Retirement Interest Only Mortgages (RIOM)

UK Finance response to the FCA Consultation CP17/32: 9 Retirement interest only mortgages

1 November 2017

Introduction

UK Finance is a trade association formed in July 2017 to represent the finance and banking industry operating in the UK. It represents around 300 firms in the UK providing credit, banking, markets and payment-related services. The new organisation brings together most of the activities previously carried out by the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association. For any queries in relation to this response, please contact june.deasy@ukfinance.org.uk

Executive summary

UK Finance remains committed to working with our members, wider industry, government, regulators and consumer groups to address the challenges and opportunities presented by an ageing population. Our response to this consultation centres around the following four aspects:

- Eligibility and scope;
- Advice provision (or lack of);
- Disclosure requirements;
- Risk and pricing considerations.

Eligibility and Scope

Age criteria

We presume that decisions on age criteria will be left to individual lenders. However, working on the basis that RIOMs would be available from aged 55, having an open-ended interest only maturity for potentially 35 years with an RIOM brings implications for funding, pricing and advice, as detailed in the following sections.

We also understand that it would be up to lenders to decide when they would wish to engage with customers to consider a RIOM; not solely at end of term, for example.

Backbook and new customer eligibility – avoiding unintended consequences

We understand that RIOMs are intended to be made available to both existing (with the ability to take out additional borrowing) and new customers; and that offering this product is an option for lenders where it fits with their risk appetites, not an obligation.

We would, however, wish to avoid the scenario where existing interest-only customers with the means to repay have an expectation that they should be able to convert their expired interest-only mortgage into a RIOM. Lenders' legal right for repayment of interest-only mortgages at end of term should not be impacted by the RIOM proposals.

LTV limits

There is no mention in the consultation of LTV limits. In terms of managing customer expectations, RIOMs may not be suitable for certain customers. For example, customers on high LTVs with properties in a poor state of repair would present increased lending risk / potential for loan losses; exacerbated if house prices were to fall.

Option to transition to a lifetime mortgage?

We should welcome confirmation of whether the proposals envisage an option to move from a RIOM to a lifetime mortgage – this is not currently available between traditional mainstream and lifetime mortgages. We acknowledge the FCA's intention for RIOMs to be available on a 'standalone' basis.

Affordability considerations

As a RIOM customer will have to service the interest until a specified life event, we presume that MCOB affordability requirements will consider both the customer's current circumstances and known future changes to income and expenditure.

Current rules require consideration of "reasonably foreseeable changes" when assessing affordability. Given that repayment is due when the last party dies or enters long term care, it is arguably entirely foreseeable in joint cases that one party will be left to afford the payments alone (and possibly care fees). Does the FCA have any insight into the number of customers at risk of not being able to afford on-going payments at this juncture?

Advice provision

Older people make complex, often inter-related decisions about a range of financial services products, from pensions, wealth management and mainstream mortgages, to equity release. This is reflected in CP17/32, which states that in considering whether a retirement interest-only mortgage that will be used to draw income is appropriate to the needs and circumstances of the customer for the purposes of MCOB 4.7A.2R, a firm must consider, in addition to the factors set out in MCOB 4.7A.6R, whether the benefits to the customer outweigh any adverse effect on the customer's entitlement to means-tested benefits and tax allowances. We note that this could extend to inheritance tax planning considerations as well.

Given the complexity of decisions being made, we query whether the RIOM is suitable to be provided on an execution-only basis. We should also welcome some guidance from the FCA on the circumstances where RIOMs could be offered without advice – for example, no additional lending, or product transfer?

Customers who may wish to have a RIOM could potentially have their needs better served by other means, via a lifetime mortgage or downsizing, for example. This could particularly be the case should their circumstances change during the life of the RIOM – death of a spouse reducing income, or care costs, for example. Promoting consumer awareness and understanding of the different features of a RIOM compared to a lifetime mortgage (including the latter allowing interest roll-up and offering protection against repossession) would be welcome.

The complexities and associated potential consequences also raise the question of whether independent legal advice should be sought by potential RIOM customers – as is currently required for lifetime mortgages.

A key finding of our recent commissioned research was the need to adopt a more joined up approach to delivering information and advice to older borrowers. We recommend that the new single financial guidance body (SFGB), due to be introduced from Autumn 2018, should explore ways of increasing the provision of and signposting to fuller information sources available to older consumers. Crucially, this needs to be integrated with pension guidance.

Disclosure requirements

We presume that the FCA would have to amend MCOB to reflect the changes that will be required to Total Amount Payable (TAP) disclosure in the KFI+ / ESIS, given that RIOMs will have no end date.

We understand that RIOMs would most likely be treated as new mortgage contracts, with new terms and conditions, but that the FCA is not ruling out the possibility for them to be treated as a contract variation. As only a new product/ contract would trigger the production of an illustration disclosing the key risks of a RIOM, consideration should be given to the disclosure requirements for contract variations, and for those entering a RIOM as a result of forbearance. Particularly as interest roll-up will not be a feature of a RIOM, meaning customers facing affordability challenges and finding themselves in arrears could still face repossession.

We also recommend the inclusion of a reminder in annual mortgage statements to review finances, as we view such a prompt as being of general benefit to customers, regardless of circumstance. We understand that specific reference to the customer having sufficient savings to repay the loan would be inappropriate for a RIOM, however.

Risk and Pricing considerations

From the customer risk perspective, as noted above, unlike an equity release product which caters for customer affordability challenges in later years – via the interest roll-up option and a “no negative equity” guarantee – a RIOM would still carry the risk of repossession.

In terms of lender risk, the uncertain / open-ended nature of RIOMs will necessitate additional funding and operating costs, including staff training for more complex cases, to administer not only the mortgage, but also deal with the long process involved in the sale of the asset on death (including dealing with the rights of remaining dwellers in the property, for example); or moving to long term care.

The nature of a RIOM will mean lenders having to take mortality and actuarial risk into account in their modelling and pricing.

A joined-up approach

We ask the FCA to work closely with PRA colleagues to come to a consistent view on the suitability of RIOMs as an option for lenders and their customers – from both conduct and prudential perspectives.

Similarly, we ask the FCA to liaise closely with FOS on the proposals, to better ensure understanding from all sides in terms of interpretation, objectives and scope. We would wish to avoid a scenario where RIOMs could be perceived as a ‘panacea’ for all maturing interest-only cases with no means of repayment, for example.