that equity release can relieve some of the pressures on long-term care costs by allowing people to remain in their own homes for longer, however, in general most felt that linking equity release to the funding of care costs was an unwarranted distraction,

> *"I actually think that equity release can be a major part of the solution to get the UK out of the fast building crisis there is around long-term care, particularly in later life. Again part of the solution is keeping people in their houses for longer, making those houses more suitable for later life living and paying for in-home care to take the pressure off hospitals and care homes and equity release will be the product that allows that to happen."* (FA1)

[23] No other European country has an equity release market of a similar magnitude to the UK. Spain is the only other country using the Matching Adjustment.

> *"I think social care funding is a little bit of a red herring. I believe the main drivers to equity release are people reaching retirement with more and more debts and people reaching retirement without adequate pension provision. This has got nothing to do with care."* (FP8)
>
> "*If you are saying that people should use their homes for funding lifestyle purposes such as home repairs and so on, my answer is 'yes' but if you are saying 'do we think they should use equity release for care'; I would say probably no because the product is not designed in the right way."* (FA2).

Some even considered that explicit linking by Government of the funding of care costs to equity release ran the risk of damaging the market. Research has established that older people tend to resent the idea of using housing equity, and other personal assets for the funding of care cost (Hewitson, Seale & Joyce, 2011; Price, Bisdee, Daly, Livsey & Higgs 2014).

> "*There is a political risk as equity release is being seen as a solution to other failures, for example not having adequate provision for care. So we have seen some suggestions by the government where they have emphasised the use of housing wealth for funding care products. And customers in general do not like that when they are forced into these kinds of solutions by the government. That then impacts on the market as a whole!*" (FP2)

Participants agreed that there may be a role for equity release in allowing the elderly to stay in their homes longer, however, they viewed equity release as inappropriate for the funding of long-term care. This may be because the length of a person's stay in a care home is difficult to predict and unless the person is half of a couple the repayment of the loan is often triggered by moving out of the home into care. It is also the case that the present system, whereby elderly householders without substantial income going into long-term care are required to sell their home and pay care costs from the proceeds, is a much more cost effective approach than entering an equity release agreement. Participants also considered that policymakers advocating equity release as a long-term care solution risked damaging the market as many people feel it 'unfair' having to use accumulated housing equity to meet care needs.

6. Conclusion

This study investigated the factors constraining the development of the UK equity release market. The investigation was based upon a thematic review of semi-structured

interviews with product providers, advice providers and the regulatory authorities. The thematic review identified five themes with insights for market development contained in each.

The attractiveness of the equity release market for insurance companies has reduced. This has affected the flow of funds into the market with the funding effects impacting most severely on externally funded providers. The advice market was identified as highly concentrated with market share dominated by three firms. Product costs (interest charges and the cost of financial advice) were considered high and viewed as deterring demand. The NNEG, a cost in terms of lower than otherwise loan-to-value ratios, was seen as promoting demand by way of the protection provided to customers and their beneficiaries. There was no appetite for Government intervention in the market to underwrite the NNEG, even if this resulted in improved loan-to-values. The reclassification of 'retirement interest-only mortgages' by the FCA offers the opportunity for the traditional mortgage market to provide an alternative to equity release.

The interviews highlighted that consumer trust was a necessary condition for the continued development of the market. Attracting high street brands was suggested as one way of strengthening trust. However, the fear of incurring reputational damage limits the appeal of the market for many financial institutions. All the high street banks and building societies (the originators of the market in the late 1970s) remain absent from the market. Major equity release providers and advice firms are often part of the same group. This raises the perception of a conflict of interest and can adversely affect consumers' trust. The ERC collates information on the frequency an advisory firm recommends the plans of a particular provider. Making this information publicly available could help alleviate conflict of interest concerns.

There was acceptance that property should be used to supplement retirement income. It was also accepted that equity release can support social care by enabling the elderly to stay in their homes longer. However, equity release was considered inappropriate for the funding of long-term care. The market was not designed for this purpose and suitable products are not available. It was suggested that policymakers advocating equity release as a long-term care solution risked damaging the market.

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Tables

Table 1: Semi-Structured Interview Guide

1	The equity release scheme (ERS) market in the UK represents half a percent of the entire mortgage market. Only 1% of the over 55-homeowners use the product. Why do you think the market is so small?
2	What are the main barriers to the development of the equity release market from a supplier's perspective? Are there any risks involved in offering equity release products?
3	From our interaction with potential and existing ERS customers, we observed that equity release products have a negative reputation. We noticed people do not seem to trust equity release products and have a limited knowledge of them. How should these issues be tackled?
4	To what extent can mandatory financial advice be useful in supporting good and fair decision making for those who consider buying ERS? How does your organisation ensure that people receive fair and accurate advice?
5	The FCA commented, "*From a regulator's perspective - are there barriers to competition or even missing markets? We believe there is a debate to be had about what products, markets could exist, and whether more entrants and innovation here might benefit consumers with greater choice and improved products*." What could be the reasons for the lack of competition and innovation in the ERS market? What should the FCA be doing to promote growth in this market?
6	The most recent report from the Equity Release Council indicates that maturing interest-only mortgages are going to drive the demand for ERS in the future. Do you agree with this? Is the pattern of consumer demand changing?
7	Our understanding is that the no negative equity guarantee (NNEG) clause attached to the product leads to a small loan to value ratio. Can something be done about that? Is there a role for the government here?
8	*Government agency as an intermediary* (Andrews and Oberoi, 2015). The Andrews and Oberoi model is described to participants. In summary, the model centres upon a government agency acting as an intermediary between the borrower and the lender. Participants were asked if they saw merit in the described model.
9	Where do you see the equity release market going? How important is the market likely to be with respect to an ageing population, lower state pension levels in the future and the increasing demand for social care funding?

Table 2: Interview Participants (Type and Role)

Service Provider Type	***N=17***
Private sector - Financial provider (FP)	11
Private sector - Specialist financial advice provider (FA)	2
Not for profit - Financial regulators and industry representatives (FRIR)	4
Role of Participants	***N=17***
Managing Director	5
Chief Executive Officer (CEO)	3
Department Heads (Risk, Compliance, Marketing, Business Development and Public Affairs)	5
Financial Regulatory Experts	3
Product Analyst	1

Note: This table provides details on those interviewed. Service provider type refers to the organisation category the interviewee represented. Role of participants highlights the position of the interviewee in the organisation. A total of 15 interviews were conducted. In two cases, two individuals represented the same organisation.

The financial advice firms, the regulatory bodies and industry representative each had a UK wide brief as did two of the financial providers, six financial providers only provided services to clients domiciled in Great Britain with the remaining two providers only offering services to customers located in London and the South East.

Table 3: Equity Release (Themes and sub-themes)

Major Themes	Sub-Themes	Factors influencing the sub-themes
Trust	Consumer knowledge	Product misconception
		Lack of adequate information
	Conflict of interest	Lack of independent information
		Information asymmetry
	Stigma of the past	Negative reputation
		Global Financial Crisis
	Fostering trust	Perception and customer experience
		Engaging traditional and reputed providers (brand names)
		Information sharing
Product cost	Customer protection	No negative equity guarantee
	Low value for customers	Loan to value ratio
	High interest rates	Government underwriting
Competition and innovation	Competing products	Interest only mortgages
		Regulatory change
	Reputational risk	Product providers
		Financial advisers
	Barriers to entry (advisers)	Advertising and marketing costs
		Dominated market
	Funding constraints	
Access to funds	Decline in annuity business	Internally funded
		Externally funded
	Regulatory aspects	Prudential concerns
		Challenges of Solvency II
Supplementing retirement income and supporting care costs	Damage to Market	Advocacy by Government
	Inappropriate (not designed for the job)	Tax and state benefits implications
		Supplement to retirement income - Yes
		Supporting care costs - No

Note: This table summarises the five major themes emerging from the analysis of semi-structured interview data. The table also highlights the sub-themes informing these major themes as well as the factors influencing the sub-themes. The themes are categorised as per their appearance and inferences drawn from the dataset.