Equity Release

Quick reference Guide Chapter 8

By the end of this guide you will be able to explain the obligations, method, identifying suitability and ethical standards required when giving advice in relation to equity release.

Giving advice

Definitions

There are a number of terms that you need to be familiar with in relation to this chapter:

MCOB rules	• Mortgages and Home Finance: Conduct of Business rules. Relevant to providers of regulated mortgage contracts, lifetime mortgages and home reversion plans.
Lifetime mortgage	• The generic term that applies to a wide range of products targeted at elderly borrowers such as home income plans, cash plans, capital drawdown schemes and open-ended mortgages.
Home reversion plan	• Enables a homeowner to sell all or a proportion of their property to a reversion provider in order to raise funds, with the customer continuing to live in the property, as a tenant, until they die or it is permanently vacated.
Shared appreciation mortgage	• A plan that enables the customer to raise capital and make no payments. The lender foregoes interest completely but takes its income (profit) from a share in the increase in the property value that has occurred redemption date.
Standard variable rate	• Headline rate promoted by the lender, changing with movements in general market interest rates.
Discounted rate	• Interest rate is variable but discounted by a specific percentage below standard variable rate.

Tracker rate	• Interest rate set in the same way as a discounted rate but by reference to some market indicator e.g. Bank of England Base Rate or London Interbank Offered Rate (LIBOR).
Deferred rate	• Interest rate variable but some of the interest rate is deferred and rolled-up to a future specified date.
Fixed rate	• The interest rate is either fixed for a specified initial period after which it changes to variable rate, or fixed for the entire life of the loan.
Capped rate	• The interest rate is variable but will not exceed a specified maximum level for a specified period or for the life of the loan.
Capped and collared rate	• The interest rate can fluctuate but only between maximum and minimum specified levels.

8.A The role of the adviser

Sales can be **advised** or **non-advised**.

Advised – the adviser must take account of customer's needs, financial circumstances, attitudes and preferences, then provide advice and recommendation in writing.

Non-advised – adviser provides information only from which customer makes an 'informed choice' although structured questions may be used to narrow the range of suitable products.

Advisers can only be regarded as **independent** if they represent the customer in seeking the most appropriate product from the whole market.

Lifetime mortgage advisers, if not independent, can represent one provider or a range of providers but must inform the customer of lenders whose products they offer.

8.B The sales cycle

The Sales cycle involves the following stages:

8.B.1 Initial contact

First contact with a customer can come about at the initiative of either party but 'cold calling' is not permitted.

The adviser is required to provide an **initial disclosure document (IDD)** once it becomes apparent that business may emerge.

8.B.2 Gathering information

Gathering information from a customer is absolutely necessary before advice can be given and should include:

- Perceived needs
- Personal circumstances
- Income and expenditure
- Liabilities and assets
- Tax position
- Entitlement to State benefits and grants
- Desire to leave an inheritance
- Likely future changes to above factors
- Lifestyle factors
- Attitude to risk

If it is a non-advised sale, this stage of the process is limited to the use of pre-determined (scripted) questions prepared by a person approved as competent to do so.

8.B.3 Matching product features, benefits and limitations to customer needs

From the fact find, it is possible to identify a customer's requirements which might be for either:

- a capital sum and / or
- income in retirement.

8.B.4 Recommendation

Where a **recommendation** is to be made, this must be provided in prescribed form under MCOB pre-contract disclosure rules.

Requires the lender to provide the customer with a **Key Facts Illustration (KFI)** which must be personalised for the customer.

This may be accompanied by other recommendations subject to separate compliance requirements which, in turn, may require advice from a person with different competencies.

General insurances (e.g. buildings and contents) are regulated under **Insurance Conduct of Business (ICOBS) rules** which have their own separate compliance requirements.

8.B.5 Concluding the contract

At the stage of **concluding the contract**, the customer enters into the contract and the terms and conditions of the plan come into effect.

8.B.6 After sale

Further advice and information may be required in future to:

- top up the mortgage with further borrowing
- pay off part or all of loan
- move into sheltered housing or long-term care
- add or remove a name from mortgage.

There may also be a requirement to provide on-going information on a regular basis.

This contact enables the provider to review needs and offer further services.

8.C Risk factors

There are a number of **risk factors** to be considered by equity release customers as follows:

8.C.1 Changes in personal circumstances

The customer may:

- marry or re-marry or form or end a civil partnership
- divorce or separate
- become a widow or widower
- invite a partner to move into the property
- have a partner leave the property
- have children return to family home
- have more children

It is the duty of an adviser to bring the customer’s attention to possible future scenarios.

If the plan requires payments, the customer may be faced with a **reduction in income** or **increase in expenditure** and the lender is obliged to take account of **affordability**.

8.C.2 Changes in interest rates

Changes in interest rates have an immediate effect on only certain types of mortgage where payments are required to the lender:

- If interest is variable rate, discounted or tracker rate, payment will be affected.
- If interest is fixed rate and term of fix has not expired, it will have no immediate effect.
- If interest rate is capped, collared or both, it may affect payment to lender depending on whether the change occurs above or below the cap or collar.

Change in interest rates will have **deferred** effect if the customer has deferred interest mortgage, affecting the outstanding balance at end of deferral period.

Where interest is rolled up, any changes will affect the **eventual sum** owed when the mortgage is paid off.

An interest rate change should have no effect on a **shared appreciation mortgage**.

MCOB requires lenders to illustrate the impact of 1% increase in interest rates based on current rate at time of issue of KFI with a warning that rates can increase by much more.

8.C.3 Life expectancy

Life expectancy is perhaps the greatest unknown variable when considering performance of different equity release products, which are dependent on how long a customer lives.

8.C.4 Minimum inheritance guarantees

Minimum inheritance guarantees apply mainly to home reversion plans and purchasing a scheme that has a guarantee can reduce the risk associated with early death. Some lifetime mortgages can also guarantee a sum for beneficiaries.

8.C.5 Taxation, grants and benefits

Taxation, grants and benefits are all important factors in assessing the relative merits of different lifetime products.

8.C.6 Leaving or selling the property

A Lifetime mortgage contract is not designed to go beyond the point at which the customer permanently leaves the property due to death or long term care. Also, early repayment is not normally expected and the interest rate is usually based on insurance industry statistics. Such statistics cannot be used to predict other reasons for repayment and charges often apply.

For home reversion plans, leaving the property is a **qualifying termination event**, which ends the tenancy agreement.

8.C.7 Providing for the family

All equity release products have an impact on the eventual value of the estate and advisers must discuss implications with customers who wish others to benefit on their death.

8.D The fact find

Impossible to give suitable advice without carrying out a thorough **fact find.**

8.D.1 Purposes

Adviser must first ascertain reasons why the customer wishes to release equity and should encourage the customer to state and clarify their **objectives** to enable the adviser to make a proposal to meet these objectives.

Adviser has to encourage the customer to think of their **long-term future** and consider:

- Would their death affect the well-being of others?
- If so, to what extent would the borrowing commitment affect them?
- Who do you want to benefit from estate?
- Are intentions likely to change in future?
- Are circumstances likely to change in future to the extent that their wishes in respect of their estate will also change?
- If the customer has not made a will, they must be strongly encouraged to do so.

8.D.2 Personal details

Basic **personal details** should be gathered, including:

- Full name
- Permanent address (and how long resident there)
- Previous address(es) if only resident at current address for short time
- Age
- Gender
- Contact telephone numbers and e-mail address (if appropriate)
- Marital status/domestic living arrangements
- Number of children and ages
- Other dependents

Correct identification will enable the provider to meet their obligations under the **money laundering regulations**.

The adviser must establish if anyone in the property is over 17 years old who will not be party to the mortgage, as ‘consent to mortgage’ declaration may be necessary (not necessary under Scottish law).

Children and dependents must be discussed, and also the importance of leaving a certain level of wealth. Need to ensure all parties fully understand what will happen to the property on death/LTC.

Additional information may be sought e.g.:

- Details of nationality, domicile and residence
- Questions relating to health and life expectancy

8.D.3 Income and expenditure

Income may comprise:

- Wage or salary
- Investment income
- Rent
- Trust income
- Maintenance
- State benefits
- Private and/or State pension

and permanency/reliability of this income should be determined.

Expenditure comprises fixed and discretionary spending.

For lifetime mortgages where no payments are to be made and home reversion plans, only limited information is usually collected. Except for ability to meet the upfront costs, affordability is not a major concern.

8.D.4 Assets and liabilities

Assets are made up of physical and financial assets, which in turn may be liquid or illiquid.

Adviser must be able to estimate the value of residential property if meaningful advice is to be given, though this will be confirmed by a competent independent valuer.

Instead of taking out an equity release product, it may be advisable to utilise other assets more effectively.

Liabilities are capital and other payments due to others. Sums due on outstanding loans with high interest rates can be a powerful motive for taking out an equity release product.

MCOB requires the lender to make the customer aware of the impact of the equity release product on the total amount paid out if high cost borrowings are to be eliminated.

8.D.5 Attitudes, beliefs and values

Customer may have pre-conceived **attitudes, beliefs and values** and other preferences that have to be taken as given.

8.E Recommendation

Any **recommendation** made must meet minimum standards laid down under MCOB.

A firm must ensure that the product is **suitable** i.e. meets objectives of customer and benefits outweigh any disadvantages.

If the customer opts for a different product, or key facts are modified after KFI issued, a new written illustration must be issued either as a pre-application disclosure or as an offer.

8.F Ethical considerations

Advisers always have a duty to behave ethically and not simply just comply with the law and FCA regulation as nearly all customers will be elderly and in some cases, quite vulnerable.

Ethical behaviour encompasses:

- Integrity
- Objectivity
- Competence and due care
- Confidentiality
- Behaviour

Check the study text if you are in any doubt as to what these terms mean.

Equity Release Chapter 8 (ER08) – End of Module Test

Multiple Choice Questions

Question	**Answer**	
1 - Where payments are required, a change in interest rates has no immediate effect if the mortgage is a:	A.	variable rate mortgage
	B.	discounted rate mortgage
	C.	tracker rate mortgage
	D.	fixed rate mortgage

2 - MCOB rules require the lender to illustrate, to the customer, the impact on the payment to the lender if interest rates increase by:	A.	1%
	B.	1.50%
	C.	2%
	D.	2.5%

3 - The risks associated with dying very soon after taking out a home reversion plan can be mitigated by purchasing a scheme with a:	A.	minimum income guarantee
	B.	minimum inheritance guarantee
	C.	no negative equity guarantee
	D.	house price inflation guarantee

4 - Once it becomes apparent that business may emerge from contact with a customer, the adviser is required to provide:	A.	an IDD
	B.	a KFI
	C.	a business card
	D.	a completed fact find

5 - Where a recommendation is to be made, the lender must provide the customer with:	A.	An IDD
	B.	A KFI
	C.	A business card
	D.	A completed fact find

6 - A lender will usually seek a 'consent to mortgage' declaration if there is someone living in the property who will not be a party to the mortgage and who is over:	A.	16 years old
	B.	17 years old
	C.	18 years old
	D.	21 years old

7 - Where the customer knows what they are looking for and informs the provider of this, this type of sale is usually referred to as:	A.	an advised sale
	B.	an execution-only sale
	C.	a non-advised sale
	D.	an independent sale

8 - Which of the following requires the provider to apply its anti-money laundering procedures?	A.	Lifetime mortgage with payments of interest
	B.	Lifetime mortgage without payments of interest
	C.	Home reversion plan
	D.	All of the above

- **End of Questions** -

Answers

Question	Answer	
1 - Where payments are required, a change in interest rates has no immediate effect if the mortgage is a:	D.	fixed rate mortgage
2 - MCOB rules require the lender to illustrate, to the customer, the impact on the payment to the lender if interest rates increase by:	A.	1%
3 - The risks associated with dying very soon after taking out a home reversion plan can be mitigated by purchasing a scheme with a:	B.	minimum inheritance guarantee
4 - Once it becomes apparent that business may emerge from contact with a customer, the adviser is required to provide:	A.	an IDD
5 - Where a recommendation is to be made, the lender must provide the customer with:	B.	A KFI
6 - A lender will usually seek a ‘consent to mortgage’ declaration if there is someone living in the property who will not be a party to the mortgage and who is over:	B.	17 years old

7 - Where the customer knows what they are looking for and informs the provider of this, this type of sale is usually referred to as:	B.	an execution-only sale
8 - Which of the following requires the provider to apply its anti-money laundering procedures?	D.	All of the above