Response to DP 16/1: Ageing population and financial services

April 2016

Building Societies Association

Introduction

Over the past few years, firms from all corners of the financial services industry have been looking at how to serve the needs of an ageing population. The BSA and its members – all 44 UK building societies and two credit unions – have been at the centre of this debate in the mortgage and savings market. The BSA therefore welcomes the FCA's decision to listen to industry and establish a forward-looking holistic strategy for the ageing population and financial services. It is only right that – just as firms are asking how their businesses need to change – that regulators ask similar questions about what kind of regulatory framework will achieve the best possible outcomes.

The BSA has brought together building societies of all sizes and from across the country to discuss the challenges. In roundtables, workshops, conference events and other forums the response has been the same. Building societies want to do everything they can to make sure they continue to serve the needs of older customers.

In the mortgage market our aim is to ensure that no credit-worthy older borrower is underserved. We know there are a range of factors increasingly pushing people into borrowing into and in retirement – factors as diverse as higher house prices, increasing divorce rates, trends in household formation, large student debts, parents and grandparents helping children onto the housing ladder and many others. However, many people also have aspirational reasons for wanting a mortgage in older age – to retire close to family and friends and amenities, to adapt or improve their home, to build the home of their dreams or to release equity to fund a holiday.

The BSA has, in various discussions, called for a more holistic approach to how we look at financing older age. We have seen momentous changes in the pensions landscape in recent years – and each of these changes has knock-on effects on the way that building societies approach lending to older borrowers.

The BSA agrees with the sentiment of many of the contributions to the Discussion Paper - we must start planning now for a future in which retirement income pathways will become increasingly diverse and consumers will be faced with complex financial choices and trade-offs. We are starting to see some of this take shape now but it will only continue to become more pronounced in the next ten, twenty years and beyond.

In November 2015 we published an interim report on *Lending into Retirement* and continue to have fruitful engagement with the FCA on this important topic. In our interim report all 44 building societies committed to reviewing their maximum age policies for mortgage lending. To date a number have responded by increasing the maximum age they will lend to – and two have removed their caps entirely. We will continue with this programme of work and to contribute to this debate throughout 2016 and beyond.

The BSA has responded to the discussion paper questions below:

Q1: Do you have any views on the ideas set out in this Discussion Paper and can you suggest areas of focus that would improve financial markets for older consumers?

We are impressed by the range of contributions to the FCA's Discussion Paper, which demonstrate that the challenge of an ageing population is a truly multi-faceted one. It is unsurprising that we agree with much of the analysis of the Council of Mortgage Lenders on the question of what kind of borrowing challenges older customers face. Therefore, the CML and the BSA have committed to working together in a number of areas to attempt to find solutions for some of these challenges across the mortgage market.

A number of these challenges are described in contributions to the paper. One is the significant challenge of pension freedoms and how to ensure that people have sufficient finance to support their needs in retirement. From the point of view of mortgage lenders this question is tied up with that of how retirement income can be used to fulfil a customer's aspiration to own their home. As an example – there is evidence of a significant proportion of customers planning to take money from their pension pot to pay off a mortgage[1]. While for some this will be a rational and financially optimal choice, especially when they have other pension pots to fall back on, for others it could leave them with insufficient funds to support their needs in retirement. Many of these people will find it difficult to replenish their pots if they only realise their error after the fact.

Yet this is a double-edged sword. Though we have seen less evidence so far, we might also envisage a number of customers with outstanding mortgage commitments who will draw down their pots at age 55 without fully realising the effect this will have. This could leave many unable to meet their credit commitments in retirement and facing financial difficulty. According to FCA figures 17% of customers said they had used Pension Wise before accessing their pot. However, FCA data also shows that 42% of those opting for income drawdown did so without a regulated financial advisor. This potentially puts their financial health in retirement at risk. This is also a challenge for lenders - how should they treat affordability 20 or 30 years into the future when there is the prospect of a borrower putting their capital at risk in retirement through income drawdown?

As such, there needs to be much greater engagement with customers on thinking through these trade-offs. More information and signposting by firms is certainly needed, as is public guidance through organisations such as The Pensions Advisory Service and Pension Wise. For our part the BSA has committed to producing a consumer guide aimed at older borrowers, which we plan to launch in the middle of the year.

For understandable reasons a number of contributions to the paper focus on the issues of advice and guidance, or more correctly the advice and guidance gap. Many older people have a complex web of income streams and assets, generally more so than those in other age groups. These might include a salary, pension income, their home, investments, property income and other asset wealth. Ideally the advice and guidance framework would be able to consider a person's needs and circumstances in the round.

However, we also recognise that this is a tough nut to crack. We cannot expect mortgage advisors to also be experts in pensions, investments, social care and the range of other things that need to be taken into account to look at a person's assets holistically. Nevertheless, some of our members do train their advisors in equity release and some offer introductory sessions on pensions. On the other hand, any independent financial advisor able to offer this service is likely to be very expensive. As such we believe that in the first instance the focus should be on public financial guidance.

We have made suggestions to the Financial Advice Market Review and the consultation on public financial guidance, such as re-tasking Pension Wise as a Retirement Wise service. We think the Retirement Wise service could be offered through The Pension Advisory Service and its potential successor, as we understand they already cover housing assets and liabilities in their fact find.

Q2: Are there specific products, services or distribution channels that are particularly associated with poor outcomes for older people?

Clearly the mortgage market has received significant media and public attention recently-especially since the financial crisis and subsequent Mortgage Market Review. A number of firms

[1] See, for example, the Partnership Group survey http://www.partnership-group.com/media/news/company/2015/pension-to-repay-mortgage.aspx

ceased lending into retirement in that period and have only slowly started to come back into the market. FCA figures do not support the various claims about older borrowers being fundamentally locked out of the mortgage market. However, we can only envisage that there will be more demand for borrowing into retirement in the years and decades to come. Indeed, the BSA's research from 2015 found that around half of 25-34 year olds thought they would need a mortgage lasting into retirement[2]. We must therefore act now to ensure that when these people enter retirement in thirty or forty years' time, the mortgage market is still able to meet their financial needs and circumstances. Building societies' commitment to carry out a review of their maximum age limits this year is – we believe – a first step in this journey.

However, there are a range of other factors we need to look at if we are to avoid poor outcomes for older people in the mortgage market. A number of these are covered in the Discussion Paper but a sample of the questions we need to ask would be:

- How do we ensure that if a customer loses some mental capacity during the term of the mortgage, they do not become financially vulnerable?
- What steps are needed in the advice process to ensure that customers understand that taking out a mortgage could affect how much of their estate is passed on in inheritance if not repaid before death?
- Can we insure against the risk that an older borrower may require social care at some point in the future and be left unable to pay their mortgage?
- How do we deal with joint mortgages, to ensure that if one borrower dies the other is not left unable to repay the mortgage?
- Can we develop flexible mortgages so if customers do face payment difficulties, there are in-built triggers to move from a repayment mortgage to interest-only? Can we work with equity release providers to offer solutions for customers who need to roll interest up?

Some of these questions have tended to be placed in the 'too hard' box. They potentially represent significant conduct and reputational risk for lenders as things stand today. However, with innovation and practical solutions to mitigate these risks there is no reason why we cannot begin to make progress as an industry along with the FCA to formulate answers. We were very pleased therefore to see the recent announcement that the FCA will consult on removing the requirement to assess affordability on lifetime mortgages with an option to roll up- and a modification by consent in the meantime.

In this light it is important to highlight that there is an ongoing issue with interest-only mortgages coming to the end of their term with borrowers lacking the means to repay. Many of these are older borrowers, and some of these cases have begun to filter through to the Ombudsman. In a couple of cases the Ombudsman has told lenders to extend these mortgages into perpetuity – essentially turning them into an interest-served lifetime mortgage. This traps lenders between doing the right thing by regulation but being sanctioned by the Ombudsman, or following the Ombudsman and being sanctioned by the FCA. Clearly this kind of uncertainty risks leading to poor customer outcomes and we ask the FCA and Ombudsman to align their approaches to give lenders greater certainty.

Of course, equity release has also suffered reputational issues in the past, but has recovered with the help of the Equity Release Council standards. Over the past couple of years there have been record-breaking amounts lent in the equity release market – though it remains small compared to the mainstream market. The BSA does not believe that equity release offers a panacea to older borrowers – many still see it as a last resort and only turn to it once they have exhausted other income sources. However, with strong advice standards and a continued focus

[2] BSA Property Tracker, June 2015, https://www.bsa.org.uk/media-centre/press-releases/around-half-of-young-borrowers-will-need-a-mortgag

on customer need it is likely that the market will continue to grow as people seek to leverage the equity built up in their homes.

Pricing continues to be an issue in the equity release market. Understandably, some of this expense is because lenders have to cover a no-negative equity guarantee, longevity risk, interest rate risk and a complex prudential and actuarial framework. However, there are also opportunities for innovation and price competition with the recent entry of some big name players. The FCA might consider what can be done to lower the barriers of entry so that customers have a greater choice of products from a range of lenders, as exists in the mainstream market.

Q3: What is the role of industry and other stakeholders (collectively as a market or at an individual firm level) in addressing the issues identified?

In the mortgage market there is a clear need for product development and innovation to suit the needs of older borrowers. We are already beginning to see some of this taking place in the building society sector. One of our members, for example, offers a discounted rate to older borrowers who register a Lasting Power of Attorney. This is a practical hedge against the risk of a borrower losing some mental capacity. Another has begun to offer a downsizing mortgage, whilst a third has a specialist product for older borrowers where a higher rate stress test is applied to reflect the fact that many retired borrowers will find it more difficult than others to raise extra income if base rates rise at a rapid rate. These are all practical product features responding to specific needs and risks.

However, we believe that there is a need for much more cross-industry working, not just among mortgage lenders but the financial services industry as a whole. For example, a number of contributions to the Discussion Paper describe how we might respond to the new pension freedoms landscape. We have moved from an environment in which many people tended to receive a definite income in retirement through a Defined Benefit pension, through one in which annuitisation of a Defined Contribution scheme was practically compulsory, to the situation we have now in which retirement incomes can diverge greatly. We clearly need to ask questions about how to support consumers through the range of pathways they could choose, as well as the difficult decisions that come with these freedoms.

We welcome proposals for defined pathways and flexible products which can adapt to a customer’s changing needs –to provide more flexibility to draw an income in early retirement for those who want it, through to the need for more certainty later in life. Customers understandably want choice, but also need to insure against longevity risk. We would suggest that default pathways could even be designed to interact with a mortgage. For example, could a default pathway be designed which ensures that a proportion of a person’s pension pot is used to repay any mortgage secured on that income for the five or ten years – or whenever the term ends - post-retirement? This might structure decumulation so that a borrower cannot take a cash lump sum above a certain level for those five or ten years, unless other structures are put in place to pay the mortgage. The full range of options could then be restored once the mortgage has been repaid. Such a pathway would give lenders greater certainty when making a lending decision twenty or thirty years into the future.

Q4: Do you have any evidence of effective approaches to meeting the needs of older people that you have already developed and tested, or that you have observed in other markets (UK and international)?

Nothing to add other than what is covered elsewhere.

Q5: Do you have any evidence of regulatory barriers that prevent effective markets for older people?

BSA members are very cognisant of the importance of complying with competition law. However, if real progress is to be made, on a concerted basis, in meeting the needs of our ageing population, firms and relevant regulators need to work together and collaborate. It would be unfortunate if firms, in attempting to meet this crucial demographic need, found competition law to be an impenetrable barrier. We think it is important that the CMA, the FCA and the industry have up-front discussions about how legitimate needs can be met in a way that is competition law compliant. Getting this right is a *joint* responsibility of the industry and the regulators.

We would also suggest that, now that the changes to mortgage regulation implemented by the MMR have had time to bed in, there could be a case for exploring how regulation might be nuanced to better help under-served customer groups. While the affordability rules work well for borrowers who can demonstrate a consistent income stream, they potentially lock out other borrowers who are, in reality, a relatively safe credit risk. For example, some older borrowers may not have an income stream from work but may have buy-to-let properties or holiday homes they could sell or raise rents from, significant savings, and investments or pension pots they could cash to repay their mortgage. Many of these people are likely to have had mortgages before and a demonstrable track record of paying them off. It is illogical therefore that somebody in their twenties with an income stream but no experience of servicing a mortgage often has more chance of getting a mortgage under current affordability rules. This is especially so given that most older borrowers will only be looking for a low LTV mortgage.

We outlined above our concerns regarding some recent Financial Ombudsman cases where lenders have been asked to extend interest-only loans into perpetuity. Some societies have expressed wider concerns about what the regulatory position would be with an older borrower whose financial position changes over the course of the mortgage term– conceivably due to needing social care or some other large expense. Following the Ombudsman's logic some of these cases could also result in the loan being extended into perpetuity rather than the lender repossessing. However, most societies do not hold lifetime mortgage authorisations. This may dissuade them from offering mortgages into retirement due to concern over having to provide 'quasi-lifetime' mortgages in future. As such, the FCA and PRA would ideally address these barriers by issuing guidance on how they would view a mortgage originated as a term loan that, due to a change in circumstances, becomes lifetime.

Finally, in response to one of the suggestions in the Discussion Paper we would urge caution against the Consumer Panel's proposal to implement a 'Duty of Care'. Firms are already subject to Treating Customers Fairly, as well as specific regulatory rules, so in one sense it is unclear how a loosely defined 'Duty of Care' would go beyond this. However, the 'Duty of Care' also risks having a chilling effect on the market at a time when what is needed is innovation. To re-iterate the point – mortgage lending is a long-term business with potential consequences which will not become clear until 20 or 30 years down the line. While Treating Customers Fairly focuses on firms ensuring that they act in the spirit of regulation at the point of sale, as well as during after sales care, a 'Duty of Care' would appear to suggest that lenders would be liable for anything that goes wrong many years in the future and whether it was foreseeable or not.

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The Building Societies Association (BSA) is the voice of the UK's building societies.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the government and parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of both the UK mortgage and savings markets