



# **European Commission Green Paper on Mortgage Credit in the EU**

## **Norwich Union Response**

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## 1 Introduction

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Norwich Union welcomes the opportunity to provide the European Commission with input for its work on mortgage credit in the EU. We are the largest provider of lifetime mortgages and home reversion plans in the UK and are, therefore, looking at this consultation from a particular angle: equity release for elderly homeowners.

The ageing UK population is creating significant concerns for future pension provision and state benefits. The savings gap has grown to £27billion and new solutions are needed to ensure retiring people are able to make their retirement years as comfortable as possible.

Equity release enables older people to unlock the wealth built up in their property to create extra cash to spend as they choose, enhancing customers' options to fund their retirement.

The needs of the ever-growing retirement market are changing. This is driven by many different factors, including increased life expectancy, increased house price inflation, less predictable equity returns, increases in annuity costs and higher expectations of retirement. As a result, pre-retired and post-retired consumers have to look across all their assets when deciding how to fund their retirement. In the UK, the ability to tap into the equity tied up in their home will be an important factor, as most retired consumers will have more capital tied up in their property than the value of all their other assets combined.

The two main types of equity release plans in the UK are lifetime mortgages and home reversion plans:

### 1.1 Lifetime mortgages – circa 95% of new business

When customers opt for this type of plan they agree to take out a loan based on the value of their home. The loan is secured on the property and provides them with cash to spend as they choose in the form of a lump sum or income stream. These loans are usually designed for homeowners aged 55 and over.

There are no monthly repayments to be made – the interest due on the loan rolls up each year and is repaid when the home is finally sold, usually when the customer moves into long-term residential care or after their death. Most consumers opt for a plan where the interest rate is fixed or capped so that they know the maximum amount of interest that can be added each year.

### 1.2 Home reversion plans – circa 5% of new business

A home reversion plan enables a homeowner to sell part, or all, of their home in return for a cash lump sum payment. Customers retain the right to continue living in their home for the rest of their life but when the home is sold, the provider receives the same proportion of the sale proceeds as originally sold to them. The reversion

provider owns the whole property, but the customer may retain a beneficial interest in a share of it and will have a lifetime lease.

### 1.3 Lifetime mortgages vs. home reversion plans

#### Similarities

- Both products enable older people to release cash from their home now and in the future, with no regular repayment. They have a right of residence for life or until they require permanent long-term care.
- Both products meet the same core consumer need for extra cash in retirement.

#### Differences

Lifetime Mortgage (LTM)	Home Reversion Plan (HRP)
<ul style="list-style-type: none"> <li>• Regulated by the Financial Services Authority (FSA)</li> </ul>	<ul style="list-style-type: none"> <li>• Not regulated by the Financial Services Authority yet (expected in 2007)</li> <li>• Self regulated by the industry body SHIP's<sup>1</sup> Code of Conduct</li> </ul>
<ul style="list-style-type: none"> <li>• Customer retains ownership of home</li> </ul>	<ul style="list-style-type: none"> <li>• Reversion provider owns home</li> </ul>
<ul style="list-style-type: none"> <li>• Customer borrows money offering the equity in their house as security through a mortgage</li> </ul>	<ul style="list-style-type: none"> <li>• Customer gives up ownership of all or part of property but retains the right of residence at no rental, or a nominal rent</li> </ul>
<ul style="list-style-type: none"> <li>• No-negative equity guarantee protects consumers from leaving debt to family or estate</li> </ul>	<ul style="list-style-type: none"> <li>• Customer retains a beneficial interest in any value of the property not sold, and can therefore guarantee inheritance</li> </ul>
<ul style="list-style-type: none"> <li>• Loan amount is based on lenders underwriting criteria, generally based on age</li> </ul>	<ul style="list-style-type: none"> <li>• Cash amount paid to customer based on underwriting criteria</li> </ul>
<ul style="list-style-type: none"> <li>• Interest is compounded monthly or annually at current interest rates, i.e. debt doubles every 12 years)</li> <li>• LTM can be indexed-linked, capped/variable or fixed rate</li> </ul>	<ul style="list-style-type: none"> <li>• Cash paid for the percentage sold will be less than the open market value, as the customer can live in the property rent free for life</li> </ul>
<ul style="list-style-type: none"> <li>• Lender cannot seek repayment until death/long term care of borrower</li> </ul>	<ul style="list-style-type: none"> <li>• Reversion provider cannot dispose of the asset until death/long term care of seller</li> </ul>

<sup>1</sup> Safe Home Income Plans (SHIP) was created by the leading providers of home income and equity release plans in 1991. SHIP is dedicated entirely to the protection of plan holders and promotion of safe home income and equity release plans. <http://www.ship-ltd.org>. Norwich Union is a member of SHIP.

## 2 Executive summary

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Norwich Union fully agrees with the Commission that equity release products need to be assessed carefully from a regulatory perspective, both to ensure that proper consumer protection safeguards are in place and to analyse their potential benefits. We strongly believe that our products play an important role in supplementing current and future pensions financing needs. Equity release can help mitigate some of the most pressing problems of our ageing society such as pensioner poverty.

In the UK, Norwich Union has been at the forefront of lobbying for mortgage regulation to apply across the whole equity release market – both lifetime mortgages and home reversion plans.

We welcomed the Government's decision to bring lifetime mortgages under UK regulation in 2004 and are looking forward to draft legislation on home reversion plans, which is expected to come into force in 2007. A fully regulated market is essential to ensure that product choice is based on *suitability*, not simply on whether the product is regulated or not.

Unless there is a clear business case for mortgage integration, Norwich Union does not believe that cross border integration and regulation will be beneficial to European consumers. Equity release products are particularly localised and dependent on country specific market factors, such as pension provision and the strength of the housing market. An in-depth assessment of national markets and cost-benefit analysis needs to be carried out to establish the business case.

If this consultation does lead to legislation, Norwich Union believes that equity release products need special consideration within the plans for EU mortgage integration. Consumers who get advice on a lifetime mortgage have different needs to those getting advice on a standard residential mortgage. This is because of the unique implications of drawing down capital from equity in the home, such as its impact on taxation, state benefits and inheritance. In the UK the law requires that these factors are taken into consideration during the advice process. Moreover, alternative solutions for the customer to raise the money must also be explored by the adviser, for example the option to sell the home and buy a cheaper property, or a home reversion plan, or the use of savings.

Currently, the sale of equity release products is only prevalent in the UK, though we understand there are also a small number of equity release customers in Ireland. Interest has been shown by Aviva subsidiaries in the Netherlands and Spain. Aviva Spain has launched equity release products, but feedback from Delta Lloyd in the Netherlands is that the current potential market is too small to warrant product and market development.

Norwich Union has no current ambition to enter into cross-border equity release trade. It is more likely that we would assist Aviva subsidiaries in other countries to develop their products with the local knowledge and networks that we believe would be required for each individual market.

### 3 The UK market

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The Institute of Actuaries estimates that homeowners aged 65 and over in the UK have over £1,100 billion of un-mortgaged equity tied up in their homes – even though nearly half of all single pensioners are dependent on state benefits.

Older homeowners borrowed £1,192 million in the form of equity release mortgages during 2004. Despite significant recent growth, the UK market remains underdeveloped and an area of great potential. This market has historically been the territory of specialist property and niche lending companies but is now being claimed by significant financial services brands such as Northern Rock, Standard Life, Prudential and Norwich Union.

Norwich Union is the market leading equity release provider with a market share of 34% (source: SHIP Q3 2005), and since 1998 it has lent over £2 billion through a range of lifetime mortgage products. In April 2005, Norwich Union introduced a home reversion plan with innovative guarantees protecting consumers from key risks.

The main changes in the equity release market over the past 12 months have been twofold: firstly, the regulation of lifetime mortgages in October 2004; secondly, increasing competition and, as a result, product innovation.

#### *Regulation*

Regulation of lifetime mortgages was included within the general regulation of mortgages by the Financial Services Authority in 2004. Mortgage regulation introduced common standards across the sales processes and the governance of regulated business. It also introduced referral rights to customers who can appeal to the Financial Services Ombudsman if they are unhappy about the response to a complaint they had received from the product provider or adviser.

It was recognised within this regulation that customers who get advice on a lifetime mortgage have different needs to those getting advice on a standard residential mortgage. This is because of the unique implications of drawing down capital from equity in the home, such as impacts on taxation, impacts on state benefits and impacts on inheritance. The law requires that these factors are taken into consideration by the adviser. Moreover, alternative solutions must be considered, for example selling the home and buying a cheaper property, home reversion or the use of savings.

Norwich Union welcomed the decision to bring lifetime mortgages into a regulated environment. For our customers, and indeed for us, it is of utmost importance to have an appropriate regulatory environment in place, guarding against mis-selling, which could severely damage this developing market.

Although home reversion plans are not currently regulated, the UK Government has stated that it will start the consultation process early in 2006 with regulation planned for early 2007. As with mortgage regulation, it is expected this will introduce common standards across advisers and providers, strict governance for regulated business and referral rights for customers to the Financial Services Ombudsman.

### ***Increasing competition***

Increasing competition has been a dominant factor over the last 12 months. This can be shown by the number of new competitors who have entered the market, the sharp decrease in product interest rates and the range of new products that have been launched. Norwich Union sees this as a very positive development, since these changes respond to consumer demand, offer greater value and choice and are likely to further fuel growth.

## 4 Response to the Green Paper

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The fundamental difference between conventional mortgages and equity release products is that the customer is drawing on an asset rather than accumulating one.

As equity release products are targeted at people over the age of 55 whose homes are likely to be their largest asset, high levels of consumer protection are required to encourage consumer confidence.

For this reason, Norwich Union believes if European mortgage integration and regulation is progressed, equity release products will require a tailored treatment. As in the UK, the sales and advice process would need special regulation to ensure that alternative methods of raising capital are reviewed during the advice process; that the impact on tax and benefits is fully explained; and that the impact on inheritance and the estate is made clear.

Below, we have answered the questions from the Green Paper that were most relevant to us from an equity release perspective.

### 4.1 Information

#### *Should the Code of Conduct be replaced?*

Norwich Union has not implemented the Code of Conduct, mainly because all requirements within the Code are already requirements under UK mortgage regulation, with the only difference being the format in which the information is presented to customers.

However, we recognise that lifetime mortgages present a very special case. For conventional mortgages, the Code is a good basis for an EU initiative.

### 4.2 Advice provision and credit intermediation

#### *Should the provision of advice to the borrower be made compulsory or be a matter of choice?*

Due to the fact that the lifetime mortgage market is still in an embryonic phase, it is difficult to predict the level of advice that will be necessary for future product developments. .

Currently in the UK, the Mortgage Code of Business (MCOB) sets out specific rules for the advice process for selling lifetime mortgages. This does not cover home reversion plans but the Financial Services Authority is currently drafting legislation to cover these plans, which should be in force by November 2007.

Under the MCOB, the sales advice process has to cover the following elements: gathering general information about the client; checking alternative sources of funds (other than releasing equity from home); clarifying the purpose of the loan, clarifying property and income details; the assessment of risk and product factors relating to

customer's circumstances and, finally, the recommendation of the most suitable course of action.

***Should conditions be applied to any advice actually provided, whether under a duty or by choice (e.g. standards for the advice, sanction for non-compliance, advance disclosures of fees, of the adviser's role and recording on durable medium)?***

As the market leading equity release provider, Norwich Union worked with UK regulators in the development of mortgage regulation. Norwich Union strongly believes that the approach taken with lifetime mortgages within mortgage regulation offers consumers a high level of protection. It ensures that key areas are covered, with full disclosure of costs, risks, as well as benefits, and that advice given focuses not just on product choice but also on whether a lifetime mortgage is the most suitable solution for the customer.

The fact that home reversion plans are currently not covered is a major gap in UK regulation of equity release products. However, we welcome the UK Government's announcement to regulate these plans in 2007 and look forward to engaging in the consultation process. We feel a fully regulated market is essential to ensure that product choice is based on suitability not whether the product is regulated.

#### **4.3 Early repayment**

***Should early repayment be a legal right or a matter of choice? If it is to be a right, should it also be made possible for a consumer to waive this right? Under what conditions? Should this right be subject to compensation in the form of fees?***

Norwich Union strongly believes that customers should retain the right to repay their home reversion plan or lifetime mortgage. In general, customers expect to retain the equity release product until they leave the property upon death or when the customer moves into long-term residential care. Although the average term is approximately 15 years, this could be over 30 years. Given a customer's circumstances can and will change over this time, Norwich Union believes a customer should always retain the right to repay.

However, product providers need to retain the right to make a reasonable charge for early repayment to compensate for breakage costs. This charge, how it is calculated and what its maximum could be, should be explained in detail to customers before they enter into the contract.

***How should such fees (whether under a right or through contractual choice) be calculated? Should there be caps, as is the case in Member States?***

Any cap could be detrimental to the long-term development of the lifetime mortgage market. Norwich Union does not believe there should be a cap, due to the potential financial significance of the long-term, fixed characteristics of lifetime mortgages, which make the issue far more acute than on residential mortgages. However, we do feel that any potential maximum charge should be highlighted to customers before entering into the contract.

### ***How should the consumer be informed about early repayment? Is there scope for consumer education here?***

As a guiding principle, the Financial Services Authority requires that all customer communications are clear, fair and not misleading. Mortgage regulation in the UK requires that certain facts are included in the “Key Facts Illustration”, which is given to the customer during the advice process. These are:

- An explanation of *whether* an early repayment charge is payable
- An explanation of *when* early repayment charges are payable
- An explanation of any other fees payable if repaid early and the current level of these fees, e.g. an administration fee
- A basic explanation of the basis on which early repayment charges are calculated
- Example cash amounts of any early repayment charges indicating the range of charges that apply over the period
- The maximum early repayment charge plus the cost of any other fees

#### **4.4 Annual Percentage Rate of Charge**

##### ***What is the purpose of an APR? Information? Comparison? Both?***

The purpose of an APR is both comparison and information. The main advantage is that it highlights potential extra costs. However, to provide a fair comparison, the assumptions made in the calculation must be the same across the industry. In the case of equity release, for instance, APR needs to be based on the same criteria, either the same mortality rates, or the same period of time.

#### **4.5 Usury rules and interest rate variation**

##### ***What are the implications of usury rules for market integration (including any relationship with products such as equity release and mortgage insurance)?***

Interest rates on lifetime mortgages are generally slightly higher than standard residential mortgage interest rates. This is due to the additional funding and risk costs associated with lifetime mortgages.

We provide open-ended fixed interest rate or capped rate mortgage contracts where the term is unknown and which can run for over 30 years. Additionally, the product provider accepts house price risk linked to the “no-negative equity guarantee”, i.e. a guarantee that, whatever happens, a customer will never have to pay back more than the sale price of their home.

The impact of usury rules on lifetime mortgages depends on where any cap is set. Unless the cap is set very low Norwich Union does not feel that usury rules will impact on lifetime mortgage interest rates.

It is assumed usury rules would not affect home reversion plans.

### ***Do such restrictions hinder market integration?***

Restrictions on the imposition of compound interest rates imposed by some member states would severely hinder market integration. Compounding interest rates is core to the lifetime mortgage and it could not operate in a market where this was restricted, because it would not be possible to deliver to consumers the core benefit of releasing cash without incurring any monthly repayments.

### ***What impact can they have on the development of particular products such as equity release products?***

It is difficult to predict the impact of usury rules on future product developments. However, any rules that cap certain elements of a product are likely to restrict future development in some way.

## **4.6 Tax**

### ***The Commission seeks information on similar or other tax obstacles to the cross-border provision of mortgages, which are likely to infringe the freedoms provided for by EU law.***

In the UK, there are two key areas of taxation that impact on equity release products: inheritance Tax and social security benefits.

When leaving property as part of an inheritance, there is a fixed threshold above which inheritance tax is paid to the Treasury. Releasing equity in a property during the citizen's lifetime may avoid this.

Social security benefits can also be affected by equity release. If a customer is in receipt of a means-tested benefit, they may lose some of that benefit when they release a cash lump sum from their property. If regular income is being drawn down from the equity in a property it can also impact on benefits. This is why the advice process has to cover these areas during the sales process.

It is clear that other European countries will have their own specific tax laws that will affect equity release products; therefore this is an issue that will have to be looked at in depth when considering mortgage integration.

## **4.7 Funding of mortgage credit**

### ***The Commission intends to create an ad hoc stakeholders working group to examine the need for and nature of action on the funding aspects (primary and secondary) of mortgage credit.***

Norwich Union would support a stakeholders working group.

***It is interested to assess to what extent a pan-European market in mortgage funding can be promoted by market led initiatives e.g. on documentation standards and model definitions to be used in cross-border funding activities.***

The capital markets currently provide a significant source of mortgage funding for Norwich Union, with investors from across Europe providing funds as part of our securitisation programme. Securitisation offers Norwich Union access to a large and diverse pan-European investor base. Standardising documentation and definitions would not provide significant benefits without the necessary standardisation of legal, regulatory and taxation frameworks across Europe.

***In this respect the Commission is interested to receive views on whether mortgage lending should necessarily be an activity which is restricted to credit institutions, or whether and under which conditions such activity could be performed by institutions which do not take deposits or repayable sums, and therefore do not fall within the scope of the EU definition of a credit institution and therefore of all related prudential rules.***

In Norwich Union's opinion it is not necessary to be a credit institution to be a mortgage lender, but providers must be properly regulated. Only FSA-regulated companies are allowed to sell lifetime mortgage products in the UK, a situation which Norwich Union strongly believes should continue. Consumer protection is of paramount concern, and it is important that firms must operate within a regulatory framework.

Norwich Union believes that it is the activity that should be regulated, not the provider, but there needs to be assurance that the provider can deliver against its promises.

## 5 Facts about Norwich Union

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- Norwich Union, the UK's largest insurance company, is part of the pan-European insurance group Aviva, which was created by the merger between CGU and Norwich Union in 2000.
- Aviva is the largest life and pension provider in Europe and the world's sixth-largest insurer. Its main activities are long-term savings, fund management and general insurance.
- Aviva has more than £291 billion in global assets under management and 30 million customers worldwide. It generates 90% of its business in Europe, where it is represented in 14 countries.
- Norwich Union is the UK's largest provider of life, pensions and investment products and has £102 billion assets under management.
- Norwich Union is the UK's top provider of lifetime mortgages, with a total market share of more than 34% in the year 2005 (Source: SHIP Q3 2005).

## 6 Contact details

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For further information, please contact:

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