

Financial Services Consumer
Panel response to:
HMT Consultation Paper:
Regulating Home Reversion
Sales

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Summary

- I. The Consumer Panel supports the regulation of home reversion schemes by the FSA alongside other, mortgage based equity release schemes. We do not accept that structural differences between these products should justify some consumers being put at a disadvantage in terms of protection, redress and compensation.
- II. The Panel is also concerned that partial regulation of the equity release market would inevitably lead to a commercial distortion and further detriment for consumers. We have already seen examples of this, such as the regulation of timeshare leading to holiday clubs emerging as an unregulated substitute.
- III. If the home reversion market remains unregulated there will be no independent and effective control over the integrity and competence of individuals involved in running these schemes.
- IV. There is a serious risk that consumers might be mis-sold home reversion plans. Only regulation, properly enforced, will ensure that advertisements for these schemes are clear, fair and not misleading and that all key facts are disclosed to consumers before they commit themselves to a home reversion plan.
- V. The Panel also believes that wide-ranging independent legal advice should be mandatory for those considering a home reversion plan and that consumers should also instruct an independent surveyor to undertake a valuation of their home, whether or not the home reversion company itself instructs a surveyor.
- VI. The nature of home reversion products means that there are groups of vulnerable consumers who could lose out if HMT decide against FSA regulation. These groups are likely to include those who will not be in a position to recoup any losses they incur as a result of mis-selling or

product flaws. HMT quite rightly did not wait for harm to occur before regulating the long term health care market and we believe that the same approach should be taken here.

Panel response to HMT Consultation Paper: Regulating Home Reversion Plans

Introduction

1. This paper is the response of the Financial Services Consumer Panel ('the Panel') to the H M Treasury (HMT) Consultation Paper on Regulating Home Reversion Plans.
2. The Panel supports the regulation of home reversion schemes by the FSA and believes that HMT must take this opportunity to protect consumers from the devastating consequences of mis-selling in an unregulated market.

Detailed Questions

Q1: What is your estimate of the number of firms that are or will be in the reversion market? How many plans are or will be provided? What might be the value of those plans? What new products might be in the pipeline?

3. The Panel is not in a position to provide the details sought, but clearly the market in equity release products is growing. It is widely acknowledged that consumers are turning to property investment – whether in their own home or buy-to-let – for income or capital to support them in retirement. In a study by Oliver Wyman & Company for the ABI¹ in 2001 it was assumed that owner-occupiers would, on average, release 60% of the equity in their homes on retirement. This clearly indicates that the equity release market as a whole is significant and substantial. Furthermore, current indications are that both the Government and local authorities see this avenue as a potential source

¹ OWC, The future regulation of UK savings and investments, September 2001

of income for older people and so there is likely to be official encouragement of this vehicle.

Q2: Readers are invited to make available any evidence they may have of how reversion plan providers may treat consumers unfairly or unreasonably. To what extent would FSA regulation tackle the issues highlighted in paragraphs 18-24?

4. It was less than 20 years ago that pensioners were the victims of one of the most shocking mis-selling scandals of the time, involving the West Bromwich Building Society, Staffordshire Building Society and Chelsea Building Society amongst others. The home income plans sold by these firms generally involved the victim taking out a mortgage, often at a variable rate and with interest being rolled up into capital, and investing the proceeds in a high risk and/or fixed rate bond. For the scheme to work the bonds would have to retain their capital value and generate a return which would cover the interest on the loan and provide additional household income. What happened in fact was that mortgage interest rates rose sharply and the income from and value of the bonds plummeted. This left many pensioners (reportedly 10,000 in 2003) crippled by escalating debt for the rest of their lives. The January 2004 edition of Which? contains an article about Britannia Building Society refusing to freeze interest on mis-sold equity release products, adding to the misery of those trapped within these schemes.
5. The fact that home reversion schemes do not involve an interest-bearing debt does not mean that mis-selling cannot take place. People can lose their objectivity when desperate for money and they will inevitably be attracted by the possibility of an immediate lump sum without the worry of borrowing. The short-term benefits of a discounted sale of all or part of their home must be weighed against the longer-term drawbacks – including an adverse effect on some means-tested state benefits. For example, Mrs A, aged 65, sells 75% of her home to a home reversion company in 2004, taking her outside the scope of

some State benefits. The market value of the property is £100,000 and the lump sum paid by the company is £40,000. In 2010 the property is worth £150,000, the reversion company's interest being £112,500 and Mrs A's interest being £37,500. Mrs A then needs to sell her home to pay for nursing care, realising around £36,000 after fees. At the end of the day she will have received £76,000 for her home, plus any income she might have received by investing all or part of the original £40,000, for a property worth £150,000. If Mrs A was fully aware of the long-term implications of the sale she might be disappointed with this, but not mis-sold. But the Panel believes that only compulsory regulation will ensure that Mrs A's long-term interests are protected, by requiring disclosure of all key facts and independent legal representation for Mrs A.

6. The idea that consumers should receive advice from an independent third party before entering into a contract is not a new one. It happens today where a borrower wishes to obtain a loan for business purposes secured on the marital home.

7. The Panel has not undertaken any detailed research into the equity release market as it now operates. However we believe that lessons can also be learned from consumers' experience with other financial products, in particular mis-selling of high-risk investments such as 'precipice bonds', endowments and pensions where sales people had a financial incentive to push such products. In all these cases the consequences for the consumer were very serious indeed, but as customers of regulated firms they did at least enjoy the protection of the Financial Ombudsman Service and the Financial Services Compensation Scheme. In addition the FSA has spent a considerable amount of time developing a new disclosure regime. This is designed to ensure that key information is disclosed to consumers purchasing financial products and, although the Panel has had a number of reservations about detailed aspects of the disclosure regime, we would

not wish to see some consumers enjoying the benefit of this while others do not.

8. There is also the issue of advertisements for equity release products. The FSA has a full time monitoring team to review financial promotions and to take up with firms any advertisements which do not comply with the FSA's rules. The FSA wrote recently to the principals of all authorised firms offering 'pensions unlocking' warning of the "emotive" and "light-hearted" tone of some advertisements, which was likely to undermine the risk warnings that the firms were required to include. The Panel is concerned that if the current position remains unchanged, advertisements for home reversion products, particularly on television, would be likely to adopt the same selling approach but without the restraints imposed by the FSA. Similarly under an FSA regime it would not be possible anyone to promote specific home reversion plans unless he/she was an approved person who had been assessed as competent to do the job.
9. The Panel agrees that the issue of pricing is a difficult one. The valuation of any property is driven by a number of factors. However as suggested in the Paper a mandatory *independent* valuation in each case (with the surveyor instructed by the consumer) could be one way of ensuring that consumers are in a position to decide whether the offer they have received is a fair one. Consumers should also instruct a solicitor to represent their interests in the sale. The other factor affecting price - the percentage of the valuation paid to the consumer – seems to be a decision taken by the reversion company on the basis of various market factors. This is an area where rules need to be in place to ensure that the consequences of the deal being offered is clearly spelt out to the consumer before he/she enters into any agreement with the reversion company.
10. Another concern is the number of opportunities in a home reversion plan for consumers to be charged fees, including arrangement fees,

legal fees, valuation fees and costs associated with investing the lump sum they have been paid by the home reversion company. These could spiral out of control in an unregulated market. Whilst the price of a product is not normally regulated, in this case it is extremely difficult for a consumer to shop around and to compare prices. The FSA might therefore need to give particular attention to assisting in this even once the market is regulated to ensure that customers do get good value.

11. So far as SHIP is concerned, any trade body of which membership is voluntary does not provide protection for consumers, although they have a useful role to play in the industry as a whole. The Panel has a number of concerns about regulatory issues such as transparency, but nevertheless we believe that regulation by the FSA, properly enforced, would provide a framework within which consumers could act with a reasonable amount of confidence. This would also avoid the inevitable skewing of the market that would result from partial regulation. In addition consumers would be entitled to the protection offered by the Financial Ombudsman Service and the Financial Services Compensation Scheme.

12. We were astonished at the suggestion in paragraph 20 of the consultation paper that consumer fact sheets provide a basis on which consumers can make informed decisions about the sale of their homes. There is no credibility in the idea that the availability of this information is a substitute for regulatory protection against mis-selling. Factsheets are, of course, useful to those who are able to understand them, but it is worth noting here information about levels of financial understanding amongst consumers. In October 2003 Carol Sergeant, then a Managing Director of the FSA, said:

“Financial literacy remains a major challenge for some consumers. Research by DFES has shown that one in four adults cannot calculate the change they should receive out of £2 after buying three items costing less than that. A significant number thought 10% of £300 was worth no more

than £25. A more recent survey by NOP for Invesco found that half of investors surveyed (and over two-thirds of the public at large) do not understand the difference between equities and bonds.”

13. Against this background it is clear that many consumers will not be able to understand the information already available about home reversion plans. They need explanations, protection and unbiased advice. Furthermore, they need information and advice both about inheritance tax (and exemptions) and the rights of dependants before entering into such arrangements.

14. The Panel is also opposed to a split of regulatory responsibility in this market between the FSA and another regulator or trade body. We believe that this would lead to a great deal of confusion for the consumer and impossible burdens on the regulators to ensure coverage of the market and consistency of treatment. There have already been examples of consumers’ interests being affected by part-regulated markets, such as the regulation of timeshare leading to holiday clubs emerging as an unregulated substitute and the different treatment of loans over and below £25,000.

Q3: What effect will mortgage regulation have on the wider equity release market, and specifically on reversion plans? Are there comparable situations that could be used as a model to predict how this might affect the equity release market?

15. The regulation of some equity release products and not others will create an artificial division within the market which could easily be exploited. As set out earlier in this letter, from a consumer perspective all equity release products fulfil essentially the same function and the structural differences between the products do not appear to be a valid reason to deny the same protection to all consumers across the piece.

Q4: How effective are the current voluntary arrangements? Do they meet consumers’ needs? Do they provide effective redress? What could be

done to improve their effectiveness and coverage? Will the proposed voluntary arrangements help?

16. Voluntary Codes of Practice and organisations such as SHIP are not a substitute for statutory regulation. Anywhere where membership is voluntary will not be effective. Such redress as is available is completely inadequate and the Panel believes that the only viable option is for regulation by the FSA of the home reversion market with entitlement to recourse to the Financial Ombudsman Scheme and the Financial Services Compensation Scheme. We particularly note that, with a voluntary scheme, there is no equivalent input on behalf of the consumer on a par with the FSA Consumer Panel. There is no automatic feedback of general trends and issues as exists between FOS and the FSA.

17. A further concern in an unregulated market would be the absence of effective controls over the integrity and competence of individuals involved and the financial standing of the companies they run. The authorisation and approval procedures operated by the FSA provide consumers with a significant degree of protection and the knowledge that those who do not meet the required standards will not be permitted to sell financial products to the public. The Which? article referred to earlier in this letter relates to the “chequered career” in financial services of Sonja Thompson. Although Ms Thompson’s criminal convictions mean that she would not be permitted to work in a position of responsibility within the authorised financial services sector, Ms Thompson would be free to run an unregulated home reversion scheme.

Q5: Could readers provide examples of the different types of arrangements in the market place, together with views as to whether or not they should be included in any definition of a home reversion plan. Would

it be possible to craft a definition that does not capture other sale and purchase arrangements that it would not be appropriate to regulate? Would it be possible to craft a definition that prevented firms from creating similar products that lay outside the boundary of legislation? Are there alternative property financing arrangements other than reversions that might be at risk of being caught by any definition?

18. We do not think it possible to draft a definition of a home reversion plan that would not be vulnerable to exploitation at a later date and this should be accepted. The sensible course is for a definition to be drafted and kept under active review. This should reduce the possibility of products being created simply to escape regulation, as happened in the timeshare market where 'holiday clubs' soon began appearing once timeshare sales themselves became regulated.

Q6: What are your views on the assumptions used in the regulatory impact assessment?

19. The draft estimate of costs, which seems quite arbitrary, does not adequately cover the benefits to both firms and consumers of a regulated market with no mis-selling. Nor does account seem to be taken of savings to the Government in state benefits by consumers using their homes to fund their retirement. The estimated cost of supervision for a small or medium sized pure reversion provider of £475,000 defies belief.

Q8: Do you have any other comments relevant to the issues discussed in this consultation paper?

20. One of the points which has struck the Panel is the wide diversity in estimates of the size of the home reversion market. This is a clear indication that that no-one really knows how big the potential market is or how it is going to develop, although all the indications are that the interests and welfare of many thousands if not millions of consumers are at stake in the medium term. It may be many years before

consumers realise that something has gone wrong with their equity release product. Some might not understand that they have been mis-sold or that the product they were sold is flawed. The key issue is that the likelihood of consumer detriment can only rise if the regulatory position remains unchanged. H M Treasury now has the opportunity to take steps to prevent or at least minimise the distress which could be caused to a particularly vulnerable group of consumers and we urge you to extend the scope of FSA regulation to include all equity release products. Not to do so would, in the Panel's view, be indefensible. If any further argument is needed, HMT should consider the plight of the 10,000 or so pensioners who are still suffering the financial impact of being mis-sold home income plans in the 1980s. Older consumers are a particularly vulnerable group and are entitled to appropriate levels of protection.

Who is on the Panel?

Ann Foster (Chairman)

Ann has over twenty-five years experience in the consumer movement. During that time she has worked at the National Consumer Council and has been a Director of the Scottish Consumer Council. She has also served on various government advisory and expert groups on a range of subjects. Recently Ann has been a member of the Health Professions Council and of Postwatch, the Consumer Council for Postal Services. She is also a Council member of the Royal national Lifeboat Institution and member of its fundraising committee.

Dianne Hayter (Vice Chairman)

Dianne is on the board of the National Consumer Council and was, until 2004, on the board of the National Patient Safety Agency. She was formerly the Chief Executive of the Pelican Centre (a cancer charity). Before that she had periods as the Director of Corporate Affairs for the Wellcome Trust, Chief Executive of the European Parliamentary Labour Party, Director of Alcohol Concern, General Secretary of the Fabian Society, a journalist and trade union research officer. She is a member of the Labour Party and on their National Executive Committee. She is currently also a research student at Queen Mary College, London.

Yvonne Gallacher, OBE

Yvonne is Chief Executive of Money Advice Scotland, set up in 1989 by Scottish Consumer Council. She has over thirteen years' experience of consumer credit/money advice issues and of working with vulnerable consumers in a variety of roles, including debt counsellor, trainer and manager. She has also lectured and co-authored a Guide to Money Advice in Scotland. Yvonne is presently a member of the FSA Consumer Education Forum and Credit Union Consultation Panel. Yvonne is a member of the Scottish Consumer Council.

Harriet Hall

Harriet is a solicitor with considerable experience of consumer policy and retail financial services. She is a former legal officer with the National Consumer Council, where she worked on the needs of low income consumers, banking, credit, mortgages, regulation of equity release and long-term care insurance, the Financial Services and Markets Bill and the proposed EU directive on distance selling of financial services.

John Howard

John is a solicitor with extensive experience of consumer issues as a presenter of the daily consumer programme on Radio 4 'You and Yours'. He is currently a freelance broadcaster and his work includes presenting personal finance programmes. He is a member of the Mortgage Code Compliance Board.

Vinod Kumar

Vinod is a social scientist with market research skills and extensive voluntary and public sector experience of policy analysis and research. Until recently, he was Head of Policy and Research at the Royal National Institute for Deaf People, and he has previously worked for the Commission for Racial Equality. Now retired, Vinod is currently Non-Executive Director of Barnet Primary Care Trust and a member of the Consumer Liaison Group of the Medical Research Council.

Nick Pearson

Nick is the National Money Advice Co-ordinator for the Federation of Information and Advice Centres. A career spent in advice organisations including the National Association of Citizens Advice Bureaux where he was Manager of the Money Advice Support Unit, he has particular experience of credit, debt and personal finance issues and of working with vulnerable consumers.

Paul Salvidge

Paul is a former senior civil servant with experience of regulatory work, employment law, competition, consumer protection, telecommunications, financial services and company law. He was previously Competition Policy and Consumer Affairs Director at the Department of Trade and Industry.

Richard Smethurst

Richard is Provost of Worcester College, Oxford University; previously a non-executive Director of IMRO, he chaired their Training Standards Panel. He has served as an economic adviser in Whitehall, and on the Monopolies and Mergers Commission, where he was Deputy Chairman.

Dave Watts

Dave is a partner in a media business, which is involved in publishing, editing and journalism - personal finance plays a large part in this. He is a former editor of Which? and Money Which? and former Assistant Director of Consumers' Association. He was also a policyholder representative on the Insurance Brokers Registration Council for nine years.

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