UK FINANCE

DP19/2: Intergenerational Differences

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UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers and facilitate innovation. We represent the full range of the industry from the largest lenders to the smallest, high street and challenger banks, building societies as well as non-banks and the regulated third-party administrators who service inactive lenders. Our members include lenders who are fully intermediated and lenders who provide advice directly to customers.

General Comment

The responses to the questions have focused on the points raised in chapters 4 (mortgages) and 6 (consumer credit) in the discussion paper.

Key Points

- Consumer credit providers will apply responsible lending criteria to all consumers irrespective of 'generation'.
- UK Finance data demonstrates that the supply of types of mortgage products are responsive to the demands of different age groups, however innovation in product design could go further.
  - For younger borrowers, affordability will remain an issue. In 2018, 51 per cent of all home-owner home purchases were first-time buyers. At the same time, mortgage term lengths have increased, so that the mortgage is more affordable.
  - There is no longer a clear boundary between later life lending (i.e. to over 55s) and 'prime' lending in practice, despite the distinction between the two within the FCA's Mortgages and Home Finance Conduct of Business sourcebook (MCOB). This has the potential to influence how these borrowers may make retirement and decumulation decisions in the future
  - For older borrowers, the transition to retirement is taking longer, with a significant part of the population employed up to age 65 and beyond. This means that 'younger' older borrowers have the potential capacity to service loans. The market appears to be reacting to demand through the wide array of mortgage products available to older borrowers, particularly those with flexible repayment arrangements.
- There are a few potential barriers to innovation for both consumer credit and mortgages (further detail is provided in our answer to question 4):

- The legislative requirements of the Consumer Credit Act have not kept pace with technological change and should be amended as part of the ongoing review into the retained provisions of the Act. We cross refer to the detailed response submitted by UK Finance to DP18/17 and the call for change to a less prescriptive regime.
- The inclusion of other household bills in the data shared with Credit Reference Agencies can help increase the understanding of a consumer's credit history, particularly those with 'thin' files. Access to reliable non-traditional data (e.g. council tax or HMRC data) has been recommended as part of the work on affordable credit as part of the Financial Inclusion Policy Forum.
- For mortgage lending, having separate parts of MCOB covering lending into and in retirement is driving a siloed approach resulting in a fragmented approach to the advice given to consumers, the qualifications and training standards required of advisers/brokers, and how products are funded and developed. This means that the market is at risk of being driven by product specifications, rather than the needs of consumers.
- There are several solutions that the FCA could consider:
  - bringing together the parts of MCOB that relate to lending in later life, for example, incorporating chapter 8 with chapters 4 and 11
  - re-evaluating the adequacy of exam standards required for advisers
  - signposting rules for any older customer, so that they are fully informed about the products and types of advice available.
- It is also useful for the FCA to consider how changing levels of wealth across generations will impact on access to lending products in the future. This includes weighing up responsible lending against affordability requirements.

Q1: Are there other factors driving changes in the consumer needs of different generations (in addition to those we have listed in Chapter 3 of this paper) that we should consider? What are these?

Q2: Are there other ways in which the factors we have identified as driving changes influence how individuals from across different age groups build up and access wealth?

Q3: To what extent are financial services providers currently meeting the changing needs across different age groups? How could innovation in product design help meet changing consumer needs of different age groups?

Consumer credit

Consumer credit comprises a broad range of products designed to meet consumer needs, irrespective of 'generation'. They help consumers smooth short-term cashflow issues or enable them to have immediate access to a service or good and spread the cost over a period of time. It is subject to robust legislation and regulation, including a requirement for responsible lending
Key factors of responsible lending are

- The credit history of the customer as an indicator of creditworthiness
- Income (and the sustainability of that income) as a factor of affordability.

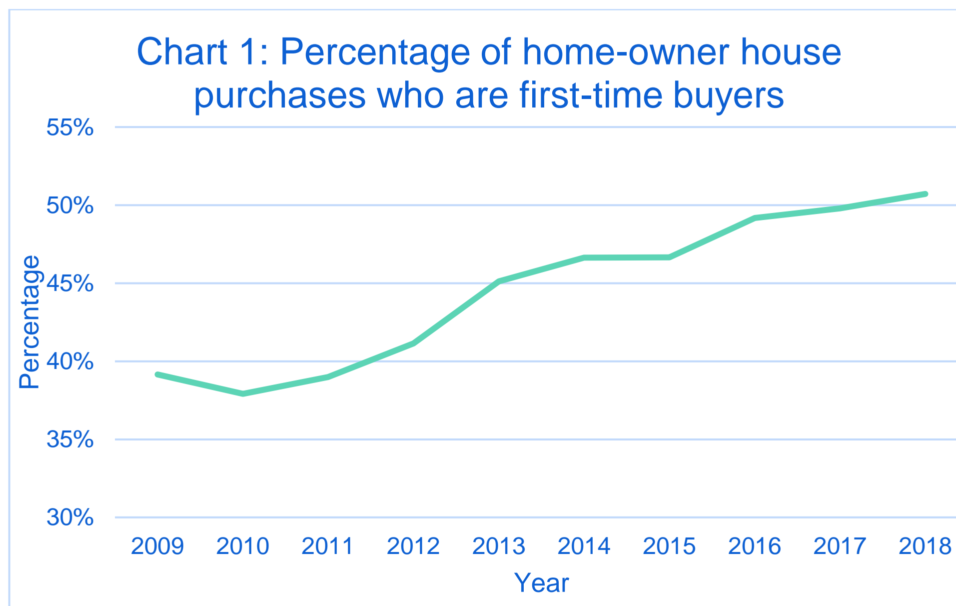
Providers will apply these criteria in the same way to all age groups. We believe this works well.

Mortgage lending

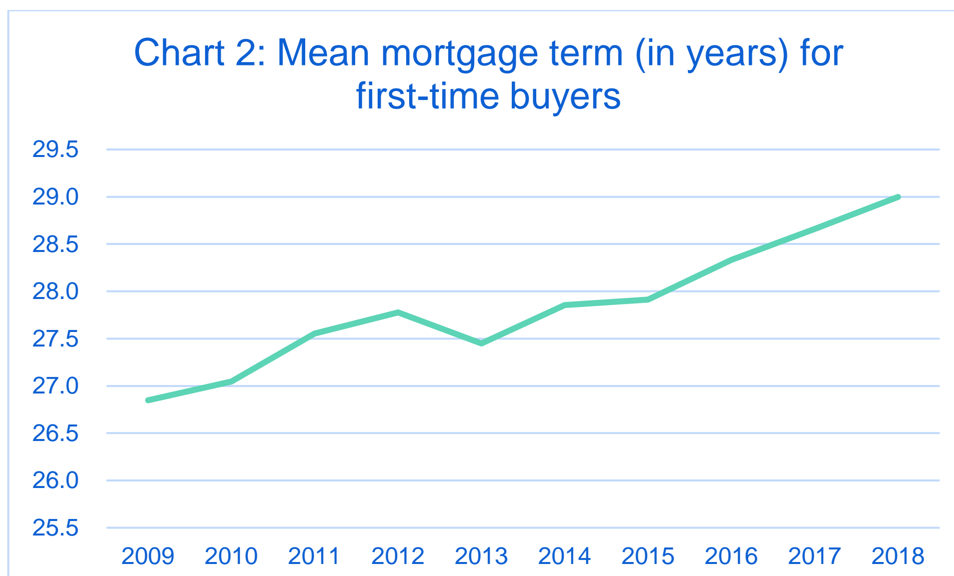
UK Finance data shows that the supply of types of mortgage products are responsive to the demands of different age groups. However, innovation in product design could go further, especially in anticipation of the changing needs of older borrowers over time. The barriers to innovation are discussed in our response to question 4.

Younger Borrowers

In 2018, 51 per cent of all home-owner home purchases were first-time buyers. This has increased from 39 per cent of all home-owner home purchases in 2009 (see chart 1). In the same time period, the mean age of first-time buyers has not significantly changed (from 30.9 years in 2009 to 31.7 years in 2018). Mortgage term lengths have significantly increased, from a mean of 26.8 years in 2009 to a mean of 29.0 years in 2018 (see chart 2). This indicates that while there are more first-time buyers getting onto the property ladder, they are taking out longer mortgages so that the mortgage is more affordable. This is largely a consequence of the tightening of the affordability rules post the credit crisis. Supply, i.e. the availability of mortgage products, appears to be responding to the demands of younger borrowers, in the form of longer-term mortgages. Latest research from Moneyfacts[1] shows that 55 per cent of all residential mortgage products currently available have a standard maximum mortgage term of up to 40 years. There has been a corresponding reduction in 25-year and 30-year term mortgages available in the market.



[1] https://moneyfacts.co.uk/news/mortgages/40-year-mortgage-terms-on-the-rise/



Affordability is likely to remain an issue for younger borrowers. Looking at historical data, over the last forty years, the mean of age of first-time buyers appears to increase in a rising interest rate environment, not taking into account changes following the credit crisis (chart 3). Loan to income values take a more linear upwards long-term trend (chart 4). In 1979, the mean loan to income value for a first-time buyer was 1.89; in 2018, this value was 3.50.

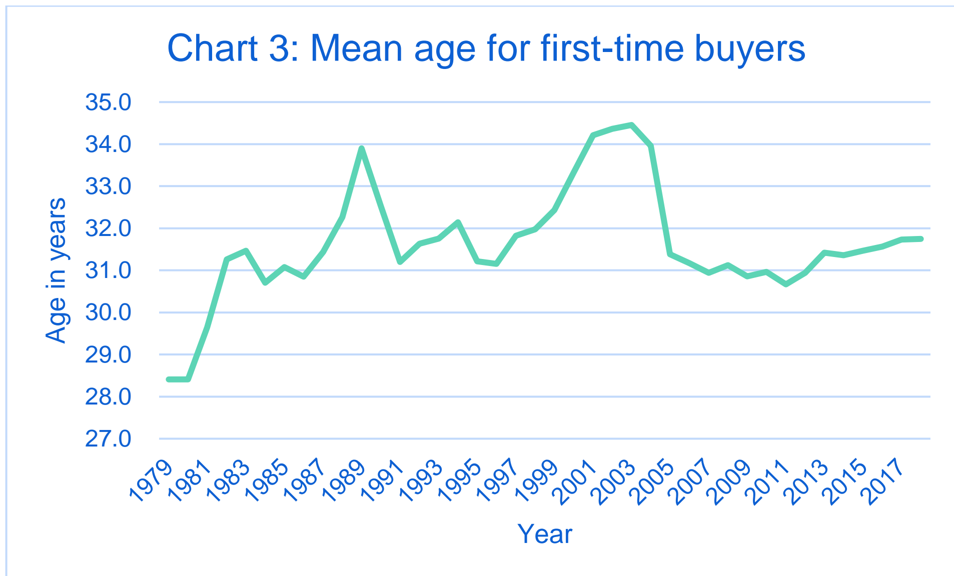
Government schemes have helped to increase access to the housing market. Help-to-Buy (HTB) is mostly being used by buyers who would typically be more constrained, i.e. younger first-time buyers. The scheme has also been used by more capable buyers, including existing or previous owners and those with significant household income and deposits. The scheme accelerates housing market access, at higher levels and for larger households. It is estimated that around 60 per cent of HTB buyers did not need state support via the scheme. Research carried out for the government said that HTB can be characterised as supporting "bigger, better, sooner" house purchases and this is supported by UK Finance data and analysis.

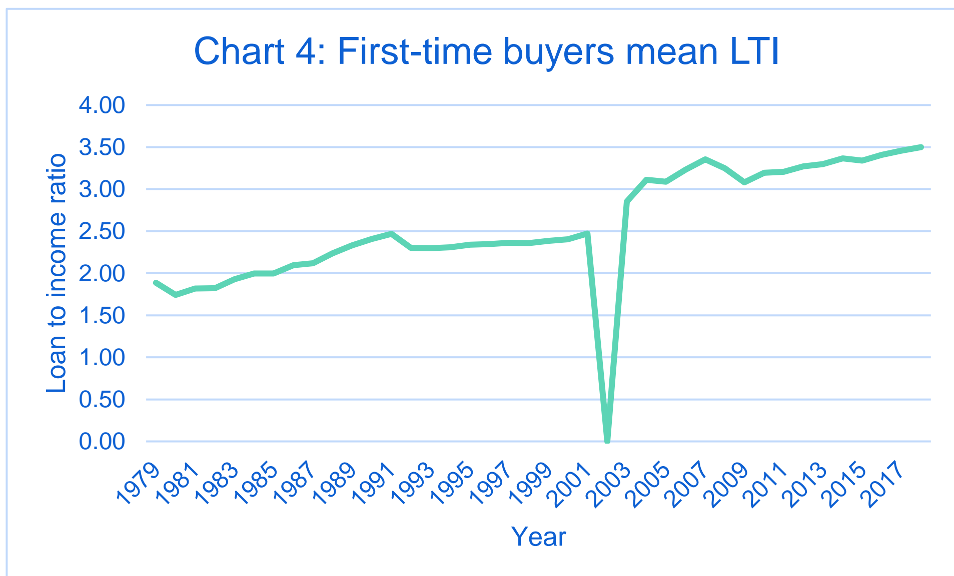
The UK Finance Regulated Mortgage Survey shows that HTB accounted for nearly half of all new build lending in England from 2016 to quarter 1, 2018. This represents 15 per cent of first-time buyer lending and eight per ent of total lending for house purchase. As well as the direct impact on the first-timer buyer and new build markets, HTB also affects the mover and second-hand markets indirectly, and through substitution effects. The typical first-time buyer borrowing through the HTB scheme has slightly higher income than other new build buyers or buyers of second-hand property. HTB typically enables purchase of properties that are around ten per cent larger (measured by number of bedrooms) and buyers typically have around ten per cent higher income and loan-to-income. Importantly, they also buy between one to two years younger than those not using the scheme. So, overall, HTB tends to help borrowers with higher incomes buy larger properties at a younger age.

Improving access to the housing market by younger borrowers is not limited to government schemes. The rise of the 'Bank of Mum and Dad' (BOMAD) is well researched by other parties. We refer the FCA to the Resolution Foundation's 2018 report[2] demonstrating the strength of the relationship between parental support and people's chances of becoming homeowners. At the age

[2] https://www.resolutionfoundation.org/publications/house-of-the-rising-son-or-daughter/

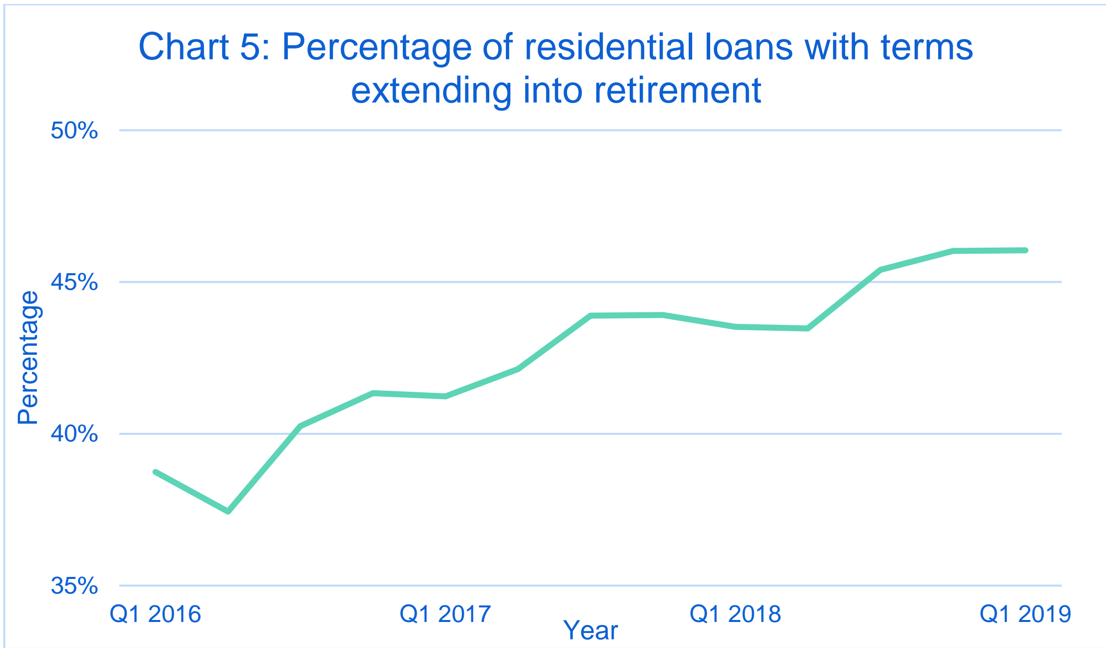
of 30, those without parental property wealth are approximately 60 per cent less likely to be homeowners than people who parents are homeowners. Methods for homeowners to transfer wealth to their children is discussed at question 5.





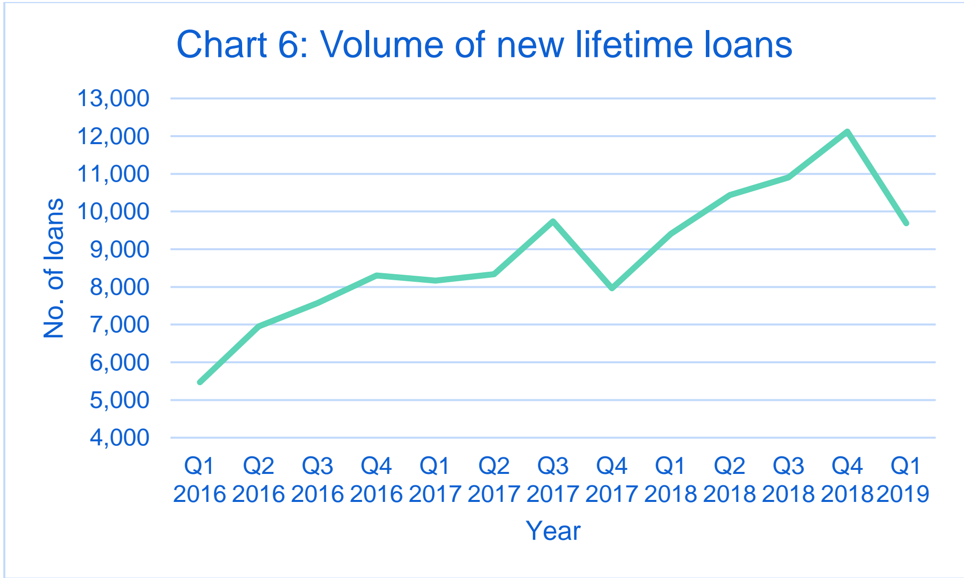
Note: We have temporarily removed 2002 figures for income multiple pending a data investigation.

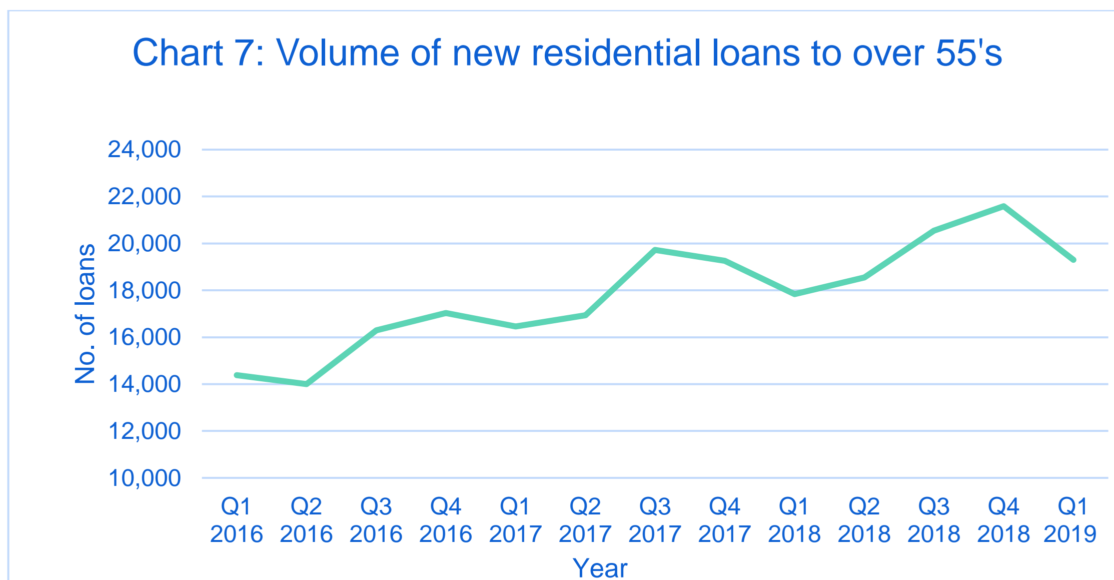
While the younger end of the market is borrowing for longer, this also means that they are ultimately borrowing into retirement. The proportion of new residential mortgages where the term will finish after the main borrower is aged 65 was 46 per cent in quarter 1, 2019 (see chart 5). This is a significant increase from 38.7 per cent of new residential mortgages in quarter 1, 2016. This has the potential to influence how these borrowers may make retirement and decumulation decisions in the future. Additionally, there is not a clear-cut boundary between later life lending (i.e. to over 55s) and 'prime' lending in practice, despite the distinction between the two within MCOB.



Older borrowers

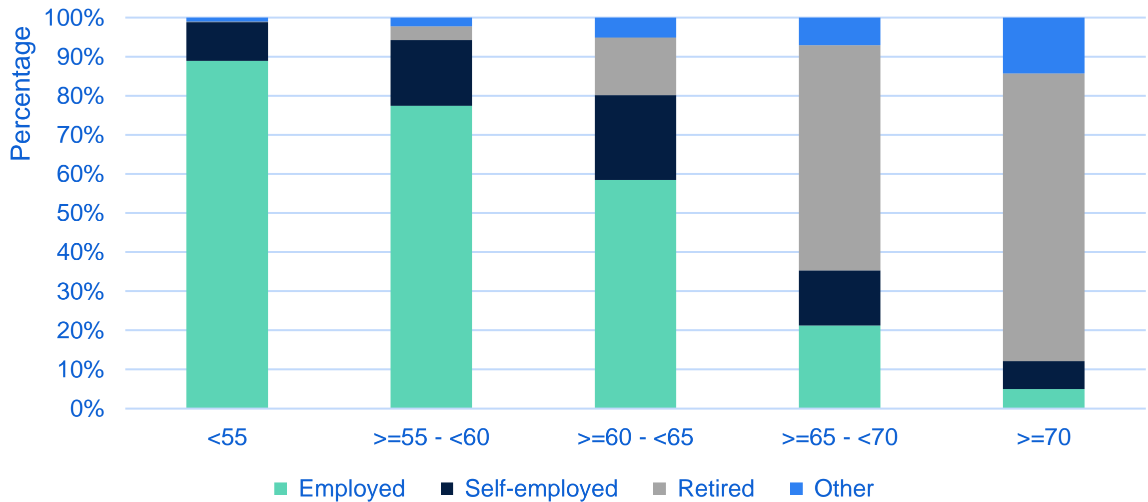
Mortgage lending to older borrowers continues to grow. Volumes of both new lifetime loans as well as new residential loans to over 55s have increased since 2016 (see charts 6 and 7).

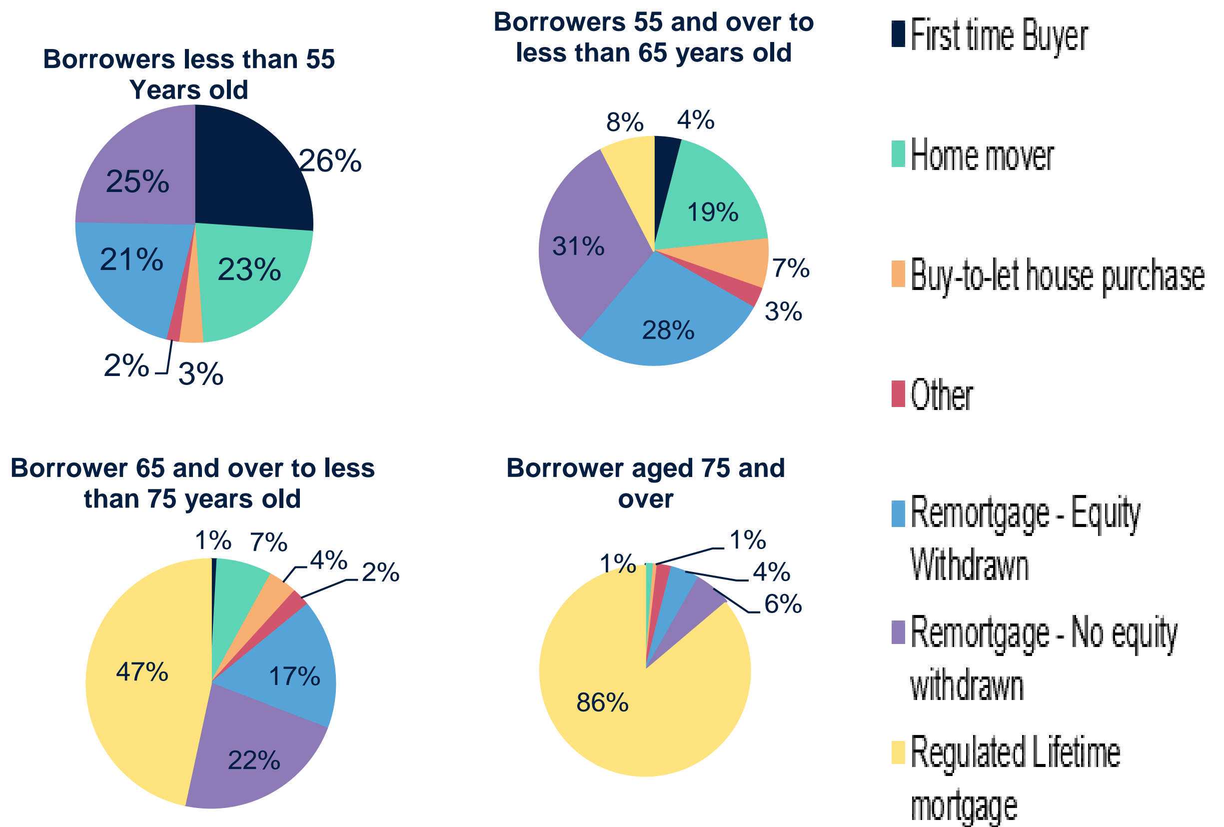




The transition to retirement is taking longer. In quarter 1, 2019, 77.5 per cent of borrowers aged 55 to 60 years were employed, 58.5 per cent of borrowers aged 60 to 65 were employed and 21.3 per cent of borrowers aged 65 to 70 were employed (see chart 8). This shows that people seeking mortgage lending in later life have employment income for longer. The implication is that 'younger' older borrowers have the potential capacity to service loans. Again, we can see that the market is reacting to this demand by looking at the types of loans sought by age group (see chart 9). The behaviours of borrowers aged 75 and over is as expected, with 86 per cent taking a lifetime mortgage. However, younger older borrowers seek a wider array of mortgage products. Only 47 per cent of borrowers 65 to 75 years old bought a lifetime mortgage, 22 per cent sought a simple refinance re-mortgage and 17 per cent sought a re-mortgage with equity withdrawn. The 55 to 65 years old age group have the most diverse needs. 19 per cent are home movers, 28 per cent re-mortgaged with equity withdrawn and 31 per cent sought a simple refinance re-mortgage. Interestingly, a not insignificant amount (four per cent) were first-time buyers.

We are yet to see the effect of Retirement Interest-Only mortgages (RIOs) on the market. While this product could meet the needs of borrowers making a longer transition into retirement, there are regulatory constraints to the wholesale supply of RIOs, discussed in question 4.





Q4: Are there any barriers (including FCA regulatory barriers or barriers to competition) that are adversely affecting access to, and use of, financial products that would meet new and changing consumer needs? Are these affecting particular age groups? If so, in what way? How should we address these while ensuring consumers still receive an appropriate degree of protection?

Consumer Credit

Access To credit

Technological developments are enabling consumers to shop around for products. Price comparison websites can provide consumers with a range of ‘quotations’ from multiple credit providers that have signed up to their site. Lenders will also provide direct quotations and eligibility checks on their own websites or in branches. Increasing digitalisation is therefore helping to increase choice and convenience for consumers across all generations, although it is recognised that this is not available to all consumers who are not digitally enabled.

The speed of lending decision is responding to consumer demand, although the legislative requirements of the Consumer Credit Act have not kept pace with technological change and should be amended as part of the ongoing review into the retained provisions of the Act. To that end, we would cross refer to the detailed response submitted by UK Finance to the review of the retained provisions of the Consumer Credit Act in DP18/17 and the call for change to a less prescriptive regime, which is channel neutral and future proofed to allow for technological and digital developments in the financial services market.

The use of a representative APR across products (and the forthcoming requirement for this to be provided for overdrafts) helps consumers understand the comparable costs of a product. There is a need for the Money and Pension Service to ensure the financial education of consumers to support their understanding of financial products including the cost of credit.

Use of credit information

Credit scoring is a long-established industry practice to deliver responsible lending decisions. Reliable and accurate data is shared with credit reference agencies (CRAs) to support the creditworthiness and affordability assessments. This information can include not only information of the payment history of consumer credit agreements, but also other bills such as rental payments, utility bills and mobile phone contracts.

For those consumers with few consumer credit agreements, inclusion of other household bills helps to increase the understanding of a consumer’s credit history. If consumers are declined for credit based upon automated decisions (credit scoring) the consumer has the right for the decision to be reviewed and to provide additional factual and relevant information to support the appeal.

Increasing data available to those consumers who do not have much information held at the CRAs (known as thin files) would help this customer segment. Access to reliable non-traditional data – such as council tax or HMRC data – has been recommended as part of the work on affordable credit as part of the Financial Inclusion Policy Forum.

The changing nature of income is a factor across all generations, whether this is the fluctuation of income through zero hours working/ the gig economy, or the reduction of income upon entering retirement. These challenges need to be understood and managed by lenders, who can take a long-run view of the consumer’s ability to make sustainable repayments over the term of the product. Where consumers have a reduced income or significant volatility in income, this could lead to a reduction in the number of credit options they can access. This is because lenders have a responsibility to ensure that lending is not known to be unaffordable or could lead to the customer experiencing financial difficulty in the future.

Mortgage lending

Affordability assessments for tenants
In mortgage lending, the changing nature of income across generations could be better reflected in affordability assessments. One example is greater use of rental payments in the income assessment for tenants looking to access mortgages. For younger generations or customers in certain geographical areas, the cost of rental payments may be a barrier to building a suitable deposit despite a reliable income. Although it is not a like-for-like comparison, the cost of servicing a mortgage may be lower than paying rent. The FCA could consider what can be done to place more relevance on good rental payment history along with the wide range of factors considered as part of an affordability assessment. Potential amendments to affordability rules could be explored as part of the FCA's policy statement to CP19/14: Mortgage customers: proposed changes to responsible lending rules and guidance.

Later Life Market
There is an existing body of research into the topic of retirement borrowing or later life lending (e.g. research reports, market commentary, customer insights from lenders). From a review of the literature, a common theme is that the regulatory framework (MCOB) is not structured to meet older customer needs. Having separate parts of MCOB covering lending into and in retirement is driving a siloed approach resulting in a fragmented approach to:

- the advice given to consumers
- the qualifications and training standards required of advisers/brokers
- how products are funded and developed.

This means that the market is at risk of being driven by product specifications, rather than the needs of consumers. More detail on these challenges follows.

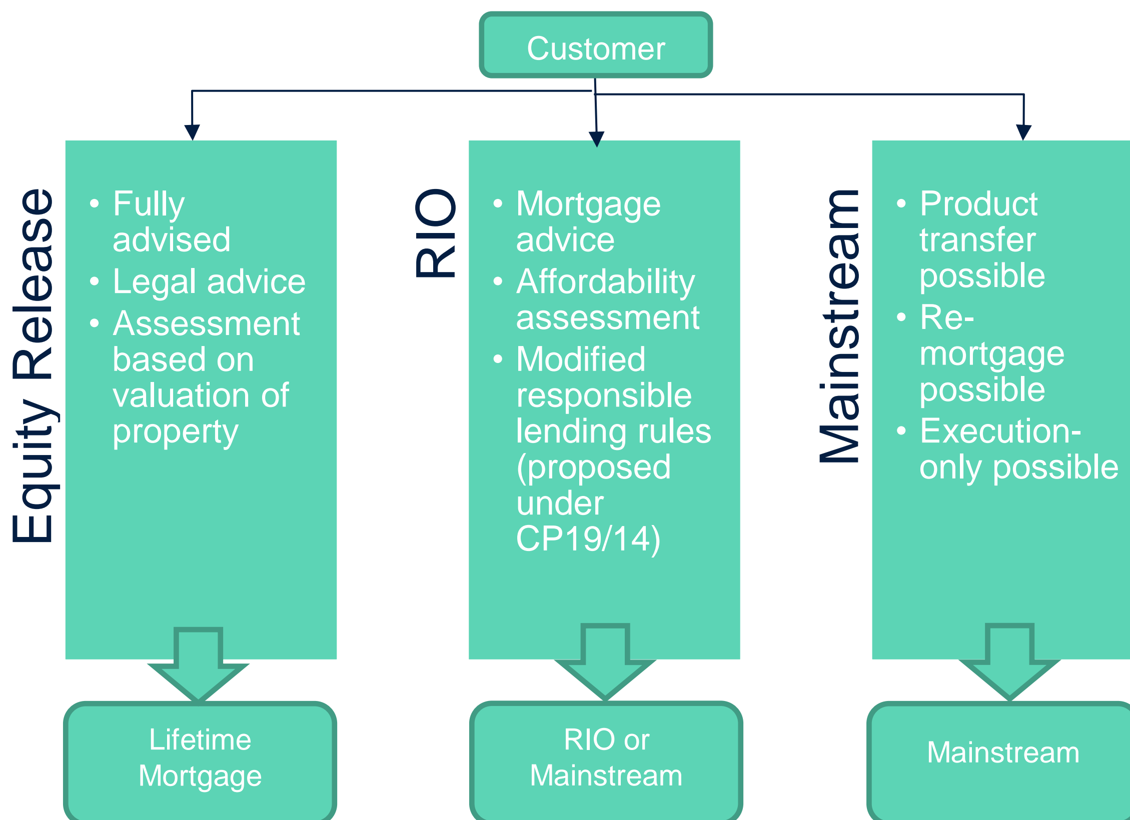
a) Definition of later life lending:

The later life lending market is increasingly siloed. Lifetime mortgages still make up the main form of lending in retirement, with products offered largely by specialist equity release providers. Building societies have largely been the first movers in launching RIO products since the rule changes in March 2018. However, the market has been cautious and, anecdotally, members have indicated that there is a high rate of decline given the required affordability assessment, particularly for joint borrowers. In the same period, many lenders have increased or even removed the maximum age that they will lend to. This means that 'mainstream' products are increasingly available to older borrowers. The FCA and PRA should work together to consider the age restrictions placed on lending into and in retirement and ensure consistency between MCOB and the Building Societies Sourcebook. They should take into account at what age older people can access pension freedoms and will have access to state pension and how this may affect financial decisions. Consumers could, in effect, be making retirement income decisions over a staggered period as they reach each of these access points.

b) Advice structure

Older people transitioning into or at retirement need to make complex financial decisions based on their expectations of longevity and health and some, perhaps limited, understanding of what income can be drawn from their assets. Consumers will be making these decisions with imperfect information and while facing information asymmetry. It is impossible to fully overcome some of these (i.e. customers are likely to be biased in their estimations of longevity and health). At the same time, the advice framework for later life products contributes to complexities for customers in accessing information and promoting consumer choice.

Those seeking to use housing wealth in later life will have differences in experiences based on whether they seek an equity release product, a RIO, or a mainstream mortgage. As illustrated in the diagram below, the advice, affordability assessment and ability to switch varies by product. Notably, it is not apparent from the rules how a customer should be referred on or informed of the availability of other later life products.



The current situation means that consumers are at risk of neither receiving the best product nor the cheapest product for their needs. Older consumers also face a greater likelihood of experiencing vulnerability, whether it be health, cognitive decline, life events or lack of financial literacy. A more holistic advice process and cohesive market would lead to greater protection for consumers and better competition outcomes. In fact, an advice process for later life consumers should include advice on pensions, tax (personal income tax and inheritance tax), benefits, long-term care needs and vulnerability (e.g. need for wills and powers of attorneys).

There are several solutions that the FCA could consider:

1. bringing together the parts of MCOB that relate to lending in later life, for example, incorporating chapter 8 with chapters 4 and 11
2. re-evaluating the adequacy of exam standards required for advisers
   a. Exam standards should have the objective of empowering advisers to fully comprehend the income needs that an older customer presents with and be able to assess if a mortgage product is the most suitable option or whether the customer should be referred to another part of the later life financial services sector
   b. whether they should be a broader later life lending qualification, encompassing all mortgage products available for this market
3. signposting rules for any older customer, so that they are fully informed about the products and types of advice available.

The FCA could consider what role the Money and Pension Service (MaPS) could play to improve customer understanding of later life lending products and what forms of advice are available. MaPS could assist with better signposting to other forms of retirement income advice to aid customers with these complex decisions.

c) Funding models – a barrier to innovation

Insurers and pension funds are more likely to fund later life products, particularly lifetime mortgages. However, increased scrutiny by the PRA on the parts of Solvency II that incentivises insurers to fund lifetime mortgages could have the effect of dampening this new source of funding.

Insurers who originate lifetime mortgages have a competitive advantage in the later life market, as they have a more direct relationship between funding investment needs and product design. Originators who rely on multiple funders to drive diversification of product offering face the risk of being constrained by both appetite of, and access to, funding. While, as argued earlier, we see that the products available do respond to consumer demand, it is unclear how responsive and deep this market is. The requirements that funders place on lenders could limit product flexibility or appetite to take on customers across a varied risk profile. It seems reasonable to anticipate that the types of products and loan-to-values offered in later life will need to adapt, due to longer transitions to retirement and the likelihood that younger generations will reach later life with existing mortgages and lower levels of wealth and equity.

One solution is for the regulators to consider how other lenders may enter into this market. Many building societies are constrained by Sourcebook limits for lending into and in retirement. Put simply, the expectation that only those societies capable of operating on the Comprehensive approach (PRA SS20/15) can offer lifetime mortgage products works as an insurmountable regulatory barrier. This creates an unequal playing field, where societies can offer RIOs (again within the Sourcebook funding limits) but not lifetime mortgages. This in turn means that customers may not get the right outcome.

d) RIO – affordability assessment

As indicated earlier, RIOs are yet to disrupt the market. It is apparent that there are RIO products being offered, however, evidence provided by members indicates that the affordability assessment is restricting consumer access.

Evidence provided by one lender, using aggregated insight from around 3000 older customers seeking a retirement lending product (not product specific) shows that on average, the typical second life income is £15,145. This means that average second life income is below the market minimum. To further illustrate, the average second life loan-to-income sought is 10.6 times income. This is driving a high rate of declines due to affordability. 72.7 per cent of customer applications were declined due to insufficient income at the start (n=60). A further 9.1 per cent of customers are declined due to insufficient income post-retirement. Declines are also gendered, with 23.4 per cent of applications declined being single females (n=95). This demonstrates that proving affordability is a significant challenge, a challenge that could possibly grow as younger generations reach later life with lower levels of wealth.

It is useful for the FCA to consider how changing levels of wealth across generations will impact on access to lending products in the future. This includes weighing up responsible

lending against affordability requirements. One such option could be a RIO with the ability to pay down capital.

Q5: Is there anything more that we could do to encourage and enable positive innovation in these sectors, or to enhance competition in the interests of consumers?

Intergenerational transfer of wealth:
Some of our members offer guarantor mortgages. This is where a parent or close family member takes on some of the risk of the mortgage by acting as a guarantor. There is a variety of guarantor mortgages:

- some lenders offer mortgages where a family member deposits cash in a special savings account that is held as security for a set number of years or until the LTV decreases
- a family member can offer their property as security
- family offset mortgages where the family member puts their savings into an account linked to the mortgage and this amount is deducted from the amount of the loan that interest is paid on.

These mortgages can help first-time buyers access lower loan-to-value mortgages or 100 per cent mortgages, reducing the need to save a deposit. These mortgages rely on parents with housing wealth who are able (and willing) to make transfers to younger generations, as described earlier.

In the personal loan market, for consumers with a poor credit history (who consequently might attract a higher rate of interest for a loan offer even though the repayments are affordable) the provision of a guarantor can help to reduce their borrowing costs. In some circumstances this intergenerational support (parents guaranteeing children) can help consumers access cheaper credit (the costs to the lender of credit losses potentially being reduced where a third party of good credit standing is guaranteeing the repayments), although the legal obligations of the guarantor must be clearly understood.

The FCA should consider how regulation can support product development across lending products.

Q6: Is there any market or firm behaviour that causes or may cause potential harm to consumers? For example, is industry failing to recognise varying needs of consumers from different age groups and as a consequence of this:

a) **Offering products which may be unsuitable to certain age groups**
b) **Excluding, discriminating against, or failing to advance equal opportunity between certain age groups for no legitimate and objectively justifiable commercial reason (or where the reason is potentially legitimate but the approach is not proportionate)**
c) **Otherwise treating certain age groups unfairly?**

Peer-to-peer home finance
As per our response to CP18/2, peer-to-peer platforms need to be fully compliant with MCOB and have the appropriate lending authorisations. We were pleased that for the most part the FCA had taken this on board and therefore we were able to support most of the proposals in CP18/2. Specifically, that the FCA will require P2P platforms to meet the same standards of consumer protection and regulatory reporting as other authorised mortgage lenders.
However, there were two areas where we felt that the proposals would put existing lenders at a competitive disadvantage: the provision of a KFI+ instead of an ESIS and the level of capital requirement. These concerns would remain if peer-to-peer home finance played a bigger role in the housing market in the future.

Personal Loans
Maximum ages are not advertised by most lenders. The ability to service a loan should not be driven by age, rather income. Age is allowable as a characteristic in the scorecard, so a high age could mean access to credit is harder. However, if an older consumer had income (from employment or pension), it seems reasonable that they could service a personal loan.

Credit Cards
Firms adopt existing customer management strategies. When a customer experiences a sustained drop in income, such as in retirement, firms might review the credit card limit offered to ensure that it is appropriate.

Q7: Are there areas related to intergenerational issues which fall more appropriately to government or another public body, but in which, in accordance with our objectives, we can play a role? If so, which ones and in what way?

Supporting no-interest loan products
For major purchases made by way of a personal loan or motor finance loan, the interest rate is typically fixed for the duration of the loan at the point the loan is taken out. This provides certainty to the customer that their repayments will not change during the term of the loan.

The cost of credit will reflect the recovery of the costs in setting up the loan, the costs of funds and the credit risk of the consumer not repaying. For short term and low value borrowing, the fixed costs will need to be recovered over a truncated period and could represent a significant amount relative to the borrowed amount. Whilst streamlined processes are adopted to make the process as accurate and efficient as possible, these are the economic realities of providing the product. The FCA has intervened in markets where it has identified that the costs of credit (or the business models) are creating harm. For consumers who cannot access commercial credit, but could demonstrate repayment of loan principal, the provision of a social policy for no-interest loans is being explored. HM Treasury has commissioned a feasibility study into a no-interest loan product. It would be useful for the FCA to engage with HMT on this work once the outcomes are known.

Contact
Should you have any questions about the content of this consultation response, please contact Sonia Fernandes, Manager, Mortgages at sonia.fernandes@ukfinance.org.uk