

Institute and Faculty of Actuaries

Regulatory Board

Steer report

Subject	Regulatory risk deep dive on Equity Release Mortgages (ERM)
Regulatory Board meeting	27 July 2021
Previous Board Update/Steer/Approval	This topic is on the Board's Horizon Scanning Register and has been discussed a number of times. The Board suggested that a deep dive on this risk will provide them with an opportunity to discuss a number of issues/developments that are of regulatory interest
International Issues Considered	Although this covers aspects relevant to international members, the key focus of the paper is related to UK matters.
Author	IFoA Executive
Purpose	Steer

A: Executive summary

1. The Regulatory Board's ('the Board') Horizon Scanning Register contains the following risk:

"Role of actuaries in advising on ERM product design and/or key very long-term assumptions/modelling (e.g. longevity, 'no negative equity' guarantees and climate risk). There is a risk of poor pricing outcomes for consumers and/or poor economic outcomes for product providers, as well as reputational risks for the profession."
2. The Board suggested that a 'deep dive' of this risk would provide an opportunity to discuss a number of issues/developments that are of regulatory public interest (the Board previously discussed ERM at March and May 2019 meetings with no specific issues taken forward at that time).
3. This paper provides background information, as well as some key issues for the Board to consider.
4. Raj Saundh, Chair of the IFoA Equity Release Mortgages Working Party, has been invited to the meeting to provide background into the activities of the working party and wider industry context.

B: Discussion

5. **Background**
 - 5.1 The Board has previously looked at the risks for consumers around Equity Release Mortgages (ERMs) and, in particular, the role of actuaries in developing these products and the extent to which they are (or ought to be) involved in the communication about the implications and consequences of these products.
 - 5.2 There have been various developments by relevant regulators and by industry in relation to ERMs over the last few years. Those are discussed further below.

6. Regulatory and industry activity

- 5.1 Current key market statistics¹ indicate that something in the order of £4bn of equity was released through these products during each of 2018-2020. Around 60% of products are drawdown plans, with average initial loan amounts of c. £80k. For lump sum products the average loan amount is c. £100k.
- 5.2 The PRA published Supervisory Statements [SS3/17](#) in 2017, with updates in 2019 and 2020. This set out regulatory expectations for the treatment of ERM for Solvency II purposes (see also PS31/18 and PS19/19), which came into force as at 31/12/2019. In particular the concept of the Effective Value Test (EVT) was introduced as a means of ensuring that firms did not take undue matching adjustment benefit for restructured ERM assets.
- 5.3 Following submissions by relevant firms to the PRA since the introduction of this approach, a [“Dear Chief Actuary” feedback letter](#) was published by the PRA in March 2021, setting out points of clarification and areas where increased consistency is being sought.
- 5.4 The FCA carried out some investigative work in relation to the activities of mortgage advisers for later life lending. This resulted in key findings released in June 2020: [“The equity release sales and advice process”](#), with guidance for both advisers and consumers, in particular it flagged the importance that advice reflects the needs and circumstances of the individual. The FCA will be undertaking further work to review the suitability of advice in this market.
- 5.5 In the JFAR’s Risk Perspective (including in the most recent 2020/2021 refresh), Equity Release Mortgages are mentioned as part of the “Unfair outcomes for individuals” and “Geo-political, legislative, and regulatory risk” hotspots. In addition to describing PRA and FCA activity, the Risk Perspective highlights the risk of consumers not having full understanding of the impact of compound interest roll-up within equity release products.
- 5.6 The [Equity Release Council](#) is an industry body which sets principles which all members must follow. This includes the requirement that all products must include an NNEG.

7. IFoA Policy and wider activity

- 6.1 The IFoA submitted responses to PRA consultations CP13/18 and CP7/19 (precursors to PS31/18 and PS19/19), which informed the eventual finalised supervisory statement SS3/17 relating to the Solvency II treatment of ERM assets.
- 6.2 The ERM working party has also been active in this area, including issuing a call for model outputs (in June 2021). The May Actuary magazine also featured [an article](#) from members of the working party.
- 6.3 There has been significant debate within the IFoA around valuation methods and in particular how the NNEG is assessed, this included an ARC research project with associated published paper in 2019 (which was subject to a previous Board discussion in 2019).

8. AMS Thematic Review on Equity Release Mortgages

- 7.1 As the Board will be aware, a thematic review is planned on the involvement of actuaries in the pricing and product development of Equity Release Mortgages. It will be based on participant questionnaire and interviews, and will hopefully also extend to review of specific actuarial outputs.

¹ Sourced from Equity Release Council [Q4 2020 market statistics report](#)

7.2 The aim of the review will be to provide insight into the key areas where actuaries work in this field, and proposals as to how existing standards, guidance and wider support to our members could potentially be enhanced.

C: Conclusions

9. The Board is asked to consider whether any of the issues raised during the course of its discussion demonstrate the need for further regulatory intervention to address any perceived risks, over and above those measures already in place.
10. The Board is also invited to consider whether any such steps should be considered now or whether those should await the outcome of other developments, including, for example, the outcomes of the IFoA's thematic review or further work of the FCA.
11. In particular:
 - Are there any specific requirements that ought to be imposed by way of an APS (or TAS if relating to a technical issue)? If so, what might these be?
 - Would non-mandatory guidance be appropriate and helpful for members in relation to any technical or ethical issues (recognising that any technical guidance would require the consent of the FRC)?
 - Are there any specific issues identified that the Board considers should be communicated to Members by way of a Risk Alert?
 - Is there other educational or CPD material that could be developed to provide support to Members working in this area?