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Study on Equity Release Schemes in the EU

Part I: General Report

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submitted by

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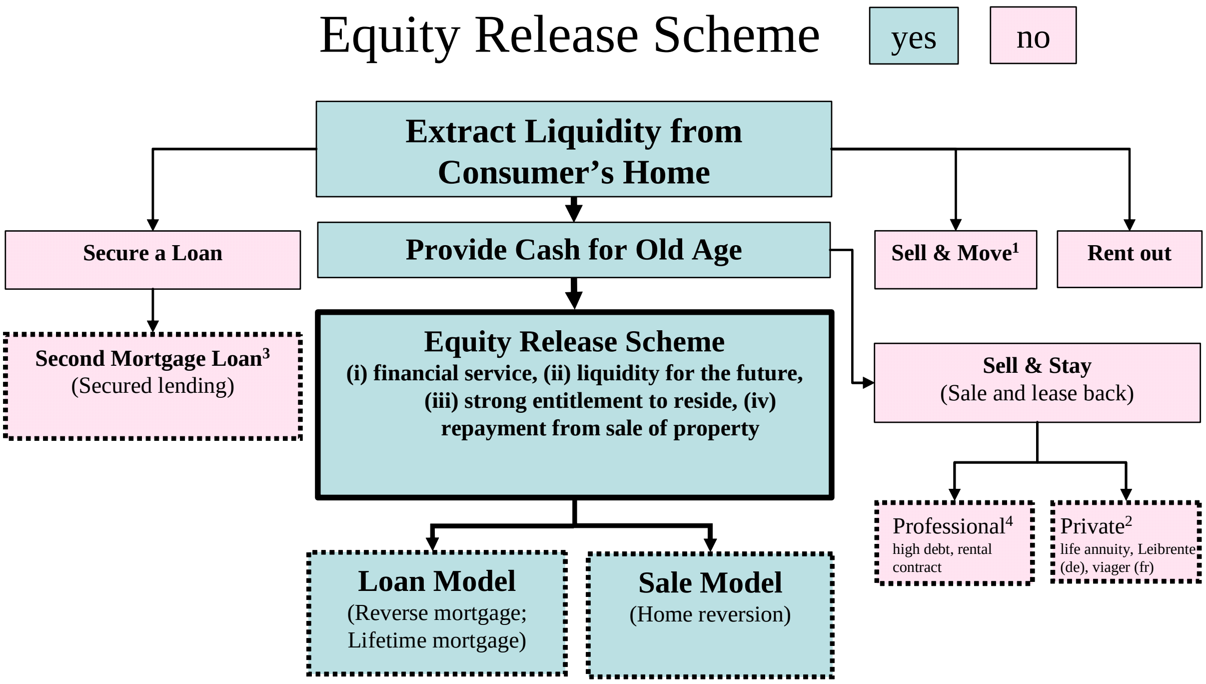
Executive summary

1. Equity Release Schemes (ERS) transform fixed assets in owner occupied dwellings into liquid assets for private pensions. They thus enable a homeowner to access the wealth accumulated in the form of his or her home, while being able to continue to live in it. An illiquid asset becomes a source of liquidity, mainly for consumption purposes.

They can take two different forms: **Loan Model ERS**, also known as reverse mortgages or lifetime mortgages, provide a loan that will eventually be repaid from the sale proceeds of the property. **Sale Model ERS**, also known as home reversions, involve an immediate sale of the property but provide for the right to remain in occupation and to use the cash price for income in retirement. The terms of reference of this project, set out in the tender, require a focus on schemes provided as financial services, excluding both private arrangements and arrangements with the primary purpose either of real estate purchase or the provision of care for the elderly.

Although the purpose of ERS may be achieved by means of virtually any form of loan, lease or sale (second mortgages, overdraft credit, leases, sale and lease-back or sale-and-move arrangements) the research targeted only products that were exclusively designed as ERS.



Footnotes: Four elements that do NOT constitute an Equity Release Scheme: NOT Keeping the right to live in one's home[1], NOT concluding a financial service contract[2], NOT leading to an improvement in medium-term cash flow[3], NOT maintaining long-term housing security[4].

ERS must therefore: (1) be a financial service; (2) be a source of liquidity for the future; (3) contain a strong entitlement to remain in occupation of the property; and (4) rely solely on the sale of the property for repayment/payment of the funds released to be used as a retirement pension. Payments take the form of a lump sum or regular income, and are either secured by means of a mortgage on the property or generated by an immediate sale. Under the Loan Model ERS, repayment is made from the proceeds of the sale of the property either on the death of the homeowner or when the property has been vacated for a specified period of time.

2. An empirical survey was undertaken for this study. A total of 315 questionnaires were sent out, to which 140 responses were received, 55 from non-provider stakeholders in the 27 EU Member States (excluding an additional 22, who made contributions by email or through telephone interviews) and 63 from providers, 45 of whom completed the questionnaire. In addition to providers, national bankers' associations, bank supervision authorities and central banks, as well as consumer organisations in each Member State, were approached. Finally, legal experts from all 27 Member States answered questions and provided reports of varying length and depth. Alongside this main reporting document, Part I: General Report, findings of the study are also contained in Part II: Country Reports and Part III: Annexes.

3. The markets for Loan Model ERS are not statistically monitored. The UK is the only Member State in which there is a private organisation of providers offering national data based on the activity of its member organisations. From estimates and statistics provided by national regulators and providers, we assume that currently less than approximately 0.1% of the overall mortgage market (EUR 6 147 billion based on EMF data) consists of ERS. According to our calculations, the overall volume of Loan Model ERS in the EU is EUR 3.3 billion, with an estimated number of close to 50 000 contracts in 2007.

The estimated volume of Sale Model ERS is EUR 1.4 billion, with just under 20 000 contracts. 13 Member States had some form of ERS, compared to 14 with none. Amongst the Member States with an existing market for ERS, those who provided for a Loan Model scheme generally offered a Sale Model scheme as well. However, some countries have started by exclusively providing a Sale Model ERS.

Three countries, namely the UK, Ireland and Spain, have developed what may be seen as more significant ERS markets, while in the Netherlands, Denmark and Finland, providers report that overdraft facilities and credit lines are the preferred forms of what are considered to be similar products. In Germany, Italy, France, Belgium and Sweden, ERS are subject to wide-ranging debate, but have not yet been well developed. The nature of this process varies widely; in France, legislators have deliberately facilitated the development of Loan Model ERS; while in Belgium, the same products are not currently permissible. Although in Spain certain forms of ERS get tax privileges, in other countries on the contrary ERS do not qualify for general tax privileges for housing finance which would require building up equity instead of releasing it. In some eastern European Member States, Sale Model ERS have begun to appear alongside traditional private home reversion schemes, which are still in moderate use. Based on the experiences and lessons from more developed markets such as the UK, it may be assumed that the sequence of introduction of these schemes begins with traditional private home reversion, progressing towards gradual partial replacement by Sale Model ERS in the first instance, which in turn gives way to Loan Model ERS.

ERS are primarily issued by banks (40%), real estate investors (19%), specialist lenders (12%), insurance companies (12%), the remainder being marketed by intermediaries (15%) operating on behalf of these providers.

The evolution towards Loan Model ERS is closely related to the size of the real estate and mortgage markets and depends on the level of need for supplemental private pensions. In this study, data on homeownership, loans, ageing, private pensions and home sales for all countries have been collated to identify four groups of Member States: those with a significant ERS market; those with only some Loan Model ERS; those with some Sale Model ERS; and those with no ERS at all. However, none of these other factors showed a particularly significant and direct relationship with the spread of ERS. Instead, only combinations of these other factors which coincide with a developed mortgage market indicate that ERS is feasible. The findings nevertheless show that ERS could have a major impact in many Member States where equity release has the potential to improve retirement pension provision, but where mortgage markets are not sufficiently developed to enable this to happen.

On the one hand, in Finland as well as in Spain and the UK, high levels of homeownership, together with a developed mortgage market, are key elements facilitating ERS or in the case of Finland its equivalent. On the other hand, lower levels of homeownership in Germany and Malta are seen as factors which are less favourable to ERS. In a number of countries, such as Sweden, the increase in house prices since 1998 has incentivised equity release. Even in the UK, a 'nation of homeowners', and despite the recent reversal in house price changes (along with lending and the economy generally), the ERS market has nevertheless managed to grow and even showed an increase of 14% in the first quarter of 2008.

4. Products specifically designed for ERS were found in half of EU Member States. Based on the descriptions given by providers, we estimate using all available sources that at least 44 equity release products are in use within the EU, 14 of them in the UK alone. Responses to the questionnaires indicate that Loan Model ERS are more common. Of the 27 EU providers which completed the questionnaire, 18 offer Loan Model ERS and 5 offer Sale Model ERS exclusively, while three of the providers which participated in the survey offer both product types.

Several factors limit the eligibility of homeowners for these schemes. These include occupation of the home by a third party who is not a joint owner, a minimum age requirement and other factors such as an existing first mortgage, a poor credit history or even foreign nationality. These factors vary from one provider to another. Some property types are also excluded, such as high-rise flats, and some property uses are ruled out, such as business use. Products are typically designed for those mainly resident in the property, but some, such as the one product offered in France, can be sold on the back of a second home.

Most providers offer a variety of forms of payment, including lump sums, monthly payments and lines of credit. Some providers restrict the purpose of payments in order to avoid abuse. Some lenders use a loan-to-value ratio (LTV) and define the maximum amount of the loan available in relation to the LTV. Statistical information as to the factual reasons for termination of Equity Release contracts is limited. The most common is death, but cases of early repayment (about 10%) and default (about 20%) were also reported by some providers. Guarantee schemes covering provider insolvency were reported, but these are not very common and varied widely in form. Factors triggering cancellation also vary widely, and include payment default and default in respect of certain obligations such as repairs and maintenance duties.

Both fixed and variable interest rates were common in Loan Model ERS and ranged from 4.83% to 8.48% APR as of Q3 2008. These must, however, be seen against the background of the different average levels of interest rates in individual EU Member States. Early repayment fees vary from no additional costs to up to 25% of the original amount borrowed, mainly dependent on the timing.

With regard to Sale Model ERS, all providers said that transfer of title takes place on completion of the contract, irrespective of whether it is a full or partial sale, and the guarantee of lifelong occupation rights and annuity rights is given on the face of the title document. Reported charges for Sale Model products amount to between EUR 1 500 and EUR 7 600, while the tax was the highest item in almost all cases.

5. Benefits and Risks of ERS for providers and consumers.

The sustained rise in house prices in many EU countries over the past decade, currently readjusting sharply downwards, has without doubt played a major role in encouraging innovative lenders to take the risk of granting ERS to a steadily growing group of customers who have benefited from an increase in their asset wealth, without a corresponding improvement in their income position.

Providers could use this demand to enter the niche market for ERS in order to achieve market share while expecting significant market growth. Their objectives would be to **benefit** through high profits from ERS sales, increase their market share in private pensions, increase their market share in mortgage loans, use contacts with elderly people to cross-sell other products such as current accounts or insurance, and finally to build their social reputation.

Consumer organisations and regulatory authorities, when asked about the benefits to providers in marketing these schemes, pointed almost exclusively to high profits. When providers were asked what benefits they see from entering what is in all countries a niche market, they agreed that high profits were the most important motivator.

For consumers, the most significant benefits available include access to credit in old age, the right to stay in the home, increased liquidity in old age, avoiding dependence on the family and a tax reduction.

The main **risk** for providers is non-recovery of their capital outlay and failure to earn any interest on it (credit failure risks). The main credit failure risks are the uncertain longevity of the occupier, the risk of increasing interest rates, developments in real estate prices and depreciation in the value of the property. The credit failure risks generally apply equally to Loan Model ERS and Sale Model ERS (even if the later does not involve a credit transaction as such). ERS also entail a number of reputational risks. Some providers have damaged the image of the product, as occurred in cases of mis-selling in the UK. Press coverage has characterised this risk as, for example, "the lifestyle dream that can turn into a nightmare."

The system requires intensive advice because of the vulnerability of and risks for prospective customers. Most of the assets of older people are tied up in their home, and they have no prospect of compensating for any loss of equity in the future. Supervision of ERS is therefore crucial. Other significant risks inherent in these schemes relate to clients' longevity, the depreciation of house prices, the emergence of negative equity and whether the property will be adequately maintained by residents. The 2008 credit crisis and the decline in house prices in Spain and the UK have accentuated these risks.

In their responses, consumer organisations and providers broadly agree about most benefits and risks but differ significantly as to whether longevity is a risk (which it obviously is for the provider while it is a benefit for the consumer), and on the question of moral hazard, namely the risk that consumers may take advantage of the loan while failing to maintain the property.

Additional consumer risks relate to ownership restrictions, which may relate to the health and wellbeing of the borrower, his family and his social life generally. Examples of such risks emerging from responses are that the consumer may be forced to move out of the home, that barriers may be created to mobility and healthcare arrangements, or the exclusion of certain household types. There are also risks for consumers in terms of the cost of and liability for maintenance and repair of the property, and whether the property can be inherited, or conversely whether a will must be made, impacting on the consumer's freedom in terms of testamentary provision.

The cost of ERS may also rise in the future, which creates poverty risks. For example, future changes in tax and benefits; inflation eroding the value of the payments over time; changes in interest rates in the future; a consumer may choose the 'wrong' product or be induced against his interests to enter into the contract. If the ERS is not covered by a bank guarantee scheme and if security is independent of the loan, the insolvency of the provider may also deprive the consumer of both home and pension. Longevity may have the same result if income is not provided for life or if the product is too expensive.

6. Economic and cultural barriers to development of the ERS market are associated with the special significance of its 'reverse' character.

Cultural attitudes towards homeownership may amount to a long-term barrier and deter consumers, especially in rural areas, from using ERS. Transforming a home into a pension requires the acceptance of three concepts:

- The home is a capital asset, not merely shelter and a consumer asset to be passed on to the next generation.
- Capital can be made liquid without giving it up completely, and liquidation is neither sale nor bankruptcy
- This process can be brought forward by means of credit.

An example given of for such a barrier is the dowry system in Mediterranean countries. Until as late as 1983, this system even formed part of Greek law. Daughters were the family house when they married. While that law has now been repealed, the culture remains. However, even in Italy and Spain, countries where there was no dowry system, a similar strong bond between the family and the ownership of property exists. In many countries, high homeownership rates coincided with insignificant mortgage markets; for example, in Italy the mortgage market represented only 3% of GDP in 1985.

Another cultural barrier is the lack of experience of the elderly in using credit. As the "normal" credit system is built on the ability of the borrower to repay the loan during his/her lifetime, this system tends to exclude the elderly. Some banks, as reported from Germany have even employed strict age limits in the past. The reverse character of the Loan Model ERS therefore presents a problem where providers develop ERS only as an addition to their general, conventional lending operations.

In addition to these structural barriers, the present financial crisis has added short-term barriers to the emergence of ERS. On the one hand, 'equity release' has been blamed for the rising numbers of non-performing loans and accused of making the refinancing of mortgage loans more difficult. The fall in house prices in the UK, Ireland and Spain has led to calls for less equity release and more caution in the use of second mortgages for private consumption purposes. While many consumers in the EU were previously able to increase their consumption on the back of the 'wealth effect' of rising house prices, whether intended or unintended, a newspaper congratulated UK citizens for having stopped this "decade-long era of the nation using its homes as cash machines. Second-quarter figures (2008 iff) for equity withdrawal showed that, rather than raising borrowed cash against their properties, homeowners injected a net £2.8 billion of new equity". On the other hand, as we hope the distinction drawn by this report will show, mortgage equity withdrawal and other mechanisms for using the home as a source of cash are not the same as an ERS.

7. Legal conditions in the Member States for ERS are generally favourable. The introduction of ERS is prevented by the prevailing law and fiscal arrangements in only one Member State, Belgium, where a clarification of the legal and regulatory environment is believed to be essential for the future growth of this market. However, as ERS, and especially Loan Model ERS, "reverse" the traditional form of mortgages, consumer protection law may require some adjustment since some information obligations are not entirely appropriate.

The use of property in the form of real estate to help meet the financial needs of elderly citizens and to increase the funds available to them has been provided in the past by concepts such as "life rent", which are found in nineteenth century Civil Law Codes, or as provision for the lifetime of a beneficiary under Common Law. These concepts have largely fallen into disuse in the modern welfare state. Since private pension schemes have become more significant, and more and more people have become homeowners by means of credit secured through mortgages, the idea of equity release has also entered legal systems where amortisation of the loan, personal liability of the borrower and time limits for the duration of the loan remain central to some regulatory schemes.

There have been a number of legal developments in this area. In the UK and Ireland, whose legal systems are based on common law, ERS have already spread and gained a significant market. These countries have developed their own regulatory body, in which mortgage as well as pension legislation has been adapted to the special features, risks and needs of products which "reverse" expectations of what an ordinary mortgage loan is, especially in contract and consumer law. Their involvement concerns consumer protection issues in general, and duties to provide information in particular.

France and Spain have instead developed an active interest in facilitating such schemes within their legal framework which, as is the case in many civil law countries, has been somewhat hostile to loans which "eat up" the value of a home instead of building it up. This legislation does not merely liberalise credit law. It incentivises the use of ERS, for example by providing tax benefits and subsidies if certain criteria are met with an obvious intention to protect consumers. Such indirect rules affect the market by privileging certain ERS products, which are therefore used more often. All other countries deal with ERS within their general civil and administrative law.

Tax law is seen as the most problematic area of ERS regulation. Stamp duties and notary fees are sometimes so significant that they make such schemes too costly for consumers and providers. Another problem lies in the actual release of equity, which may be subject to income tax. This applies especially to the Sale Model ERS. A number of countries support homeownership by exempting mortgage payments from income tax in the same way as payments into private pension schemes. ERS usually does not qualify for either of these tax exemptions, since these loans do not give access to homeownership, instead offering an exit from it. The pension taken from the equity of a home does not consist of designated savings from income. Although they amount to part of a payment from a loan, these pensions may even be taxed if the equity had been built up within a state supported pension scheme.

Banking supervision law, which has not yet been harmonised as it relates to the extension of credit, has developed different regimes. In some countries, a banking licence is required, with the result that all Loan Model ERS are subject to the full supervisory regime, and they are subject to banking law (Austria, France, Germany, Greece, Portugal, Slovakia, with a special permission for credit unions in Poland). Most Member States require formal notification, registration or authorisation for all mortgage credit providers, including non-banks, combined with special supervision. Only Cyprus, the Czech Republic, Denmark, Estonia, Finland and Latvia allow mortgage lending without such arrangements, but even in those countries, non-banks have not been identified as operating in this area. This may be due to the restrictions on accessing refinancing where the market is much more regulated and supervised.

Some countries require an additional insurance licence for ERS, since annuities are seen as payments under uncertainty, which is often complied with through the split of ERS into two products, the loan and the annuity, and the ERS product is then sold in collaboration with an insurance company.

In civil law, only Belgium has regulated the traditional form of mortgages in such a way as to impede ERS in principle. On the other hand, the Netherlands, for example, has defined the mortgage loans for which it provides special consumer protection in terms of their purpose, that being the acquisition of a home. As a result, such rules are not applicable to ERS.

Most regulations affecting ERS exist to protect consumers through the creation of duties to provide information in marketing materials for the scheme in question, and through additional advice at the pre-contractual and contractual stages. While some Member

States apply the Consumer Credit Directive to ERS, others have laws with similar contents but enacted outside its framework. The European Code of Conduct on Home Loans overlaps with many of these rules. In the UK, there is a framework of self- and other regulation, the FSA being the most significant regulatory authority.

While in general terms the reversal of the conventional mortgage does not significantly change the form and contents of the requisite information in order to enable adequate choice, some duties would require adaptation, especially where the legislator forbids excessive lending and requires restrictions on the amount of credit available. Responsible lending must be seen differently where the loan is not required to be repaid from of the borrower’s regular income. At the same time, the target group for the information may be too narrow if the specific problems of ERS as they affect the family and heirs are taken into account.

A special barrier to ERS lies in the principle of Anatocism. As far as the legal regime for sureties is concerned, Loan Model ERS share the problems of diversity with all mortgage loans. This has particular significance for ERS where, as is the case in Germany and Austria, the nearly exclusively used form of a mortgage, the *Grundschuld*, provides for an independent second claim not linked to the size of the outstanding debt of the loan by law but only by contract which at least theoretically allows to trade it separately. Although these problems are limited through contractual links, abuse is not excluded and may require special trust which, again, may act as a barrier where as it has been the case for example when foreign less supervised hedge-funds acquire the loans. Some countries also have general restrictions on securing future debt. In this case, the reverse character of Loan Model ERS, where the loan is built up instead of being repaid, may make additional securitisation necessary.

Problems may also arise from insolvency and bankruptcy law. The insolvency of the provider will directly affect the intended pension. In addition, detached mortgage systems may even lead to sale of the home at auction without the consumer having received the sum borrowed and secured against it. In Member States where non-banks are active and are not part of any collective insolvency protection scheme, the risk to the retirement pension is apparent and may discourage consumers from entrusting their home to a bank.

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A. Theory of Equity Release schemes (ERS)

Equity Release schemes (ERS) started life in the USA in the 1980s in the form of Reverse Mortgage Products, and were disseminated throughout English-speaking countries (Canada, Australia, New Zealand and the UK)[1], using varying products and definitions. Although many countries have introduced their own terminology, the more longstanding English-language tradition is still worth taking as a starting-point.

I. Definition

'Equity Release scheme' is the term primarily used in Anglo-Saxon countries to describe both the process and the products that allow homeowners to secure substantial lump sums or regular income payments by realising part of the value of their homes, while being able to continue to live in it. They should be kept distinct from other forms of equity release, which extract cash just on the "*value of property for consumer spending and paying-off debt*".[2] Equity release in its modern form as a financial service started in the most advanced credit societies. For this reason, we focus particularly on the English terms of these products.

1. Descriptive (legal) definition: 'Mortgage', 'Reverse', 'Lifetime', 'Pension'

In the UK, the term used for the most common type of ERS is 'lifetime mortgage'. Although the word itself suggests that it will last until death, some definitions merely refer to the long-term nature of the loan, e.g. "*A lifetime mortgage is a way of borrowing a set amount of money against the value of your home, in the form of a long-term loan, and without the need to move*"[3]. The legal definition of 'Lifetime mortgage' is defined by the UK Financial Services Authority as: "*A type of equity release scheme - a loan secured on your home, which is repaid by selling your home when you die or go into long-term care*." The Financial Services Authority also stresses the cash nature of the product when it describes it: "*Equity release is a way of getting cash from the value of your home without having to move out of it – by borrowing against it or selling all or part of it for a regular income or a lump sum*". "*The loan you get is a cash lump sum. You pay interest on the loan each month at a fixed or variable rate. The amount you originally borrowed is repaid when your home is sold*."[4]

A trade association for lenders has used the following definition for equity release: "*A way of unlocking the value of your property, without having to move home. It is used mostly by older homeowners who either have paid off their mortgage altogether or have only a small amount left to pay. You can release the value of your home to give yourself a lump sum or a regular income (or both). If you live in the property until you die, the money from its sale is used to pay the lender before anything left over is paid to your beneficiaries. If you sell the property before you die, you repay the money you borrowed*

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[1] In Australia, reverse mortgages are defined as "An arrangement where the owner of a property mortgages that property to receive a regular income from the mortgage lender (and not vice versa), based on the equity value of the property." (Bloomsbury Reference, Dictionary of Banking and Finance, 3rd edition 2003). In the USA, a reverse mortgage is defined as a mortgage that allows consumers to borrow against the equity in their home, as a reverse mortgage is primarily available to people aged over 62. Generally, regular repayments on the loan are not made until the borrower leaves their home to move into care, sells their home or dies. At this point the loan ends and must be repaid with interest (see: http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea13.shtm).

[2] See for such equity release outside Equity Release Schemes and not linked to old age *Homeowners steer clear of equity release while climate still uncertain,* The Times, October 8, 2008.

[3] Nationwide Building Society, see: http://www.nationwide.co.uk/search/DisplayArticle.aspx?article=1035.

[4] Financial Services Authority, see: http://www.moneymadeclear.fsa.gov.uk.

from the lender. With some types of loan you might also have to make regular interest payments."[5]

The basic function of making fixed capital available as cash in old age is also visible in the words used in other languages, which we will try to translate literally.

In German, such products are known as *Immobilienverzehr*, which means literally 'eating your home' ('real estate consumption'). The words *umgekehrter Hypothekenkredit*, on the other hand, are the literal translation of 'reverse mortgage'. In French, *prêt viager hypothécaire* means, literally translated, 'old-age mortgage loan', which conveys the concept of 'lifetime mortgage'. The words *prêt hypothécaire rechargeable* translate as 'rechargeable loans' which convey the reverse character of this type of mortgage, compared with that of an ordinary mortgage which, especially in France, must be repaid in instalments. 'Rechargable' offers an image of the mortgage as a credit line (overdraft, credit card credit) where the borrower takes out a loan, repays it and repeats the process as required. Other Latin languages follow the French wording and use the same Latin roots. While in Italy, the *prestito vitalizio ipotecario* focuses on the lifetime aspect, the Spanish language puts emphasis on the reverse character of the loan, calling it *hipotecas inverses* or *hipoteca revertida* or *re-hipoteca*.

The Dutch and Flemish versions ("opeethypotheek") are close to the German concept. They focus on the aspect of release of cash, describing it as a way of 'liberating assets from the home', defining it as *vermogen uit de eigen woning vrij te maken*. Also seen from the perspective of ordinary mortgages is the definition as *Hypotheekverstrekking*, which means, 'prolonging' a mortgage, as opposed to ending it by repaying it. In Belgium, where the two national languages are drawn from each family, the name *crédit hypothécaire inversé* (inverted mortgage) or *crédit pension* (pension credit) illustrates both ways of looking at it: from the point of view of the pensioner (pension, rent) and from the point of view of the developer of these products: (reverse) mortgage or sale respectively.

2. Functional (economic) definition: 'Equity' and 'Release'

While the above definitions are mainly descriptive, economic analysis uses the words 'Equity' and 'Release' in order to explain ERS to potential customers and providers, and explain the functions of these products.

ERS are thus defined from the perspective of the different forms of capital used in accounting. A balance sheet distinguishes between fixed and liquid assets in the analysis of available capital. Liquid assets are financial assets, while real estate is a form of fixed asset. The process of transformation is thus well described by (gradual or total) 'liquidation'. Fixed assets are transformed into financial assets or 'liquidated'.

'Liquidation', however, is a seen by both the general public and lawyers in the context of its use in bankruptcy schemes, in which all assets must be transformed into money value i.e. liquid assets. The word describes the total 'liquidation' or transformation of an insolvent firm into financial assets that can be distributed to the creditors. As the word 'liquidation' thus has a negative connotation and also creates an image of transformation of all of the fixed capital into liquid assets, the word 'Release' avoids this misunderstanding. It describes a positive interest on the part of the owner (rather than that of his or her creditors) in liquidating fixed assets step by step as required. The word 'Release', means, 'let go' or 'set free'. The individual's fixed capital, generated through ownership, is transformed into a more useable form. Although the correct word is in fact

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5 Council of Mortgage Lenders, see: http://www.cml.org.uk/cml/consumers/equityrelease/What.

'liquidation', it is never used; in its place, other verbs can be found, such as 'mobilising', 'converting', 'extracting', or even 'liquefying' fixed assets.

Even more difficulties of interpretation exist in the use of the English word 'Equity'. This word has no direct homologue in other languages.[6] As it plays a dominant role in accounting, from where national legislation must draw its terminology, the problem is usually circumvented by combining the word 'asset' or 'capital' with a qualifying attribute like *Stammkapital*, *Firmenkapital* or *Eigenkapital* (German), *capital/fonds propres* (French), which describe equity as 'own' assets. It thus defines those parts of the firm which 'I own' truly in economic terms and which are not 'borrowed' from third parties.

With regard to real estate, the word equity thus faces two obstacles. The first comes from the word 'ownership'. It intends to describe the part of 'own capital' which the 'owner' of the home in fact owns. However, in fact the word 'own' has a double meaning: 'own' capital means the residual value of the home after liquidation when secured creditors have been paid. 'Ownership', on the other hand, is a legal term which gives title to the 'homeowner' over which creditors hold a security for their loan. 'Own' capital in the home in legal terms is seen purely in terms of entitlement to the proceeds of sale of the property corresponding to the security held in it.

Equity overcomes this confusion and introduces an economic term, which replaces the traditional legal term of ownership in order to describe, "*the difference in value between a person's debts and the value of the property on which they are secured*" or expressed differently, "*the difference between the market value of a property and the claims held against it*".[7]

In societies where penetration by the money markets has been less pronounced, traditional forms of ownership treat homes less as a form of capital so that they remain as fixed capital. Language in these circumstances is less adapted to creating an understanding of the two different aspects of homeownership: legal ownership, which gives certainty in terms of housing and economic ownership ('equity'), which provides wealth that can also be used for other purposes. The Internet dictionary LEO does not provide a specific word in German, French, Italian or Spanish for 'equity in real estate' beyond the word 'own' (*eigen, propre*) which is used in the context of companies. Even in the area of investment, the word 'private equity' is not translated in German or Italian but used in the English form. We therefore have to assume that there is also a lack of understanding and experience with the idea of purely economic ownership, which opens a home to a use entirely distinct from its occupation.

3. Additional elements: 'Owner Occupancy' and 'Pensions'

Although the words Equity Release do not indicate the way in which the equity should be released and for what purposes, ERS for the purpose of this research represent a narrower view of Equity Release that classifies them predominantly as products within the range of private pension schemes. This is mirrored in the intentions and marketing messages of most providers but does not typically reflect the dominating present practice. This is for example true for the requirement of continuous owner occupancy while releasing equity in a form that guarantees the payment of a retirement pension but also for other elements like life-long pensions and monthly payments.

6 Alternative uses of the word that come to mind but which are not meant here are those describing impartiality and fairness (e.g. in law) or when referring to the ownership stake/interest of shareholders in a corporation. Perhaps the Spanish word for equity "valor liquido" (liquid value) is a useful description for visualising what exactly is expected of this term for the purposes of ERS.

7 Both definitions come from the Internet dictionary, see: http://www.thefreedictionary.com/equity.

a) Use of the home

– Real estate

ERS relate solely to equity in real estate property. Although any form of property and capital contains 'equity' insofar as it has a market price, ERS are exclusively used to describe equity released from homes.

– Homes

Since all definitions and products are aimed at people who live in their own homes, ERS exclude real estate which is already flexible in that the owner can rent it out or sell it to third parties in order to realise its cash value.[8]

– Owner occupancy

Since ERS are targeted at people in need of additional income but whom also need to continue to live in their own home, continuous owner occupancy requires an additional legal safeguard to ensure that the former owner or the indebted owner retains their right of occupation.

b) Purpose of paying pensions

The use of the home to support retirement provision would ideally have two distinct elements: payment of instalments and lifetime payments. Payment of instalments respond to the need for a monthly income, lifetime payments respond to the need to be covered, especially at a time where no other sources of additional income are feasible.

– Pensions

The final goal of ERS is support in old age in the form of cash payments. As elderly people need continuing income reflecting their former monthly income from employment, all social security schemes provide for monthly payments in old age.[9] Used as a supplementary income in old age, ERS could have the same form. It is not, however, a pre-requisite, as other pension schemes demonstrate. Private pension schemes often allow the opportunity to take up all or a significant amount of the money saved on retirement. This applies even in pension schemes where state subsidies only envisage support for the pension function because the lump sum can then be invested into pension schemes which transform them into the payment of an annuity.

– Lifetime

Finally, the purpose of pensions is closely linked to lifetime, since true pension schemes should provide for lifelong payments. While some ERS strictly require that the risk of longevity be covered by the scheme, it seems to be sufficient for our definition that the way the payments are provided should at least allow for such coverage.

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8 The traditional form of old age pensions has been the "Zinshäuser". At the beginning of the 20th century in countries like Germany and France wealthier people used to invest their savings into newly built "rent houses" which were seen as a safer investment than money investments at that time. This "fixation" of liquid assets into real property could be seen as reverse "reverse mortgages" and very early "pension funds".

9 The definition of a subsidised private pension in Article 1 4 a) of the German Alterszertifizierungsgesetz requires "a monthly payment in the form of a lifelong pension … The payments have to be either the same or increase… up to 30% of the accrued capital may be paid to the pensioner outside the monthly payments."

II. Forms of Equity Release

'Equity release' as a mere conversion of fixed assets into liquid assets can have two legal forms: the sale of a home and conversion of capital into money, or taking up a loan secured against the home which may be repaid out of a postponed sale or liquidation of the home. In the cultural and legal tradition both forms have always been seen as alternative forms of use of one's own capital for specific purposes: the 'rent model' (*locatio*[10]) where only the use of the capital is transferred to a third party, and the 'sale model' (*emptio vendita*), where the legal title to the capital itself is transferred to a third party.[11]

Both legal forms may be used to serve the purpose of ERS, since they liquidate all or part of the equity in a home. ERS may be marketed as a loan or as a sale. In order to distinguish them from each other we will call them the 'Loan Model' and the 'Sale Model'.[12] Because historical development has seen the sales-based type preceding the Loan Model, we will start by describing the arrangements falling under the Sale Model. The Loan Model type, however, reflects current use of the legal forms, because such arrangements are in line with the increasing importance of renting, leasing and credit, which has even led to the characterisation of modern market economies as service or credit societies.

1. Sale Model

The problem faced by elderly people in terms of lack of cash to spend in their old age, combined with ownership of a home of value to others in the future, is not new. Historically, it found its solution in the form of a reversionary interest or *Leibrente*. This meant that the owner in occupation of the property transferred ownership to a third party, in return for payment of a pension for his or her lifetime. *Leibrente* literally means 'a pension on a person's body'.

Such schemes, however, lacked the right to continuing occupancy by the former homeowner. In the modern British version, home reversion schemes or plans enable the homeowner to sell either part or all of the property at a discount, whilst retaining the right to remain in the house either rent-free or paying a small nominal rent until death or a move into long-term care.

These schemes provided by private parties gradually lost popularity, largely because of the arbitrary outcomes and adverse interests in the anticipated and actual longevity of the occupant, and the occupant's own preferences. There is a persisting conflict of interest between the buyer, who would gain from the early death of the seller, and that of the seller, who will have had a good deal if he or she has a long life. As such, transactions were often made between close neighbours or relatives, the tension may have had untoward effects on their personal relationships. In ancient times, such systems were based on a fixed and accepted status, where both parties assumed that it was the expression of God's will for the seller to have a long life and ongoing support

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10 Roman law used this rent model of "*locatio*" for labour ("*location operorum*"), real estate and other fixed assets (*locatio conductio*) and money (*locatio specialis*) thus showing that the labour contract, the rent agreement and a loan have the same legal roots. See Mayer-Maly, Th. *Locatio conductio: eine Untersuchung zum klassischen römischen Recht*, Wiener rechtsgeschichtliche Arbeiten 4, Herold, Wien u.a. 1956.

11 The rent system prevailed in the closed feudal economy that was then gradually replaced by the sales society of a market economy until the 20th century. According to analysis, society is in the process of transforming into a service - and credit society where the rent model again dominates. See Rifkin, Jeremy, *The Age of Access: How the Shift from Ownership to Access Is Transforming Capitalism*, 2000).

12 The Loan Model (referred to in the preliminary stages of the research as Type 1 model) will also be referred to as "*Lifetime mortgage loans*" and the Sale Model (previously Type 2) as "Home reversions". By *provider*, we will generally be referring to the originator of the product and not the arranger or adviser involved in the sale of ERS.

from the buyer. In modern thinking, the party that has been disadvantaged may be less likely to accept this in the same way, which may lead to tensions.

Since financial services providers have entered the market, taking up the role of intermediaries between individuals seeking to exchange future ownership of their property for cash income, the risk can be spread across a large number of contracts. This has created a more economically rational model, by creating a market beyond the private sphere, for both those wanting to put their house for sale in exchange for a pension annuity payment and those wishing to acquire a property at a lower price but not wanting to occupy it in the medium term.

These Sale Model products involve the sale of all or part of the home, at a discount, to a company or third party, which pays out the cost of the purchase in the form of a similar flow of funds either immediately or through regular payments. The transfer of money resembles a normal sale transaction.

As the empirical evidence will show[13], however, sale-based equity releasing products only make up a small proportion of total schemes in the EU, either displacing the relatively small numbers of remaining private schemes, or they are in fact not strictly speaking ERS at all, since they lack the element of retirement provision. Since owner occupancy can be combined with a sale, people with high levels of personal debt may take up these opportunities to escape the threat of overindebtedness by refinancing existing debt from the sale proceeds. Under the pressure of existing debt and the need to stay in the home, the scheme may be open to abuse and the house price achieved may be very low.[14]

If only schemes in which the occupant has a secure right to stay in the property for life without payment of rent are taken into account, very few schemes would qualify as ERS.

2. Loan Model

The limitations of ERS, in offering only a sell-and-stay option for those wishing to release equity from their home, have been largely overcome by modern, credit-based models involving the use of the housing asset as collateral. They have become commercial financial services in the form of mortgages, converting the fixed capital tied up in real estate into liquid assets. While schemes based on the Sale Model still link the pensioner and the buyer, Loan Model schemes separate the ERS transaction from a property transaction in terms of the home. Technically, the difference lies in the time of the sale. While in Sale Model ERS the transaction begins with the sale of the dwelling, the sale in Loan Model ERS may occur at the end of the transaction. As a result of the relatively short history of this form of ERS, empirical data on the termination of Loan Model contracts are too limited to enable meaningful conclusions to be drawn; however, it is not now expected that properties will be sold systematically to realise the repayment of outstanding debt, despite original intentions. If heirs want to keep the home, they will have the right to redeem the mortgage so that no transfer of the title in the property occurs at all.[15]

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13 See Section C.I describing the market size for ERS in the EU (on p.21).

14 The service provided by these property professionals active in sale and lease back activities is an immediate sales transaction, agreed at a significantly reduced market price, with an additional agreement attached to have the ex-homeowner as a tenant. Because these transactions result in the person renting the property (and not having usufruct or a lifelong occupancy right as in the case of Sale Model ERS), they are also referred to as 'sale and rent back schemes'. These offerings, most appealing to those facing extreme repayment difficulties, are described in Part II: Country Reports under the UK country section 2 c) on products. Though these are a feature of developed real estate markets and far from unique to the UK market, a recent study by the UK's Office of Fair Trading has investigated and shown concern over these products and the circumstances in which they are sold. See http://www.oft.gov.uk/news/press/2008/118-08.

15 See below for the legal situation (on p.110) and the factual situation (on p.40).

Even though these aspects constitute a clear distinction from most existing Sale Model ERS, there may still be cases where they overlap. If, for example, instead of taking a mortgage as security, the bank takes ownership of the property when the loan is granted, and then what resembles an instalment purchase by the bank amounts in legal terms to a loan.[16]

With regard to ordinary 'second' mortgages, which are not taken out to acquire or improve the home but to finance consumer goods or refinance existing debt, the main distinguishing characteristic of ERS is that, unlike a traditional (or orthodox/classical) mortgage loan, the individual will not have to pay back the loan (with certain products) as long as he lives in the property.

Loan Model ERS will include all products based on the principle of a loan secured against the home, paid out as a lump sum or an annuity.

The potential size of the market for such schemes is limited by demand and the need for additional sustainable liquidity, homeownership with sufficient equity, and the fact that moving house is not the obvious option. Providing a source of sustainable liquidity should not jeopardise or compromise continued occupancy of the property. 'Sustainable' liquidity provides a cash income to the user of this product over the medium to longer term, and a meaningful contribution to the household budget.

The positive budgetary effect stems from postponing repayment on the sale of the property to an unknown future date. Although the mechanism of equity extraction does not exclude the use of traditional home loans and flexible mortgages to release equity[17], these other alternatives do not fall within the definition of this research because repayment is expected principally from other income rather than from the property itself.

3. Comparison

a) Differences in design

Under Sale Model schemes, whilst legal ownership of the property is sold to the company and the occupier becomes a tenant (but remaining responsible for the property, the bills and other outgoings relating to it), the occupier is still guaranteed the right to live there for life by way of a lifetime lease (usually rent free or sometimes for a nominal rent – e.g. in the UK a token amount of £1 per month is sometimes expected).

As will be explained in a further section[18] on the various features these ERS can have, some lenders or equity release providers in certain countries will tend to provide the capital released in the form of a regular income, an 'annuity', whereas others, in a different country, will give consumers a choice between a lump sum and an annuity, or a combination of both, or even flexible drawdowns.

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[16] This scheme was tried out by a German bank in the 1990s. Due to public criticism and a lack of demand because of the accumulation of benefits by the bank (interest rate fluctuations, increase of house price, early death) this product was withdrawn.

[17] Equity release can refer to any form of financial use of residential property, including mortgage loans, drawing on the value of the property as security to produce capital and/or income. This is explained in more detail in the next sub-section of the report.

[18] Details on the payment method (or the way funds are accessed) are summarised under Section C.III.3. d) describing product features (on p.37).

Table 1: Differences in design

	Loan Model	Sale Model
Time of Sale	End of contractual relationship	Beginning of contractual relationship
Owner of the property	Consumer	Provider
Maintenance of the property	Consumer	Provider (where not transferable and transferred to the tenant)
Risk of negative equity	Possible	No risk
Profit from increased house prices	Consumer	Provider
Loss from fall in house prices	Consumer but potentially the Provider if negative equity occurs and guarantee against this promised	Provider only (for total sale); Consumer and Provider (for partial sale)
Repayment of Principal	Possible in case of negative equity	None
Payments due	Occasional servicing of interest payments	Occasional rental payments
Provider	Banks and some other mortgage lenders	Insurance/other provider
Amount of equity released	Typically less than 100%	Typically 100%
Cultural acceptance	Low in countries where a home is regarded as the most important asset	High in countries where tenancy and homeownership have similar status

b) Differences in performance

Sale Model ERS, known as a home reversion scheme or plan in English-speaking countries in the EU, involve a purchase by the provider of a percentage share in the property for a fixed cash price, typically at a price below the market value of that share. On the owner’s death, the company will receive the percentage share of the sale proceeds of the property.

The banking product, often known as a lifetime mortgage in those same countries, involves a mortgage loan secured on the property, which will typically not involve repayments for the lifetime of the borrower and will be repaid out of their estate upon death. Repayment capacity is therefore not relevant, and only the value of the property is of concern. Differences in culture within the EU are highly significant in relation to this emphasis on lending practices based on collateral rather than on the individual's ability to repay the loan.

The proportion of equity released depends upon age, sex and, when applicable, health. The lower the life expectancy, the more equity may be released.

III. Summary

The subject of this research, commissioned by the European Commission, is set out in the tender. ERS are, as outlined above, defined by the following characteristics:

- They provide access to the wealth accumulated in the home while the homeowner continues to live there;
- They provide for payment:
  - in the form of a lump sum or regular income;
  - secured by a mortgage on the property or generated by the proceeds of sale;
- The funds are repaid from the proceeds of the sale of the property either on the death of the homeowner or when the property has been vacated for a specified period of time;
- They target older homeowners with low levels of mortgage debt.

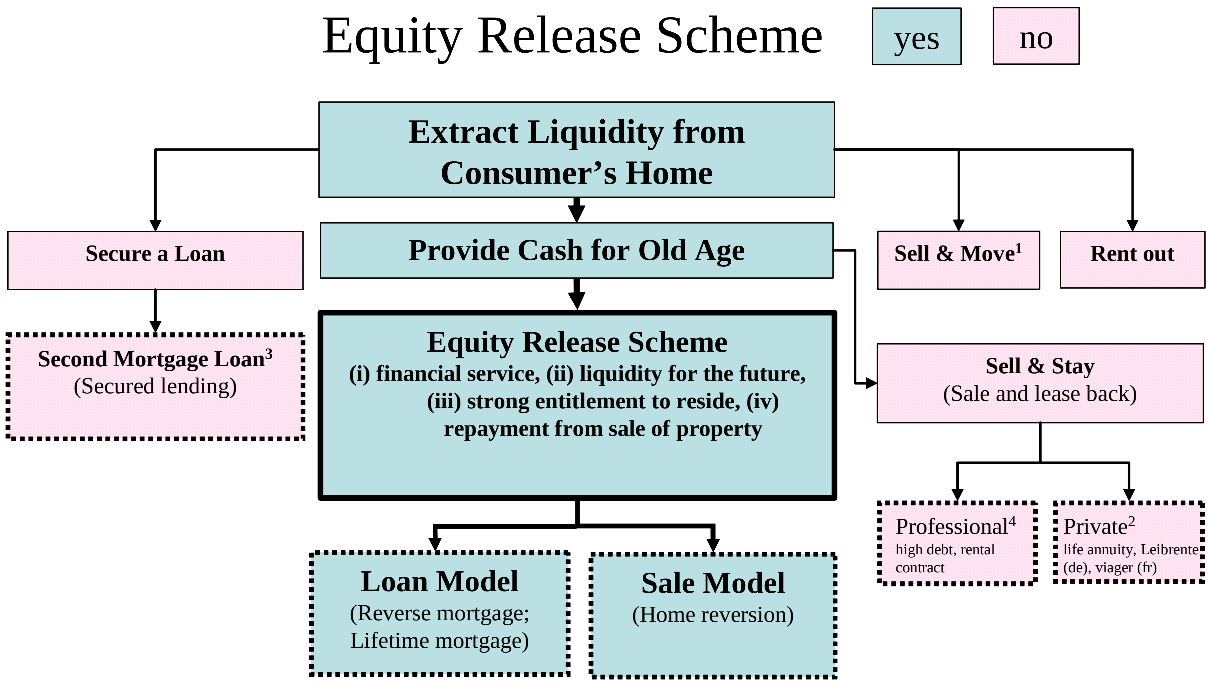
We addressed this task by developing a theoretical framework explaining the use of existing products in an increasing number of EU member states, in order to reach the following definition of ERS, which was used in all questionnaires to explain the type of evidence sought:

> "*ERS transform fixed assets in owner occupied dwellings into liquid assets for private pensions. They thus enable a homeowner to access the wealth accumulated in the form of his or her home, while being able to continue to live in it. An illiquid asset becomes a source of liquidity, mainly for consumption purposes. They take two different forms: Loan Model ERS provide a loan that will finally be repaid from the sale proceeds of the property. Sale Model ERS involve an immediate sale of the property but provide for the right to stay in it and to use the cash price for retirement payments. For the purposes of this research we will focus only on schemes which are distributed in the form of financial services excluding both private arrangements and arrangements by providers whose primary goal is the purchase of real estate or the offer of care for the elderly*."

ERS must therefore (1) be a financial service, (2) be a source of liquidity for the future, (3) contain a strong entitlement to stay in the property, and (4) rely solely on the sale of the property for the repayment/payment of the funds used for retirement pensions.

For greater clarity, we have converted this description into a chart, which also includes products and schemes outside the scope of our research.

Figure 1: Equity Release schemes



Footnotes: Four elements that do NOT constitute an Equity Release Scheme: NOT Keeping the right to live in one's home[1], NOT concluding a financial service contract[2], NOT leading to an improvement in medium-term cash flow[3], NOT maintaining long-term housing security[4].

B. Methodology of the research

I. Tasks, existing literature and stakeholders

1. Tasks of the study

With the present project, the Commission intends to broaden its knowledge of existing schemes and developments.

> "*The purpose of this study is to widen and deepen the Commission's knowledge of ERS or their equivalent, to present an overview of the different schemes that are available in each Member State and to describe the legal and regulatory framework underpinning their sale. When the results of the study are available, they will serve as a valuable source of information for the Commission and as a basis for the decision as to whether future measures are needed in respect of the equity release market.*
>
> *The scope of the project is limited to the 'agreed definition' that qualifies them as an Equity Release scheme*".[19]

Empirical evidence of ERS was obtained by questioning the various stakeholder groups and other available resources. The outline of the tender and iff's proposal requires information on:

- Products (classification and factors of differentiation in all Member States, Comparison of the schemes by eligible age, minimum value of home, maximum/minimum amount to be borrowed, etc.);
- Markets (according to size, providers, and general users as well as individual scheme; ratio to the total mortgage market of each Member State, numbers, types of providers involved (credit and non-credit institutions), intermediaries;
- Risks and benefits (negative equity, impact on means-tested social welfare entitlements etc; superannuation or increased spending power for the consumer);
- Regulation (Pre-contractual information as to risks, general regulatory requirements; authorisation, supervision, consumer protection rules, constraints on the use of the funds);
- Where there are no ERS (list of Member States, regulatory impediments, commercial or cultural reasons).

2. Literature and internet resources

Material made available by providers and public officials on the Internet to inform the public and to advertise existing schemes has been identified in order to obtain an overview of the products available. In the US, an enormous volume of brochures and leaflets is available on the subject of reverse mortgages (Loan Model), as is a handbook

[19] As stated in the European Commission's terms of reference. To see an extract of the Commission's Call for Tender (MARKT-2007-23-H) see http://www.money-advice.net/media.php?id=3295. (In order to facilitate the finding of material underlying this research *iff* has saved such material which is difficult to find in its public database called Financial Information Services (FIS) under http://www.money-advice.net).

for the legal profession[20]. In Europe, the amount of publications and information remains limited.

In terms of general literature, the handbooks and descriptive literature available mainly in the US were distinguished from books offering a more structured and scientific introduction to these schemes, these being more useful for the purposes of this research. The material has been downloaded from the websites of providers and financial authorities (see Part III: Annexes I.1.).

General literature in English, French and German has been used to prepare the theoretical framework. The group had access to specialist studies in Spain, the UK, Germany, France and Belgium, which were available only in the language of the country concerned, but have largely been translated from Flemish, Spanish, French and German and incorporated into the national reports by the researchers themselves (see Part III: Annexes I.2.)

3. Meetings with stakeholders

Although not formally part of the study, iff used two stakeholder events in order to obtain the views and concerns of experts and consumer representatives, as well as to help raise awareness of the ideas and concepts behind ERS. A workshop in Hamburg and a meeting of experts in London were held and initiated by iff alone. The organisation of these meetings was not part of the project as proposed by the European Commission. It should however be seen as offering an important contribution to the fact-finding mission.

A workshop on 'Reverse Mortgages' was held during the ECRC Hamburg conference on financial services on 7 June 2008. It consisted of 4 speakers representing opinions from research, the banking profession and the consumer perspective, namely, Achim Tiffe (iff), Gunnar Lang (ZEW, Centre for European Economic Research); Edda Castello (Verbraucherzentrale Hamburg, consumer organisation); Axel Vogt (Investitionsbank Schleswig-Holstein, state development bank), and 30 participants, including bankers, consumer representatives, money advisors and lawyers. The workshop revealed interesting information relating to practice of, and consumer problems arising from, ERS. Speakers agreed on the increasing interest by policy makers and providers of financial services in investigating the viability of bringing reverse mortgage products to the German market. In view of the fact that it has taken so long for a product to appear, it may be that the market requires government involvement to stimulate the process. Discussions on the German market revealed that, where these products exist at all, they are confined to rare and isolated examples involving wealthy individuals, and do not amount to a commercially available product in Germany.

A second meeting organised by iff in London coincided with an international conference on 13 and 14 November 2008. As a number of the experts involved in this study were present at these meetings, the research team used the opportunity to discuss some of the findings of the research with a broader international participation before the submission of the final report.

Finally, Professor Elena Perez-Carillo of the University of Santiago de Compostella in Spain visited iff during the week commencing 11 August to discuss details relevant to the legal section and the national report for Spain.

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[20] The book, Nauts, Ch.; Bridewell, D. A., *Reverse Mortgages: A Lawyer's Guide to Housing and Income Alternatives*, American Bar Association 1997, is a 291 page practical guide to reverse mortgages and other senior-housing issues. It contains a collection of writings by experts in the field of equity release, and is a book promoted by the American Bar Association, whose two main authors also cover the various arrangements that seniors can make to tap into the equity in their homes or find alternative housing options. See http://www.abanet.org/abastore/index.cfm?section=main&fm=Product.AddToCart&pid=5460029.

II. Empirical survey

The core of the empirical evidence in this project is derived from an international survey based on questionnaires sent to the following stakeholders[21]: providers and their trade associations, regulators and supervisors, consumer organisations, academics and other interest groups. This was supplemented by interviews with various stakeholders including written contributions from legal experts.

1. Individuals and organisations interviewed

The research relies mainly on institutions and individuals for information specific to ERS. Since the structures dealing with these products differ from one Member State to another, potential target groups for the questionnaires had to be identified. It was agreed from the outset and submitted in the proposal that four groups should be contacted: (1) providers, including their trade associations; (2) consumer organisations; (3) officials concerned with the regulation and supervision of these products; and (4) legal experts.

It is obvious that knowledge of ERS will stem primarily from providers and financial authorities. Involvement of consumer organisations is however needed in order to gain a better understanding of the reasons for variations in the dissemination of and demand for these products. While ERS and products are already well known and accepted by consumers in some Member States, in others they are not offered at all.

Since questionnaire return rates and the quality of the information provided depends on the precision with which these questionnaires are targeted to organisations and individuals who are knowledgeable and have a particular interest in the subject, it was necessary to establish the distribution of skills and responsibilities in each country.

a) Providers

As far as providers are concerned, the research team used firstly, the Internet, and secondly, existing research in Germany and France in order to identify addresses of the relatively few providers already engaged in this area. The research team was further able to draw on the help of the European Mortgage Federation (EMF) and the cooperation of several other European trade associations for credit and non-credit institutions, including Eurofinas, the European Banking Industry Committee (EBIC) and the European insurance and reinsurance Federation (CEA), which agreed to forward the questionnaire to their members. It was crucial for the project to find all existing providers, as well as financial service providers which envisage the distribution of such products in the future or which have used them in the past.[22]

b) Consumer organisations

As there is still little knowledge about ERS within a number of consumer organisations and little information has been distributed hitherto in most countries, the most informative contributions came from the few countries in which ERS have a longer tradition. Though consumer representatives were contacted in each country, fully completed questionnaires were received from only a third of Member States.

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21 References made to the word "Stakeholders" refer to all those parties that have an interest in the existence of the ERS market. This refers to all actors including the providers of financial services. It should not be confused with references made to the "Stakeholder Questionnaire" which was named in this way in order to differentiate it from the "Provider Questionnaire" addressed to the providers of ERS only.

22 A list of all financial services providers distributing and planning to distribute ERS is available in Part III: Annexes II.

c) The regulators: banking, insurance and financial authorities

The European Commission has provided the research team with a list of national governmental officials involved in mortgage lending matters. In addition, coverage of all the relevant bodies responsible for regulation apart from the European Central Bank involved considering national structures. Although there is a clear trend towards consolidation of the number of supervisory authorities into one Financial Services Authority[23], the survey had to take into account that three main systems continue to exist.

The widespread 'sectoral model' is used in 11 Member States (Greece, Spain, Cyprus, Lithuania, Slovenia, Bulgaria, Romania and with some variations in France, Portugal, Finland and Luxembourg) and is based on a separate authority for each sector (banking, securities and insurance). This contrasts with the 'single regulator model' preferred by the UK and some of the smaller new EU Member States (whether by transferring all the financial supervision functions to the national central bank, as in the case of the Czech Republic and Slovakia, or by creating a new single authority separate from the central bank, as in the UK, Estonia, Latvia, Hungary, Malta, and now Poland). In between these two models, the 'twin peaks model' (practiced in the Netherlands and to some extent in Italy) allocates responsibilities according to supervisory objectives (i.e. prudential supervision and conduct of business regulation are the responsibility of two different authorities). Elements of this model are also present in the French and Portuguese supervisory structures.

Since ERS are situated between insurance and credit, countries with split authorities have a duplication of responsibilities in this area. Some of the respondents from the regulatory agencies were also responding on behalf of their role in an additional stakeholder group supported by the European Commission that helped us with our study, namely the Government Expert Group on Mortgage Credit (GEGMC).

d) Legal experts

Legal experts have been selected according to their involvement in national research in ERS (Spain, Germany, Belgium, France) and their efficient collaboration in previous European research projects. The legal questions were based on an initial evaluation of the information provided by stakeholders (providers and non-providers). Certain countries, such as the UK, Spain, Ireland, Germany, France, Italy and Finland have been covered more extensively than others have, where less precise information concerning ERS was available. Spain and the UK play the role of forerunners in terms of the involvement of the authorities in enabling ERS to develop. However, recent legislation in a number of countries, such as France and Ireland, shows that the legal information available on the subject is likely to grow significantly over the next few years. Dr. Elena Peréz-Carillo has coordinated the legal expertise, which is covered in Section E on page 86 of this report, and has assisted with the reporting on the Spanish system[24].

2. Questionnaires

a) Two questionnaires with a confidential and a non-confidential part

Two groups were formed based on two overlapping circles of respondents. Providers are knowledgeable about individual products and markets, whereas non-providers (primarily

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[23] European Central Bank, Recent Developments in Supervisory Structures in EU and acceding Countries 2006; ibid. EU Banking structures: The impact of ageing on EU banks 2006.

[24] The list of legal experts that have contributed their expertise on their country is available in Part III: Annexes IV. The country reports containing their legal analysis are available in Part II: Country Reports.

regulators and consumer organisations) can offer information about markets, as well as the cultural and legal environments. The main difference between the two questionnaires concerned product details, their price, design, and the terms on which they are sold. Both groups, however, have a set of information in common which could be evaluated together, thereby increasing the number of responses in our sample. In addition, both groups functioned as control groups in that they were asked for information about the other group. This led to follow-up interviews.

The two questionnaires are provided in the Annex VI and VII. Each questionnaire includes three sets of questions:

- Questions which only this group of respondents is able to answer;
- Identical questions for both groups;
- General questions concerning the other group's area.

The supplier side expressed the concern that much of the data concerning a specific provider and a specific product may be confidential and, in particular, information concerning business size, turnover and strategy. This would therefore require them to decline to provide information relating to those areas. As the tender requires provision of this data, and as direct information is the only source in most countries, confidentiality was improved by splitting the provider questionnaire into two separate parts:

- Part 1 contains general information about the provider, the product and the market, which is not confidential;
- Part 2 contains product specific information and is not related directly to the provider or to the product name.

This was explained to providers by means of the following annotation:

> "***Confidentiality****: All data will be treated confidentially. The study will contain only aggregate data and no data will be transmitted to third parties. To ensure all answers remain anonymous, this part of the questionnaire will be evaluated without relation to part 1 (which contains your corporate data)*."

Since filling out such questionnaires can be very burdensome for providers, there was a general risk that more information will originate from those with a political interest in EU policies than those simply dealing with ERS in practice. For that reason, iff endeavoured to raise interest in the project from its own experience. The letter from the Commission accompanying the questionnaire demonstrated the political importance of responding. Iff also offered to send the report to respondents only after it has been finalised and approved by the European Commission. The text used to introduce the questionnaire can be read by going to Annex VII and VIII where the questionnaires have been reproduced.

b) Development of the questionnaires

The questionnaire was developed following the following steps:

1. In the first stage, ERS were defined theoretically and the key research questions were drawn up. The outcome of this investigation with regard to existing research and the tender is shown under Section C of this report.

2. In a second step, hypotheses concerning the possible outcome of this research in relation to dissemination, barriers, incentives, features, risks, etc., were discussed with economists, sociologists and lawyers based at or cooperating with iff.

3. These hypotheses were operationalised into research dimensions and sub-dimensions. The dimensions are enumerated below.

Table 2: Research dimensions

GENERAL	(1) Details of organisation/association; (2) National Equity Release products; (3) Typical form of sale; (4) National market, data, size; (5) Typical user; (6) Public awareness and reports; (7) Risks and benefits; (8) Law
ERS	(1) Provider, (2) Distribution, (3) Product design, (4) Pre-information, (5) Advice, (6) Complaint procedure,
REGULATORY ENVIRONMENT	Regulation through authority/supervision, self organised
POTENTIAL BARRIERS	(1) Cultural (2) Economic (3) Legal

Each of these dimensions was then split into more concrete sub-dimensions and was allocated indicators in the form of a concrete answer underlying the hypothesis in this sub-dimension. The questions were then formulated in a way that the indicators are properly represented and that the standards of question construction (question writing (language, vocabulary), placement and filtering) were met and tested.

c) Testing

The questionnaire was tested first in Germany and then discussed with experts from Spain. While this led to a revision of the language and of questions likely to attract low response rates, the test led to the allocation of general information to the first part. It also led to an enlargement of coverage, since a number of responses were anticipated from providers which as yet offered no products but which were in the process of designing them. In order to obtain the results of their work, which will enable future products to be included in the research, we also opened up the questionnaire to information of that nature. As the question asks for the respondent’s understanding of exactly what an Equity Release product is and, because experience drawn from the various meetings suggests that this understanding is relatively diffuse, it was decided to make “*repayment solely out of the value of the house*” a strong indicator through our questions.

Testing was also conducted with the cooperation of the European Mortgage Federation whose legal committee gave valuable feedback on the research about the content and clarity of the questionnaire.

3. Participation and general overview of responses

A total of 315 questionnaires were sent to the various stakeholders. Responses totalled 140. Of this total stakeholder number, there were 55 responses from non-provider stakeholders in all 27 EU Member States providing completed questionnaires and detailed information on the general situation for ERS in their respective countries. Another 22 non-provider stakeholders made contributions by answering questions using email or giving telephone interviews. The number of participating provider stakeholders (including provider associations) was 63, 45 of which completed the questionnaire. The overall average response rate to our survey was approximately 45%, with variations ranging from Portugal and Estonia, with a response rate of 17% and 14% respectively, to Hungary and Belgium with 82% and 83% respectively.

The following gives an overview of the quantitative aspects of the participation in this survey.

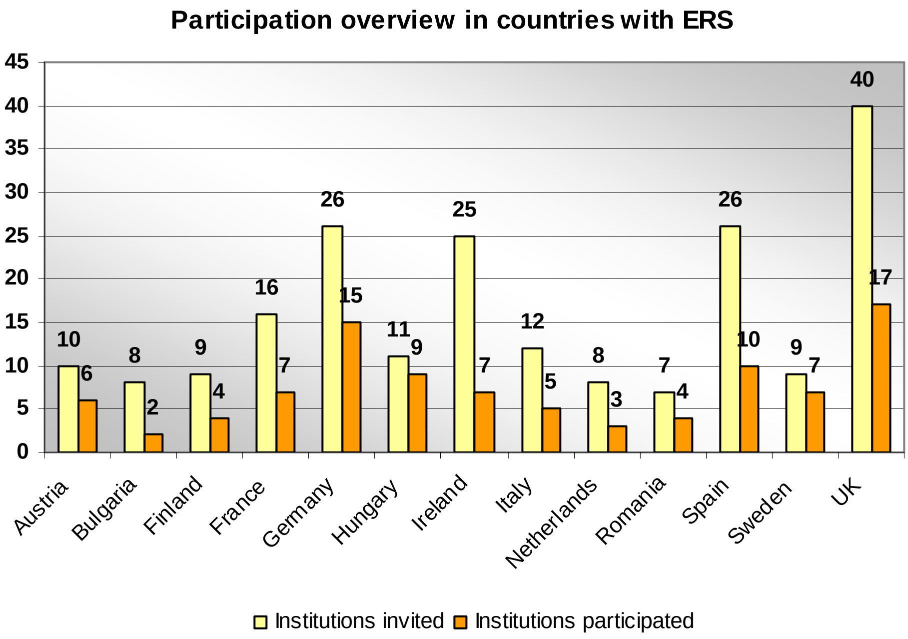
Table 3: Participation by Stakeholder group with and without a completed survey questionnaire[25]

Country	Providers		Government		Consumer associations		Others	
	Invited	Participated all/with survey	Invited	Participated all/with survey	Invited	Participated all/with survey	Invited	Participated all/with survey
Austria	5	2/1	1	1/0	1	0	3	3/2
Belgium	3	2/1	1	1/1	1	1/1	1	1/1
Bulgaria	1	1/1	3	1/0	3	0	1	0
Cyprus	1	0	3	2/1	1	1/1	0	0
Czech Rep.	3	1/1	3	1/1	1	0	2	0
Denmark	4	2/1	2	1/0	1	1/1	1	1/1
Estonia	0	0	2	1/1	4	0	1	0
Finland	3	3/3	2	1/1	3	0	1	0
France	5	3/3	4	1/1	4	1/1	3	2/2
Germany	17	8/6	2	2/1	2	1/0	5	4/2
Greece	1	1/0	2	0	1	0	2	1/1
Hungary	5	3/2	2	2/2	1	1/1	3	3/2
Ireland	18	4/2	2	2/2	3	0	2	1/1
Italy	6	2/2	1	1/0	3	1/1	2	1/1
Latvia	2	0	1	1/0	1	0	1	1/1
Lithuania	0	0	3	2/1	1	0	1	0
Luxembourg	1	0	3	1/0	1	0	1	0
Malta	3	3/2	1	1/1	2	1/0	2	1/1
Netherlands	3	2/2	2	1/0	1	0	2	0
Poland	3	0	3	1/1	3	1/1	3	2/2
Portugal	4	0	3	1/1	2	0	3	1/1
Romania	1	1/1	2	1/1	1	0	3	2/1
Slovakia	1	0	1	0	1	0	1	1/1
Slovenia	1	0	2	1/0	1	1/1	1	0
Spain	19	7/6	3	2/1	1	0	3	1/1
Sweden	3	3/2	2	2/1	2	1/1	2	1/1
UK	25	11/9	2	2/2	2	1/1	11	4/3
EU	7	4/0	0	0	1	1/0	2	1/1
Total	**145**	**63/45**	**58**	**33/20**	**49**	**12/10**	**63**	**32/25**

[25] The second column entitled "Providers" includes intermediaries; the third column entitled "Government" includes regulators. Participation was differentiated by those participants who completed a survey questionnaire and those who preferred to share their views on the questions and the subject either orally or electronically (all/with survey). In addition to national stakeholders, EU level stakeholders (i.e. European associations) are also shown in the table.

The overall feedback from the countries where ERS are offered was with approximately 49% somewhat higher then the average feedback from all Member States with 45%. Very little responses were received from Bulgaria (25%) and Ireland (28%), a higher rate from Netherlands (38%), Spain (38%) and Italy (42%).

Figure 2: Overview of survey participation in countries with ERS



Source: iff survey results

However, from the responses given by providers and provider associations in the five countries referred to above, the results may vary. Whereas Spain and Italy have a participation rate of 37% and 33% respectively, participation in Bulgaria is significantly higher at 100%. Given that only one provider is known, the result is not surprising. The participation rate of the Netherlands was 67%. Consumer organisations and other experts, such as notaries, in the main decided not to participate. Ireland, however, had an even lower rate of involvement in the study at only 22%, as explained below.

Generally, responses from individual providers related to whether or not ERS products existed at all and to the availability of information about them, or to whether there was an ongoing debate within the country concerned as to potential regulation or the development of these products.

The participation rate of providers in responding to the questionnaire was relatively limited even in Member States where ERS were known to exist, but the responses from providers which did complete our survey or which agreed to be interviewed were very valuable. It is not surprising that the UK was the Member State that had by far the most providers participating in the research, followed by Spain and Hungary. 85 of the 103 providers identified by regulators are located in the UK, Ireland and Spain. All answers received in the form of a completed questionnaire have been included in the survey results. Where no answers were obtained, this was mostly because the provider did not in fact offer any ERS of their own or from another originator. Where responses were unclear or ambiguous, the research team approached the provider a second time.

Table 4: Number of providers as indicated by national regulators

Providers as indicated by regulators	**Number of Provider(s) per Member State**
United Kingdom	40
Ireland	27
Spain	18
Italy	5
Hungary	3
Germany, Finland	2
Austria, Bulgaria, France, Netherlands, Romania, Sweden	1
Total	*103*

Source: Responses from providers, regulators, iff survey results

When we looked more closely at the providers indicated for Ireland, which at the interim stage had not yet responded to our questionnaires, we discovered that almost all were brokers and therefore assumed that they were not the correct addressees for our questionnaire. Furthermore, a number of companies have ceased to offer ERS recently due to the current credit crisis. This explains the lower response rate from Ireland to a certain extent. A similar, though less pronounced, observation applies to a number of providers in the UK and Spain, where a number of credit intermediaries are also involved in the marketing of such products.

We therefore assume that our response rate is relatively high taking into account the diversity of products. From the information provided by the 27 ERS providers, and based on the descriptions given by providers of their products, we estimate that at least **44 different equity release products** exist. A few of these have not yet been launched.

In terms of the number of products, the UK is again in the lead with 14 products, while Hungarian, Swedish, Italian and Spanish providers indicate that providers specialising in this area offer up to three different products each.

As iff contacted all national bankers' associations, bank supervision authorities and central banks, as well as consumer organisations in each state, using various channels, it may also be assumed that non-response indicates continuing low levels of interest in this area in the country concerned. While consumer organisations (half of Member States) are normally concerned only when such products have not only been launched but have conquered at least a discernible share of the market, or at least public debate, it is interesting to note that ERS is already an issue at EU level.

4. Summary

The empirical survey consisted of a total of 315 questionnaires, to which 140 responses were received. Of this number, 55 responses came from non-provider stakeholders in the 27 EU Member States (excluding an additional 22, who made contributions by email or through telephone interviews) and 63 from providers, 45 of whom completed the questionnaire. In addition to providers, national bankers' associations, bank supervision authorities and central banks, as well as consumer organisations in each state, were approached. Finally, legal experts from all 27 Member States answered questions and provided reports of varying length and depth.

C. Socio-economic survey

The empirical evidence provided by this section is based on a survey of providers, financial regulators and supervisors, consumer organisations and legal experts in EU Member States. It uses objective data accessible through general statistics such as Eurostat, but is primarily based on evidence supplied by our interview partners. While some research has been done at national level, for example in Germany and Spain, the findings of which have been incorporated into the national reports, only very few supra-national reports dealing with ERS, retirement pensions, or homeownership and welfare currently exist[26].

I. Markets for ERS

In its 2005 report entitled "*Ageing and Pension System Reform*", the OECD[27] highlights the under-developed potential role of financial services in the provision of retirement pension schemes. It finds evidence for its emergence only in the UK and the Netherlands.

> "*In markets such as the Netherlands, the United Kingdom and the United States, flexible refinancing practices and a wide range of mortgage products have enhanced households' ability to manage their debt position and interest rate exposure, and extract equity from their home. Reverse mortgages (or home equity conversion mortgages) target older homeowners, and offer a variety of cash flow profiles. Payments to households are structured similarly to an annuity, and repayment is not required as long as the borrower uses the home as his or her principal residence. However, in most countries, these instruments are still scarcely used, including because they require a relatively high degree of household financial education. Even in the United States, where the reverse mortgage market has developed rapidly in recent years, it remains very small*."

1. Volume

In order to provide figures on ERS in the EU in the absence of official statistics, we have relied on two sources: responses from providers and responses from other stakeholders, a heterogeneous group referred to as 'non-providers' and including the knowledge of regulators in particular. The data in terms of the EU market in ERS has been broken down by Loan Model or Sale Model schemes as defined in the previous section of this report.

The total number of Loan Model contracts reported for the year 2007 was 23 532, the lowest number of contracts being in Austria, whereas the highest number of contracts was reported from the United Kingdom, where there is a thirty-year tradition of this type of product (16 592). In Germany, the two existing Loan Model products were only brought onto the market in 2008 and thus do not appear in the table for 2007. 2008 was also the year which also saw the first appearance of a Loan Model ERS in Romania.

The market in Loan Model ERS is very small in relation to the ordinary mortgage market. It currently represents less than approximately 0.1% of the overall mortgage market (EUR 5 714 billion based on EMF data). The estimated volume of Loan Model ERS in the EU outstanding is about EUR 3.31 billion, with an estimated 45 238 contracts[28].

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26 Examples of these include work done by the OECD and promising avenues through the EU's Survey of Health and Retirement in Europe (SHARE).

27 OECD 2005 report entitled *Ageing and Pension System Reform* p.51. Available under: http://www.money-advice.net/media.php?id=3270. See (fn 19).

28 Figures provided by respondents as of October 2008 for the year 2007.

Table 5: Total amount of ERS (Loan Model and Sale Model) sold in 2007

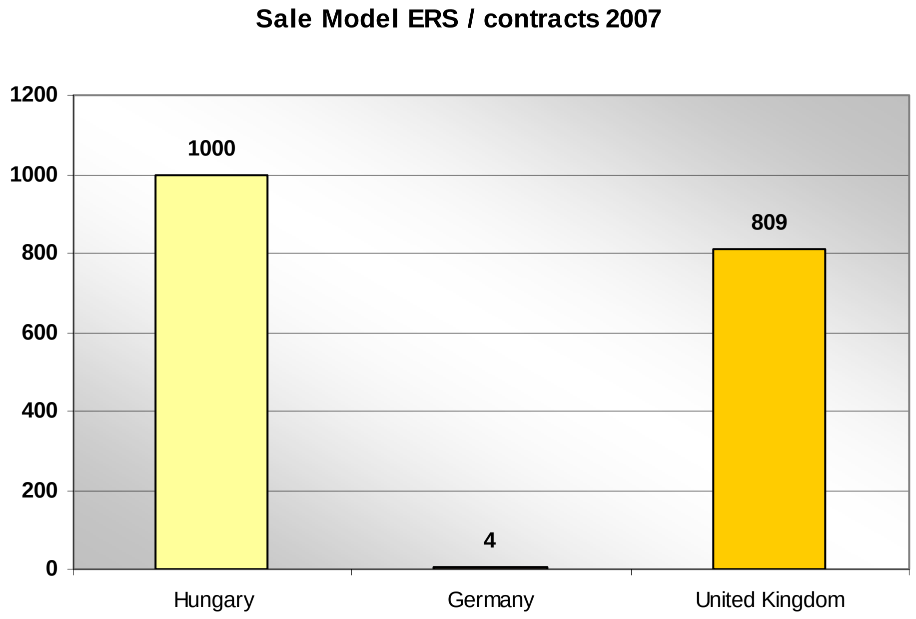
Country	**Total amount of ERS – Loan Model**[29]			**Total amount of ERS – Sale Model**		
	Outstanding Amount (EUR million)	**Average Amount per contract** (EUR)	**Number of contracts**	**Outstanding Amount** (EUR million)	**Average Amount per contract** (EUR)	**Number of contracts**
Austria	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	n/a	n/a	n/a	n/a	n/a	n/a
Finland	n/a	n/a	n/a	n/a	n/a	n/a
France	20.0	100 000	200	n/a	n/a	n/a
Germany	10.0	100 000	100	n/a		12
Hungary	3.2	n/a	n/a	214.0	41 961	5 100
Ireland	n/a	n/a	n/a	n/a	n/a	n/a
Italy	74.3	247 500	300	n/a	n/a	n/a
Netherlands	n/a	n/a	n/a	n/a	n/a	n/a
Romania	n/a	n/a	n/a	n/a	n/a	n/a
Spain	1 268.0	352 222	3 600	n/a	n/a	n/a
Sweden	110.0	44 000	2 500	n/a	n/a	n/a
UK	1 825.0	55 303	33 000	1 131.0	77 466	14 600
Total	3 310.5	83 387	39 700	1 345.0	68 233	19 712
The following countries do not offer any type of ERS		Belgium, Cyprus, Czech Republic, Denmark, Estonia, Greece, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Slovakia, Slovenia				

Source: Responses from providers, regulators, own calculations

Of the eight providers of Sale Model ERS, six reported the number of contracts for 2007. The total number of Sale Model contracts reported was 1 813 contracts, which is relatively low in relation to the number of Loan Model ERS reported by the providers in question. The overall figures, as indicated by regulators and calculated via the indicated market share of some providers, amount to about 20 000 contracts.

29 Based on self-evaluation by providers participating in the study.

Figure 3: Sale Model ERS contracts in 2007



Source: Responses from providers, regulators, own calculations

Based on the information about the estimated market share supplied by the providers participating in the study and the total number of the contracts involved, the estimated number of contracts for Sale Model products represents about one third of the overall market in Equity Release products.

The total volume of the current market in Equity Release products in the European Union, based on the estimates and data from participating providers, is estimated at about EUR 4.47 billion, with about 60 000 clients.

A table summarising the responses from all stakeholders with regard to providers and existence of ERS by type is included under the methodology section B.III (see p.16).

Table 6: EU providers of ERS[30]

Country	**Loan Model or Sale Model**	ERS Providers identified
UK	Loan Model and Sale Model	40*
Ireland	Loan Model and Sale Model	27*
Spain	Loan Model and Sale Model	21
Austria	Loan Model	1
Finland	Loan Model	2
France	Loan Model	1
Italy	Loan Model	5*
Netherlands	Sale Model	1
Sweden	Loan Model	1
Romania	Sale Model	1
Bulgaria	Sale Model	1
Germany	Loan Model and Sale Model	2
Hungary	Loan Model and Sale Model	3

* includes some intermediaries

Source: Responses from providers, regulators, iff calculations

The majority of providers in **Ireland** transpired to be intermediaries.

The only general statistics specific to ERS are available in the **United Kingdom**. According to SHIP (Safe Home Income Plans), the trade association for Equity Release providers, the overall size of the ERS market is EUR 1 560 million in 2007. This is made up of EUR 1 454 million Loan Model ERS and EUR 106 million Sale Model ERS. This figure is supported by the responses to our questionnaire, in which five providers reported their turnover and market share. A quick consistency check taking the 18% market share of one provider reporting on his Loan Model product and the total outstanding ERS mortgages produces a total of EUR 1 532 million in 2007, a figure which is in the same ball park as the one indicated by SHIP.

The differences are greater if we take the figures provided by four Sale Model product providers, whose estimated market share adds up to 52%. The total number of Sale Model products then ranges between EUR 102 million and EUR 192 million, and an average of EUR 140 million. This figure is somewhat higher than the figure provided by SHIP. Nevertheless, in view of the clear dominance of Loan Model products and the size

30 Note that this table refers to providers identified and not providers whom have taken part in our research. We also remind the reader that products that resemble Loan Model ERS exist in the Netherlands, Denmark and Finland, but because these are not classified as ERS, Denmark and the Netherlands are not judged as having an ERS market. Nevertheless, special attention should be paid to the case of the Netherlands, which in this table only is shown as having one provider of Sale Model ERS: This may contradict information in both Part I: General Report and Part II: Country Reports which treat the Netherlands as a Member State without ERS. This is because awareness of the existence of this one provider only took place at the closing stage of the study and no information is available at the time of writing.

of the housing market in the UK, Sale Model ERS does not represent a significant form of ERS scheme in the context of the housing market as a whole. The number of clients derived from these figures would amount to 42 883 consumers using Loan Model ERS, and about 1 560 using Sale Model ERS. Both types make up less than 0.1% of the mortgage market and the population of the UK.

In **Spain,** there are about 3 600 Loan Model ERS contracts.[31] According to the Spanish media, the average size of contract is around EUR 352 260, which is probably an overestimate with respect to the statistically valid UK figures which are much lower.[32] It would amount to a total of EUR 1 268 million. In **Hungary,** one provider of both product types reports that there are about 3 000 contracts in Hungary, which, based on his statement of the size of his ERS business and his market share, would amount to EUR 157 million. The **Swedish** report also indicates that the market there is very small. In **Germany,** only four contracts were sold in 2007, so that the total was less than EUR 1 million.

The Sale Model ERS in **Hungary, Bulgaria** and **Romania** are largely available from a single provider, which has started to market a Sale Model product in several South Eastern European Member States.

The Scandinavian countries are a special case. A **Finnish** provider, for example, assumed that his product was an ERS. One provider offers the product to 5 500 clients with a total amount of outstanding credit at EUR 300 million, which in the context of the overall ERS market, would make Finland one of the leading ERS markets in Europe. However, the product does not fit the criteria of this research, namely that credit should be for life and only repaid from the eventual sale proceeds of the home.[33] They resemble second mortgages for old age. Similar products are well known in **Norway.**[34] Similarly, in **Denmark,** although 38 contracts amounting to a total of EUR 1 599 million were reported by a survey participant, after closer inspection these products were also not judged to constitute ERS for the purposes of this study. Also associated with these three aforementioned countries is the **Netherlands**, which despite the OECD explicitly having cited the country as having a significant Equity Release market, is shown in our Dutch national report[35] not to have Loan Model ERS. Instead, these loans provide second mortgage credit, which could indeed be used for equity release in old age, but which nevertheless failed to match our definition.[36]

The **Belgian** bankers' association has produced a feasibility study in the form of a memorandum to the Belgian government. We drew a significant amount of information from this report as to barriers and potential action[37], and we also assume that this report

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[31] Jubilarse en casa, *Borrador Informe de Stiuación y Estado de Desarrollo de la Hipoteca Inversa en Espana*, 2008 (unpublished expertise) p.13 mention 2800 contracts for 2007. 2500 are quoted in elmundo.es Viernes, 24 October 2008 *Feliz futuro a la hipoteca inversa.*

[32] See Part II: Country Reports II.1 Spain (p.39).

[33] The description of the product is as follows: "Our ERS product, called HomeFlex, was launched in 2005. It consists of a combination of loan and current account. If the customer owns a home and has free equity, he can be granted a loan up to 75 % LTV using the home as collateral. In combination with the loan, the customer gets a current account. The loan is a balloon loan with 10 years' maturity - customer only pays the interest. After 10 years, the loan can be renewed, paid back or an amortization scheme can be made. Customers can also pay the loan back any time during the maturity without extra cost. The customer pays an up-front fee for the product. Interest rate for both the loan and the current account is the reference rate + customer margin. If the amount on the current account exceeds the amount of the loan, customer will not be paid any interest on the exceeding amount. Tax at source is deducted from the interest paid on the account." (Response from Questionnaire PQ13).

[34] As cited in the Belgian expertise in Part II: Country Reports XIII.3.b) Belgium (p.118).

[35] See Part II: Country Reports XX.3 Netherlands (p.145).

[36] See Part II: Country Reports XX.3 Netherlands (p.145).

[37] See Part II: Country Reports XIII.1 Belgium (p.114).

would have mentioned the Dutch ERS market if its size were significant. The treatment of second mortgage loans as distinct from ERS also applies to **Malta**, where the only response available is that banks have started to market second mortgage loans and that ERS are not yet offered.

2. Developments – the UK example

Since figures for ERS are not available for most Member States, the development of the scheme is difficult to assess. For this, we must refer to the number of UK schemes, which can probably be used to predict future development since they confirm our general theoretical expectations. Historically, the original form taken by the first schemes was the private reversion of home equity through sale and leaseback arrangements, *Leibrente*, which have since been commercialised by real estate professionals into Sale Model products, and are now increasingly being followed in turn by the development of Loan Model products. Thus, ERS are taking the same path as consumer credit in general, which started with borrowing from family and neighbours, then developed into instalment purchases which were then gradually professionalised into bank loans and increasingly separated from the goods whose purchase was being financed.[38]

Table 7: Development of ERS

Chronology	Forms	Providers	Activity
First step	Home reversion or Sale and lease back	Private	Renting
Second step	Sale Model	Real Estate Brokers, Insurance companies	Sale
Third step	Loan Model	Banks, Insurance companies	Loan

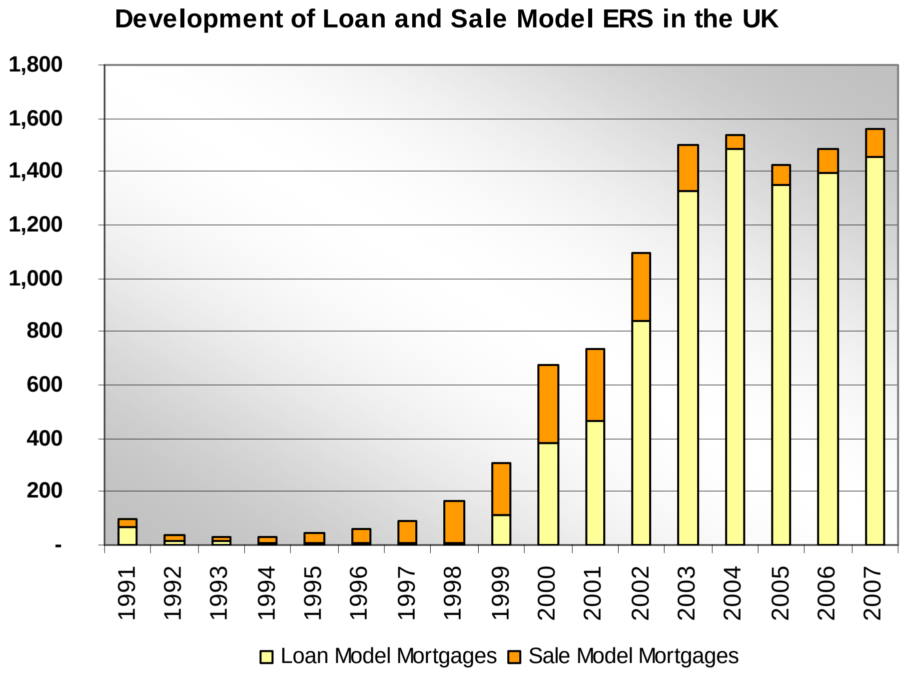
Source: iff own classification

The figures submitted by SHIP for the UK show a clear trend from Sale Model towards Loan Model products over time[39].

[38] For this history of consumer credit, see Reifner, U., *Verbraucherverschuldung*, 1978 pp.116 ff.

[39] Extreme caution should be taken when judging this trend from the SHIP data shown above because of sample effects. SHIP membership has grown over time and did not include some important Loan Model ERS providers in the earlier years.

Figure 4: Development of ERS in the UK



Source: Figures provided to iff by SHIP (http://www.ship-ltd.org/)

It shows that there is still a certain market for Sale Model ERS, which historically dominated the ERS market and which reflects the situation in some new accession states. Nevertheless, what has happened in the UK since 1999 will probably also be the future for ERS systems in the EU. As a whole, Loan Model ERS are likely to grow while Sale Model ERS may stagnate.

The experts in Germany, Spain and Italy have reported that an empirical survey of households suggests the emergence of a large variety of forms of home reversion systems, using the home as a source of income in old age combined with occupation rights. This insight is quite important for future developments, since even without the professionalisation of services into Sale Model ERS, the different forms that an equivalent 'sell and stay' private transaction may take will indicate the kind of needs consumers express with regard to their homes and retirement pensions.

A rough estimate for the EU as a whole totals EUR 4.655 billion, with an estimated 59 412 contracts released from homes in 2007 in the specific forms of Loan Model ERS and Sale Model ERS.[40] Loan Model products dominate the ERS market and can be compared with the total outstanding mortgages on private homes of EUR 6 147 billion for home loans in 2007 in the EU.[41]

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[40] See Table 5 above (on p.20).

[41] Hypostat Nov. 2007; for the Eurozone see Eurostat Monetary Financial Institutions: Bestandsangaben http://www.bundesbank.de/statistik/statistik_eszb_neuesfenster_tabelle.php?stat=outstanding_amounts&lang=.

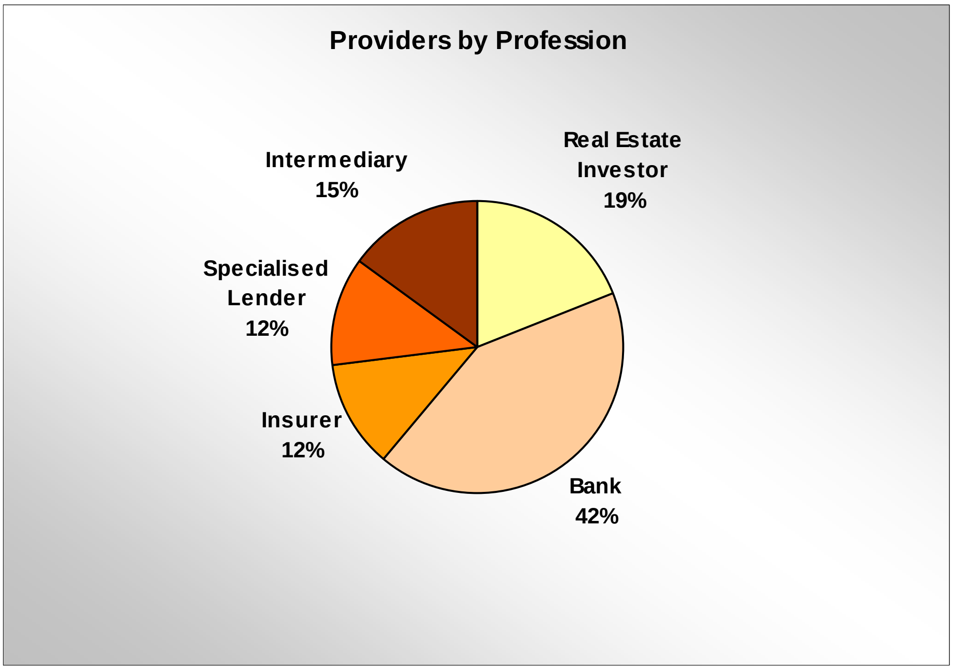
II. Parties involved in ERS

1. Providers

The survey obtained responses from 27 different providers in Europe. Approximately 1/3 was based in the UK (8); the remainder were based in Spain (3), Hungary (2), Finland (2) and Germany (4); Sweden, Netherlands, Romania, Italy, France, Denmark, Bulgaria and Austria each had one participating provider. The vast majority (18 providers) marketed Loan Model products. Six marketed Sale Model products. Three providers offered both.

Most of the providers of ERS schemes were banks (11) and insurers (3). They, together with three other specialist lenders and three intermediaries offered Loan Model products. The other intermediary and six real estate developers offered Sale Model products.

Figure 5: Providers by profession



Source: Responses from providers

All providers stated that there is a need for specialisation in this area. As we will see below, marketing must be close to the client either by using direct marketing or intermediaries. The figures also reveal that the housing and real estate sector is focussed on Sale Model ERS, while the financial services industry must either directly or through refinancing be involved in the supply of Loan Model ERS.[42]

All banks and insurance companies offering such products had more than 250 employees, similarly most real estate developers were larger in size while intermediaries and the specialist lenders were relatively small, with less than 50 employees and a turnover of less than EUR 10 million.

Among the banks were some major providers, such as Rabobank, Royal Bank of Scotland, and Dresdner Bank. Most, however, were specialist mortgage banks, and the commercial banks participating in this area have mortgage specialists and a specialised

[42] For the licensing of providers, see Section E.II. below (on p.94).

back office to offer such schemes which, due to number of risk factors and the complicated structure of these combined products, require a high degree of professionalism.

2. Consumers

Following the definition of ERS, both types require that the user must be a consumer who is not using the home for business purposes and that the user live in the property for a significant period of time after completion of the transaction, having been its owner prior to the contract, in Sale Model arrangements, and remaining so until death or a move into long-term care in the Loan Model of ERS.

The average user reflects the distribution of gender in society. 50% were male and 50% female. If only the biggest market, the UK, is considered, there were more women users than men (57% to 43%). Women have longer life expectancy and therefore form a high proportion in terms of market share. In the 70 – 79 age group, which is significant for ERS, 57% of users in Germany are women and 43% are men. In older age groups, the ratio changes further to about 70% and 30% respectively.[43] It is therefore to be expected that there will be more female ERS users than male.

Most providers require a minimum age for the product, which reflects its function as a retirement pension product. Most set this limit at 60, some at 55 and others at 65. In the Scandinavian countries, except Sweden, and in the Netherlands, there is no such limit because Loan Model products are very flexible and allow for equity repayments, small sums and even drawdowns. In countries where there are legal rules defining the user of such systems in terms of eligibility criteria for relief and special treatment, as is the case in Spain and Sweden, the minimum age is fixed. It is set at 60 in Spain and 55 in Sweden.

The actual average age of users wishing to enter into these kind of contracts is 72 years, which is also the value most often given in the survey. It is probably the age at which people know what they intend to do with their homes, especially with respect to their children, and also the age at which they face the true value of their pensions.

The following table shows the minimum as well as the average age of users in practice.

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[43] Bundeszentrale für politische Bildung Figures for 2005 under: http://www.bpb.de/wissen/X39RH6,0,0,Bev%F6lkerung_nach_Altersgruppen_und_Geschlecht.html.

Table 8: Age of users in practice

Country	Min. requirement	Actual age	Median
Germany	60 or 65	72-76	74.5
Spain	60 or 65	70-85	76
Finland	60 or 65		
Hungary	65	72-85	78.5
Malta			70
Italy	55	79-82	80.5
Netherlands	65		70
Romania	60		70
Sweden	55		68.5
UK	60 or 65	67-83	72.4
Median	60		72.4
Maximum	65		85
Minimum	55		55

Source: Responses from questionnaires (incl. alternative products and ranges)

The questionnaire addressed to providers also asked for information on the typical user of equity release products. These users are usually about 70 years of age, living in an urban environment and having property values of around EUR 300 000. They use the product to maintain their standard of living. In short, they are 'asset rich and cash poor'. While in Spain, married users predominate, in Hungary only a third is married. In Italy, users typically had a high income before pension reform drastically reduced their pensions. In Italy, widows account for about 40%. In the Netherlands, married couples at the age of 70 may also have an interest in "*making an expensive trip or buying a car, a boat or a camper*"[44]. In Sweden, the large increase in house values may be an incentive to take out some of its equity. In the UK, "*a cash lump sum or access to a flexible reserve of funds for people who wish to remain living in the property for life, mostly keen to leave some inheritance*"[45] is seen as typical. 42% of users are couples. Some customers intend to improve their home with the funds received, many in order to adapt it to their emerging needs, as they grow older.

III. Products

1. General description

Equity Release products can be divided in two groups, loan-based products and sale-based products as defined in the theoretical part at the beginning of this study. Both products allow the customer to reside in the home, unless they change domicile, die or need care in a nursing home.

Equity Release Loan Model products are based on a loan linked to a property as security, which means in general a reverse mortgage. The customer can take out lump sums, monthly payments or have a line of credit.

[44] See response from Questionnaire PQ2.

[45] Statement of the UK legal expert in the survey.

The key feature of the roll-up lifetime mortgage is that the consumer makes no initial repayments whatsoever. Interest charges accrue on top of the principal mortgage loan, or are 'rolled up' over time. The accumulated interest and the original loan are only repaid when the home is sold, either after the borrower's death or if the borrower decides to move into long-term care. If the borrower moves house, lifetime mortgages could allow the customer to transfer the loan to the new property and secured against it, though there could be also restrictions or caveats attached. The interest rate charged on a roll-up lifetime mortgage can be fixed at the outset, capped at an upper level, or can be variable. When the estate is sold for more than the outstanding sum due under the loan, the provider or the customer (or the customer's inheritors) will take the residual sale proceeds, depending on the terms of the contract. Some contracts have a 'no-negative equity guarantee', which means that the provider can only use the estate to recover the loan, interest and costs at the end, and no personal liability is attached to the loan.

Equity Release Sale Model products are based on an up-front sale of the property. The homeowner sells it at a discount, whilst retaining the right to remain in the house either rent-free or subject to payment of a small rent until death or a move into long-term care. The customer can sometimes buy back the reversion, in which case the costs associated with this would be included in the terms offered.

Special types of sale-based products are part sales, in which the homeowner often has the option to sell all or part of the amount retained after a specified period, and accumulating reversions which are structured and marketed as a reversion, in that the provider actually owns a proportion of the house. The annuity pays the interest due, and any surplus provides the consumer with a monthly income. The principal loan remains outstanding and is repaid on disposal of the estate. Some providers also offer the same option of using funds released subsequently to purchase a lifetime annuity, which provides monthly or annual payments guaranteed for life.

Reversions were criticised in the past[46], because in the event of death in the early years, the customer has received poor value. Because the property was sold at a discount, the amount realised was relatively low compared to its market value. To counter this, some providers offer the option of a lower initial payment in exchange for an additional payment on demise. This death benefit usually decreases over time, is typically limited to the first five years and will also apply if the customer moves into long-term care. The debt is equal to the value of the house at all times and there are no issues regarding retained equity or negative equity. Note that often, for these products, the term 'company' as opposed to 'provider' is preferred, because the organisations offering these products are not always credit institutions. In these schemes, the key expense from the consumer's point of view is the loss of equity up-front, due to sale at a discount on the actual value of the property, alongside a significantly reduced claim to future house price growth. The up side is that the consumer can and often does retain a share in the property.

The technical aspect of an ERS could be seen as consisting of three elements, combining sale, mortgage and retirement pension in the form of a financial service.

2. Data basis for the description of existing products

The description of existing products is based on the completed questionnaires received from providers and other stakeholders (including regulators, consumer organisations etc…). Equity Release products have existed for 30 years in the United Kingdom, but with

46 For examples see Part II: Country Reports I.2.c) UK; VI.6.b) Italy; XV.2.c)(2) Greece.

the exception of Spain, they have only had a presence in the EU Member States for five years or less. ERS are therefore a new development in the EU.

Of the 27 providers in the EU that have filled out a questionnaire, 18 providers offer Loan Model ERS (whereas 1 provider offers two Loan Model products), 5 providers offer Sale Model ERS only and three providers offer both types of products. Four providers that responded to the questionnaire actually did not offer Equity Release Products.

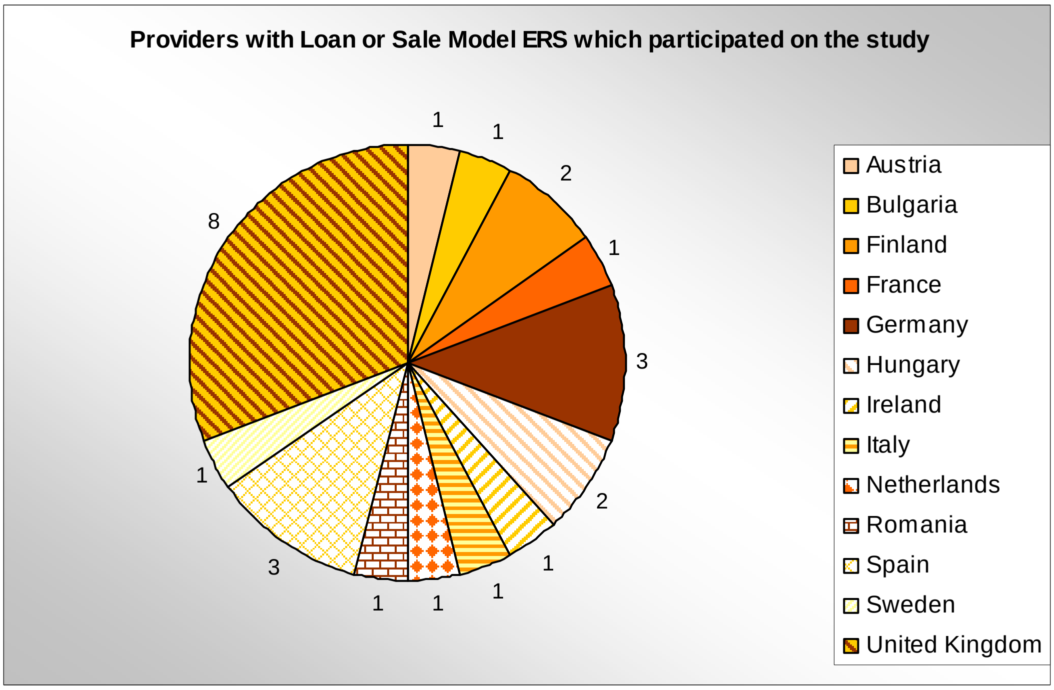
Table 9: Number of providers by type

Number of providers by type which they offer	
Loan Model	18
Sale Model	6
Loan Model and Sale Model	3
Number of providers with ERS	**27**

Source: Responses from providers

The main Equity Release product is the credit-based reverse mortgage (or lifetime mortgage) product. Below is also a pie chart reminding of the geographical representation of the providers who completed a questionnaire.

Figure 6: Participating ERS providers[47]



Source: Responses from providers

[47] Although the pie chart shows an ERS provider from the Netherlands as having participated in the study, this was not in fact possible due to the sole Sale Model ERS provider only having been discovered at the closing stages of our research. We have included the Netherlands in order to be consistent with previous tables reporting that 13 Member States have ERS. As explained in (fn 30) accompanying Figure 4 on p.23, the Netherlands has nevertheless been classified in Group 4 alongside Member States with no ERS. This is not to be confused with the provider from the Netherlands that has shared valuable information on his product, which was deemed not to be a Loan Model ERS according to the definitions set by the study. See Part II: Country Reports XX the Netherlands for more detail (p.144).

3. Common criteria for all ERS

This section describes the characteristics of the different schemes that have been found in the EU[48]. Three of the 27 providers (Austria, France, Ireland) gave only limited information about their products. The following information was therefore based in the main on the 24 completed questionnaires. The information reflects solely the policies of the providers and not legal obligations.[49]

a) Procedure

Usually all providers work with an internal or external surveyor for the **valuation** of the house or apartment.

b) Personal restrictions

ERS are **restricted to homeowners** – house or apartment. They have full ownership rights without any outstanding mortgages[50]. Spouses are generally accepted under a joint contract, but this will entail changes to the terms of the product offered. Only providers from the United Kingdom, where the Equity Release market has been developed over the past 30 years, reported that other types of households are also generally accepted: "*Any 2 people living together can apply jointly (provided they are both eligible) e.g. spouses, brothers and sisters, unrelated people, unmarried couples. Married couples and civil partners must apply jointly*." A **third person** is normally also accepted as a housemate in the house/apartment. Two providers (from Germany and the United Kingdom) said that they would not accept another person besides the homeowner(s) living in the home.[51]

The **minimum age** for Equity Release products as a requirement of the providers, was reported to be between 55 and 65 years, and the most common minimum age chosen by providers for commercial reasons was 60 years. As already covered in the section on the typical user of ERS above[52], the range of the minimum age for different products can be as much as 10 years (55 – 65) as is the case in the United Kingdom. Differences in the minimum applicant age accepted by providers also exist in Member States in which a minimum age is defined by law for specific Equity Release products (e.g. Italy and Spain). Other providers did not respond as to the minimum age, but stated that their products are designed for retirees, pensioners or former freelancers, sometimes giving an age of over 70 years as the typical costumer.[53]

The most frequent **factors for personal non-eligibility** are an existing first mortgage, a bad credit history and foreign nationality[54] reported by half of providers. Foreign nationality in mortgage loans is often connected with real estate in another country, which is not accepted as an equivalent security for a mortgage in the country of the provider. Another reason could be that there are more debt collection problems with borrowers who may leave the country. Therefore, most credit assessments include the national identity of the Applicant. Providers sometimes also mentioned that a clear

48 Product details and features relevant only to Loan Model ERS are described in Section C.3.III.4 (p.43), while those unique to Sale Model ERS in Section C.3.III.5 (p.46).

49 For legal analysis, see Section E.I.2 below (p.87).

50 See Part II: Country Reports on Sweden VIII., Italy VI., Finland VII., Spain II. and Germany IX.

51 Question No. 3.11 "Can a third person live with the owner or co-owner of the property?" was denied in that case.

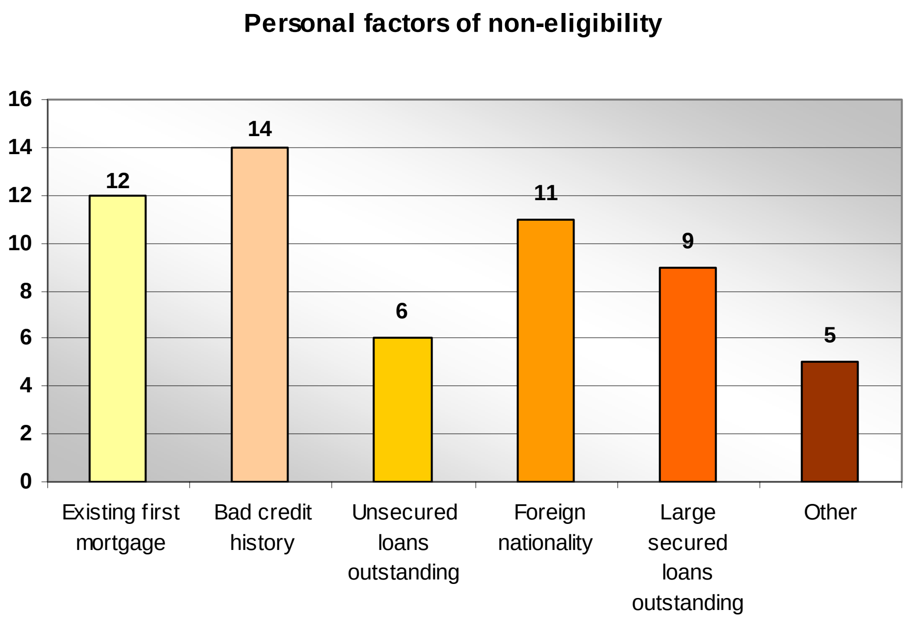
52 See above (on p.28).

53 Spanish Provider: "Dirigida a: Personas físicas mayores de 70 años, que sean titulares de viviendas."

54 In the Questionnaire for providers it was not distinguished between consumers from other EU-Member States and consumer with nationalities outside the European Union.

permanent right to reside in the country is sufficient for foreign customers. Other factors are less common, and are set out in the chart below.

Figure 7: Personal factors of non-eligibility



Source: Responses from providers (n = 24)

Other reasons mentioned were undischarged bankruptcy and lack of mental competence. Some responses stated that pre-existing secured debt above a specific limit must be paid off from the funds released.

In two-thirds of products (20 out of 31), no minimum **income** was required and there was no significant difference between the Loan Model and Sale Model. Nevertheless, in most cases the customer must complete a document setting out household income either as part of the normal application process for a mortgage loan or during a special advice procedure for Equity Release products. Only five providers (all from the United Kingdom) said that income need not be declared.

Medical **tests**[55] (2 cases in the United Kingdom) and other tests[56] (5 cases in Denmark, Spain, Sweden, United Kingdom) were not very common for these products but credit checks were used in half of Loan Model cases (9 cases in the United Kingdom, Italy Finland, Spain, the Netherlands, Denmark and Germany) in contrast to Sale Model ERS (0).

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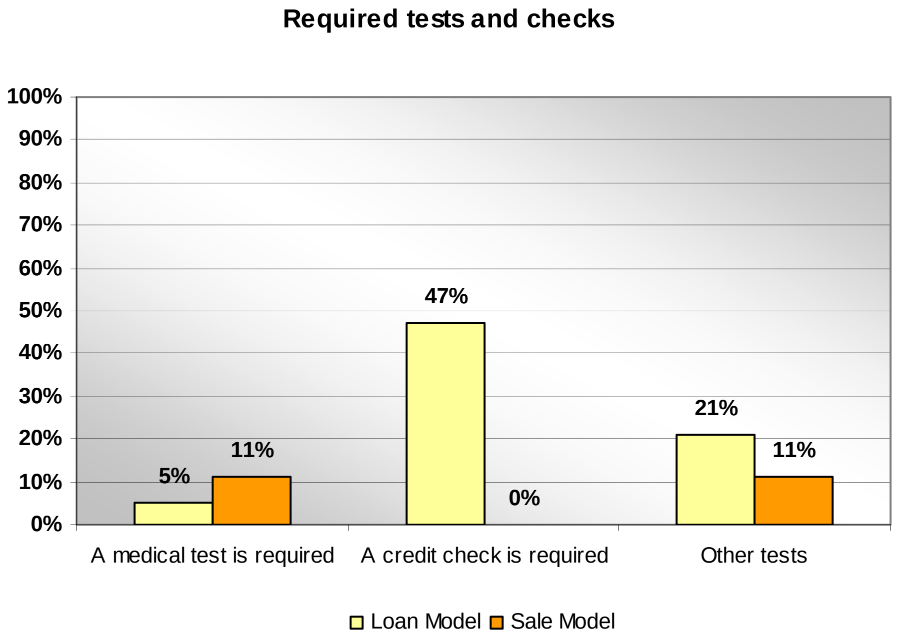
[55] Used only in specific cases: Provider 1: "Only in impaired life cases", Provider 2: "Medical tests not required, but can be used to obtain preferential terms."

[56] Named were: special check of property, legal check of the title to the house, identity and money laundering, bank account and instalment plan in case of existing loans.

Figure 8: Required tests and checks



Source: Responses from providers

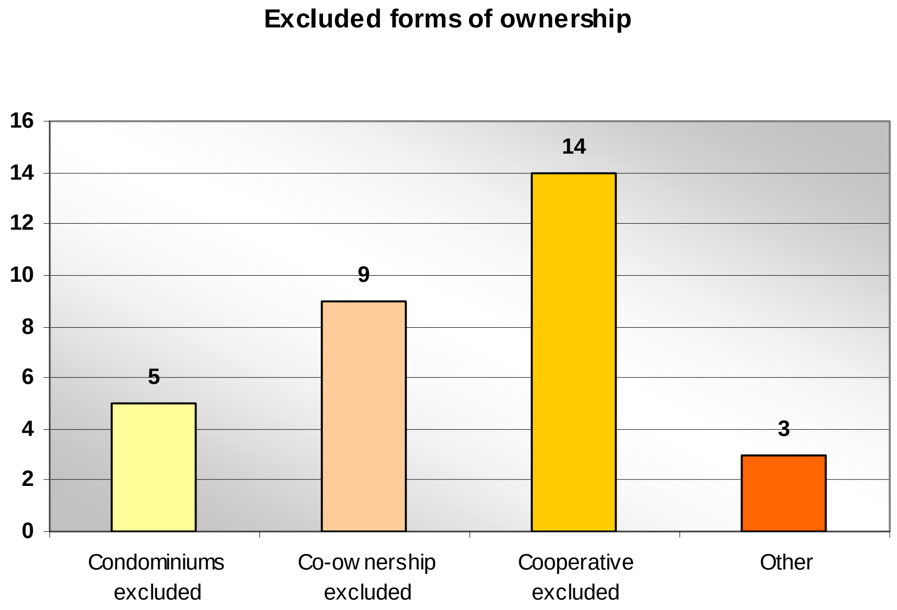
Three providers said that they carry out no tests at all and two said that they conduct general psychological tests (Hungarian and Romanian provider). A reason could be to avoid discussion with the beneficiaries and legal problems in the future about the effectiveness of the contract. We assume that these providers want to be sure about the legal capacity of the client at the time of conclusion of contract, taking into account that the typical client is a retiree in his last decade with a consequential high risk of dementia.

c) Property restrictions

Nine of the 31 products stipulate no **minimum property value**. 14 providers did specify a minimum property value of the property, which varied from EUR 20 000 in Hungary to EUR 200 000 in Ireland. The median was around EUR 83 000. Only two British providers have changed the minimum value in the last 5 years, in one case by about 50% from £ GBP 50 000 to GBP 75 000.

Specific **forms of ownership** are often excluded for products based on both Model types, for example cooperatives.

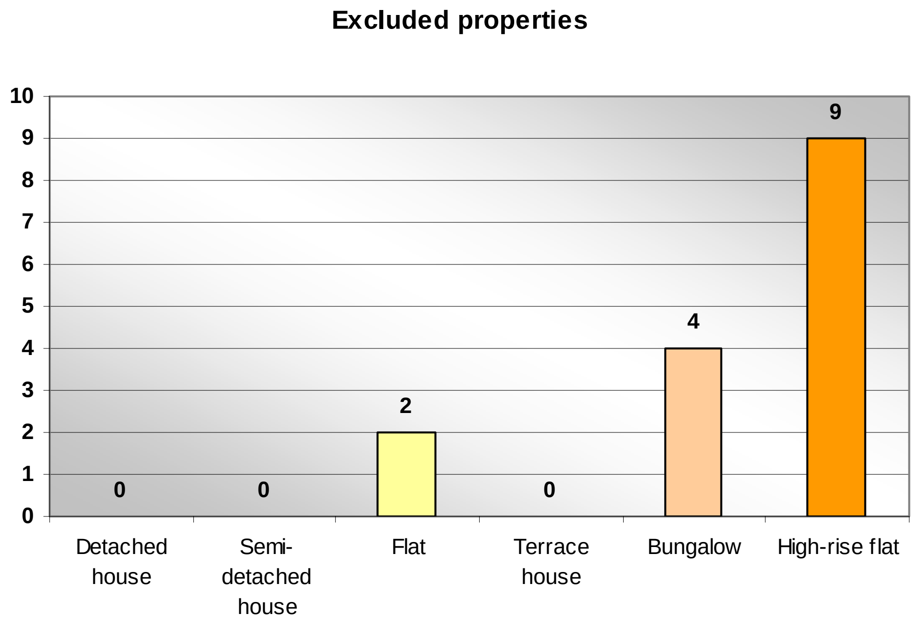
Figure 9: Excluded forms of ownership



Source: Responses from providers (n = 23)

British providers remarked that condominiums are not known in the United Kingdom and two British providers said explicitly that leaseholds are accepted. Only a few **types of property** are excluded, mostly high-rise flats and bungalows. We assume that this is because future prospects of the value of these types of real estate are in general bad, combined with past experience of privately owned high-rise flat. Two providers stated expressly that the purpose of ownership of the property must be for permanent residence and two others said that maisonettes are also eligible.

Figure 10: Excluded properties

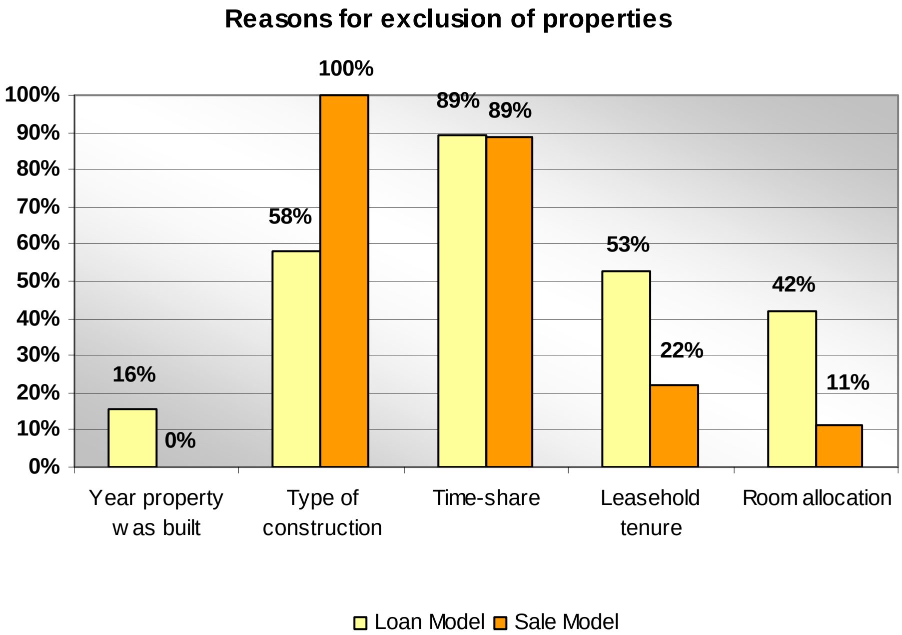


Source: Responses from providers (n = 27)

Time-sharing and types of construction were the reasons most often given for exclusion, such as 'built of steel-frame', pre-fabricated houses, built entirely from wood or concrete and clay-built housing. Some traditional types of houses, such as those build out of clay, are also excluded by providers. The reason could also be down to the low current values of these types of housing and poor or uncertain prospective values. The resale value also depends on criteria such as room allocation (e.g. size, shape, convenience of bedrooms or kitchen etc..) and the type of real estate, which could be a reason why room allocation is also named as an exclusion criterion.

Other **reasons for exclusion** are lack of adequate home insurance, business use or laboratories at the property, hydro-geological risk (area at risk of flooding), seismic risk (areas at high risk of earthquakes or volcanic risks), and poor maintenance (identified through the property valuation).

Figure 11: Reasons for exclusion of properties



Source: Responses from providers

The location of the property is also a reason for exclusion. Providers explicitly named properties in isolated areas and postal code areas in their country, which they exclude generally. These exclusions covered up to one-third of one Member State, because of historically low house prices and low house values in rural or remote areas generally. **Excluded areas** are for example parts of Northern Ireland and Scotland, the Channel Islands and the Isle of Man for some providers in the United Kingdom. Even if a provider offers its product nationwide, the focus lies in general on urban areas.

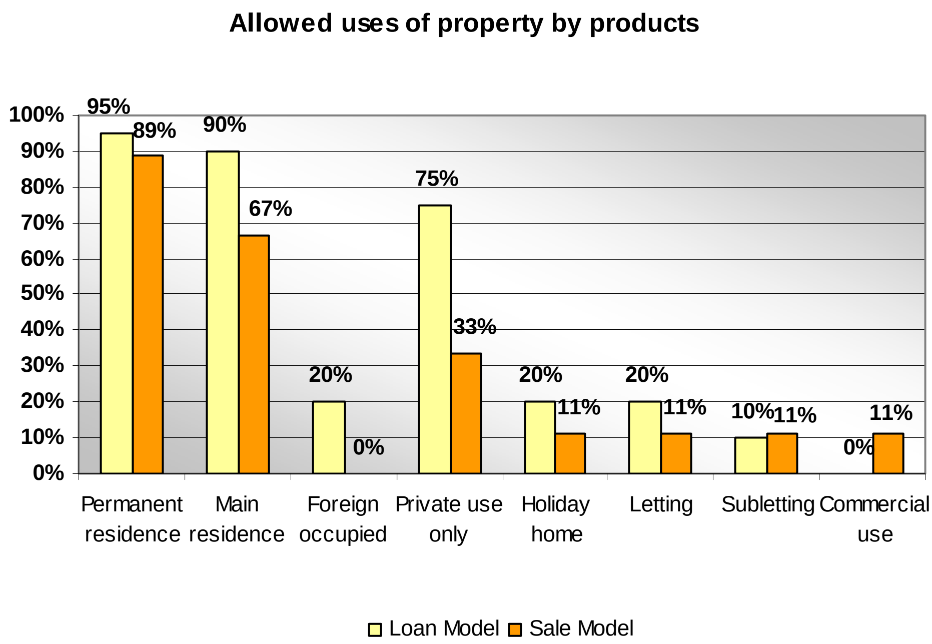
One-third of providers said that they do not market their products **nationally** and none of the providers market Equity Release products abroad.

In general, all registered owners must **sign the contract**. Providers from Denmark, Spain, Finland and Italy reported that the owner of the property must normally also take out the loan. In Spain, one provider said that the other owners must consent to execution of the reverse mortgage where the beneficiary does not own 100% of the property.

Where **persons other** than the owner or co-owner of the property also there, the requirement that they also sign the contract on the Member State. In the United Kingdom, all providers make this a requirement. In Germany and Hungary, responses varied and in the other Member States (Denmark, Finland, Spain, Netherlands, Italy, Sweden, Romania), all providers said that this is not necessary. In the United Kingdom, providers also commented that "*any occupier over the age of 17 who is not party to the mortgage must sign a deed acknowledging the mortgage and postponing their rights to the property in favour of the mortgage. They must receive independent legal advice before signing*." They also reported that, in the case of tenants or other persons living at the property, they must sign a waiver in advance undertaking to **vacate the property** on the customer's death.

Permitted uses of the property slightly vary between Loan Model and Sale Model products. In virtually all cases, the property must be the permanent and main residence of the customer. The most significant differences are in relation to private use only and commercial use.

Figure 12: Allowed uses of property by products



Source: Responses from providers

One provider reported in relation to permanent residence that "*leaving home for a period of six months or more triggers repayment action*".

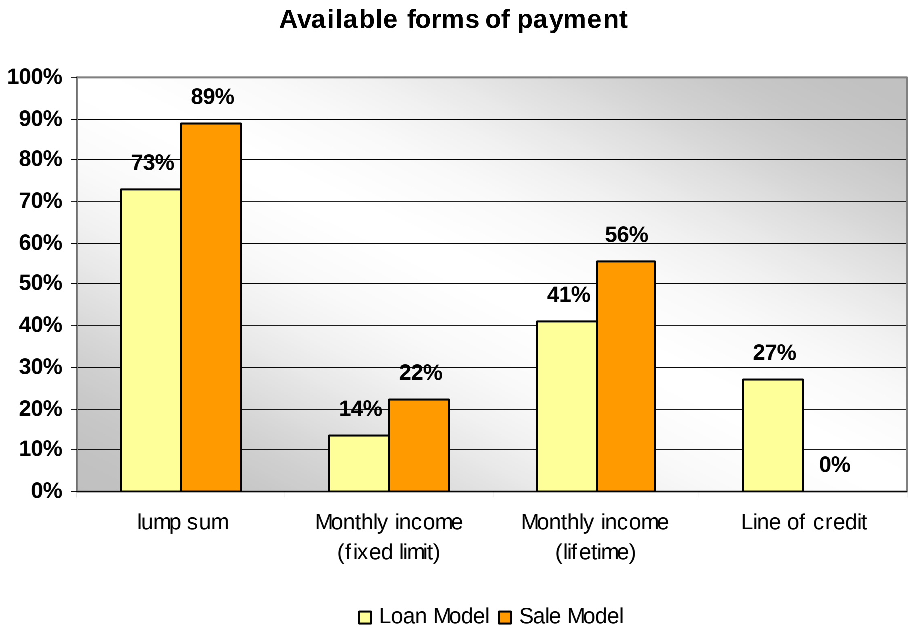
d) Form of payments

In both types of Equity Release products, different forms of payments are common. Although as previously stated[57] we have assumed that monthly payments would be the most suitable for ERS, a lump sum payment was cited by most providers as the most common payment method, followed by monthly payments for life. Lump sums are of course easier to handle and often a necessary step for obtaining an insurance product which then can guarantee a lifelong pension which is paid in instalments. These schemes

[57] See theoretical section B.I.3 above (on p.3).

are similar in this respect to investment plans or savings plans, in which an endowment is built up which then can be used to buy a pension plan. In so far the information does not reveal whether the possibility of being paid is effectively used and if economically this lump sum is turned into a lifelong payment. Lines of credit are only used for Loan Model credit-based products. In cases of monthly payments, the majority offer lifetime payments. Nevertheless, some providers (in Austria, the Netherlands, Finland, Germany, United Kingdom) indicated in case of monthly payments that they are paid only for a fixed time. In these cases, further payments are uncertain because though further agreements are sometimes possible, they are not guaranteed[58].

Figure 13: Available forms of payment



Source: Responses from providers

Most providers offer different forms of payments without significant differences as between the two types of ERS. A payment only in annual tranches, the form adopted by the Danish provider, is atypical. In Germany, one provider limits the lump sum payments to a maximum of five tranches.

Table 10: Overview on payment forms

Forms of payment offered	**Number of products**
Only one form on offer	13
Choice between two forms	14
Choice between all three forms	3
Special form (DK)	annual tranches

Source: Responses from providers

If the customer is free to set the level of payments, providers stipulate minimum payments such as EUR 130 a month or EUR 13 000 to EUR 32 000 as a minimum for lump sums. Where lines of credit apply, minimum limits are set, for example EUR 3 850.

58 See for example the Finish provider: „The agreements are made for 10 years at a time. After that the situation is checked and the agreement continued if necessary."

One provider set a minimum lump sum at 25% of the house value – all cited examples came from British providers. In two cases, providers said that the maximum is set at EUR 150 000 (Austria) and EUR 400 000 (Ireland) respectively.

In Spain, one provider stated that 90% of the loan must be paid out in **monthly payments**. One German Sale Model provider also said that the payments are only available as monthly payments.

e) Control of payments

Providers of Loan Model schemes in Spain (2), the United Kingdom (2), Austria (1) and Italy (1) report **controls over the use of the loan** (see description below). No providers said that such controls are applied in Sale Model products. Only six out of all 30 products involved control of the use of the loan.

In Italy, the provider requires **a declaration** from the borrower(s) to the effect that the owners, "*declare in the loan agreement that they will not use the loan for: 1) speculative financial investments (i.e. they declare they will not purchase high risk financial assets); 2) purchasing other properties in their name (but they can donate the proceeds from the loan to family members who will use the proceeds to purchase a property in their name); 3) for the restructuring of the property (meaning extensions or major alterations, but they are allowed to use the loan for minor upgrades or maintenance works); 4) for financing the borrower's entrepreneurial activities*."[59]

This contrasts with the United Kingdom, where one provider reported that "*the loan can be used **for any legal purpose** except the purchase of an asset-backed investment or for business purposes in whole or in part*."

f) Security of payments

Guarantee schemes covering provider company insolvency were reported in one-third of cases.[60] Responses varied widely and there was no identifiable standardised guarantee scheme. Four providers reported that ownership of the property automatically reverts where monthly annuity payments cannot be made (Hungary, Germany, the United Kingdom (2)) – this is presumably subject to a specific contract clause. A Spanish provider referred to "rent insurance" and the Netherlands provider pointed to the general deposit guarantee scheme of the Central Bank which offers protection of up to EUR 40 000. Two UK providers referred to the Financial Services Compensation Scheme in the United Kingdom, while a third UK provider said that "*the UK Financial Services Compensation Scheme covers our customers but not in relation to mortgage lending, including equity release products.*" No "specific guarantee scheme" was reported from Finland and the Italian provider said that where there is "*an up front lump sum there is no need for such a guarantee.*" The same answer "*not necessary*" was given by one German provider.

g) Combined products

Combination with other products does occur in relation to half of the products offered under both types of Equity Release.[61] This includes sale of rent insurance, life annuities, buildings insurance, term assurance and annuities. Annuities were named by seven

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[59] These requirements are those of the provider in his loan agreement. See response from Questionnaire PQ 7.

[60] Question No. 5.5: "Is there a guarantee scheme in case your company should become insolvent?"

[61] Question No. 5.6: "Is this product sold in combination with another financial product?" Possible Answers: Never, Occasionaly, 30-50%, 51-70%, 71-100% of the time.

providers with an explanation that funds paid out as a lump sum under an ERS can be converted into a regular income payment. Sometimes, the product itself is a combined product, for example, the combination of a loan and a current account which are always sold together (Finland). Although the series of transactions may involve combining the purchase of an ERS with the subsequent purchase of an investment or annuity contract, there is no evidence of product ‘tying’ (the practice of making the sale of one product or service to the customer conditional on the purchase of a second distinct product or service) when they result from a separate, independent decision. Even an ERS product offering in the form of a credit line running from a current account cannot be seen as a case of tying since this form of credit is only imaginable in the form of an account. It is only once significant additional services are combined to it, that one could consider the practice as a form of tying.

h) Contractual terms

By definition, most products provide for a lifetime arrangement. In two Member States (Finland, Denmark) providers reported that the **duration** of their credit-based product (Loan Model) is limited and only valid over a fixed number of years. While this provides for liberty to terminate the relation, it does not necessarily imply it. In practice, there could be a prolongation, either in the same product, or as described above, by investing the sum into an annuity.

Asked about the situation arising where consumers **default in respect of their obligation to carry out repairs and maintenance**, providers’ responses varied from a request to do the necessary works, to acceleration of the loan through to triggering cancellation of the contract (Spain, Finland, Italy Sweden). Three providers said that they have no experience with that kind of situation or no specific rules. Four providers (United Kingdom, Germany) stated that, in those circumstances, they would have right to enter the property and have the works carried out themselves, adding the cost to the mortgage. Two providers (Hungary, Romania) said that in Sale Model products, the provider pays maintenance costs, not the consumer.[62]

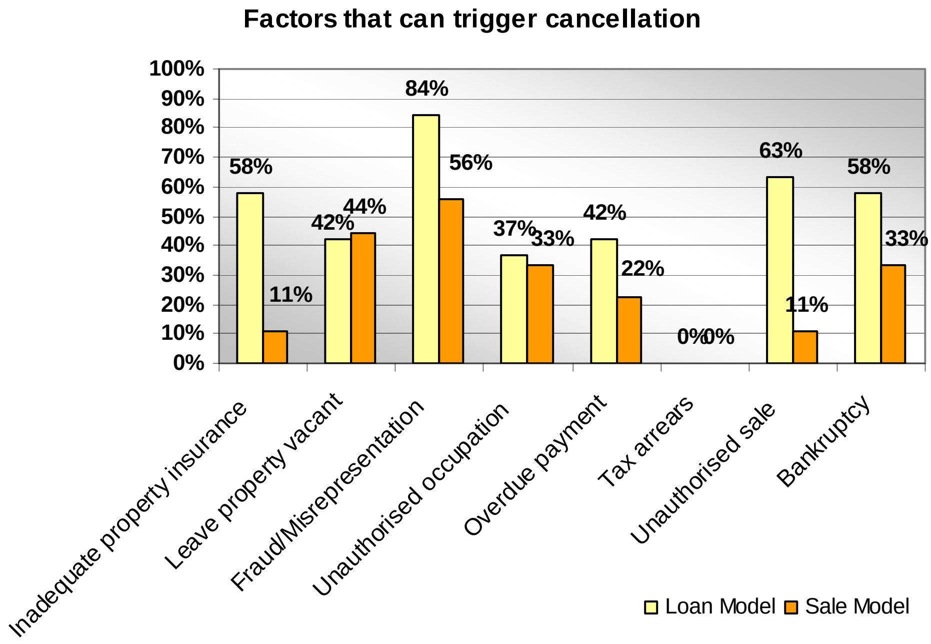
Regular inspections of the property were reported by two British providers (every 6 months, and every third year respectively).

Consequences of **payment default** and insolvency could only occur where customers have to pay instalments for the duration of the contract (Denmark, Germany, Finland, the Netherlands, Sweden). Foreclosure, loss of the property and personal bankruptcy are the usual consequences cited by providers. For all other providers, payment default would not arise during the period of living in the property.

Other **reasons for termination** of the contract are inadequate property insurance, vacancy of property, fraud/misrepresentation, unauthorised occupation, overdue payment, unauthorised sale and bankruptcy. Other reasons mentioned by providers were rental of the property to third parties, change of use from residential to business, or if the customer fails to carry out agreed maintenance:

[62] For the legal rights of the provider in these cases, see pp.110-118.

Figure 14: Factors that can trigger cancellation

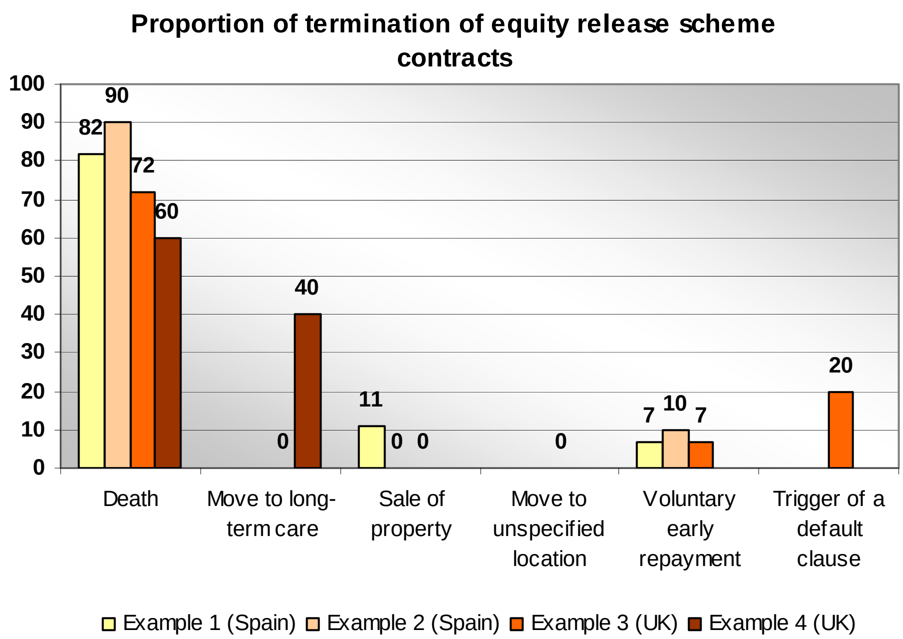


Source: Responses from providers

Specific clauses relating to **eviction, foreclosure or debt collection** after cancellation were only reported by two providers from Romania and Hungary, and two providers from the United Kingdom. The latter reported that payments must be overdue for 12 months before and the best price possible must be achieved when selling the property after obtaining a repossession order.

Statistical information as to the **factual reasons for termination** of Equity Release contracts was limited. Nine providers reported that they do not have this kind of information. Only four providers offered substantive information on this. In these four cases, the majority of contracts were terminated by the death of the owners, the remainder were terminated as a result of a move into long-term care. Nevertheless, up to 10% are subject to early repayment, and up to 20% of terminations may arise from cancellation of a default clause. These four reported cases (2 providers from Spain and 2 from the UK) are shown in the chart below, and they only apply to Loan Model ERS.

Figure 15: Proportion of termination of ERS contracts (Loan Model ERS only)



Source: Responses from providers

Asked about the **portability** of products, providers reported that Equity Release products may be transferred to another person in 6 out of 31 cases (19%) and may be transferred to another property in 13 of 31 cases (42%) without any significant difference between Loan Model and Sale Model.

The customer is always entitled to the **surplus following repayment** in Loan Model products. Providers of Sale Model products stated that in 6 out of 8 cases, the provider recovers the entire surplus or shares the surplus with the customer or the inheritors, depending on the percentage the customer has sold to the provider.

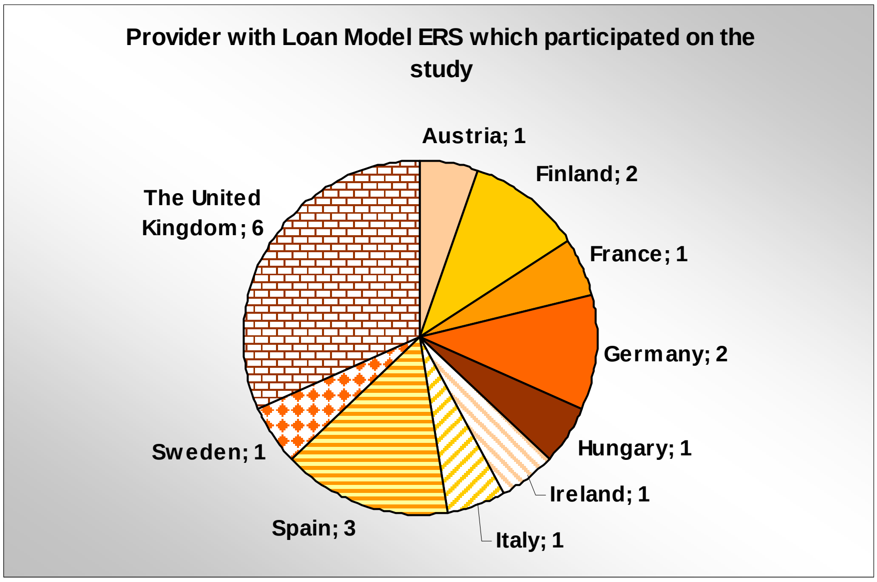
A **shortfall on sale**, applicable to Loan Model ERS only, is in some cases a personal liability which the provider could enforce against the customer or their inheritors (Germany, Finland, the Netherlands, Spain) but, more often, and in the United Kingdom in particular, providers reported that they must satisfy their claims from the property alone[63]. Italian providers distinguish between normal sale, in which payment is limited to the sale proceeds of the property, and fraud, where any balance attracts personal liability.

Advice from third parties other than notaries, where there is an obligation to consult them in Member States like France, only in the United Kingdom is there a requirement in relation to three Loan Model products for legal advice from a solicitor.

[63] This limited liability is similar to the "non-recourse" loans that typically define reverse mortgages in the United States, whereby the only asset backing the loan is the mortgaged property itself.

4. Loan Model products

Figure 16: Participating Providers of Loan Model ERS



Source: Responses from providers

The Loan Model Equity Release product is a credit-based product linked with a mortgage. Amortisation is never required by the providers.

Some lenders use a **loan-to-value ratio (LTV)** and define a maximum size of the loan available in relation to the LTV. Typically, these LTV limits are variable, the key determinant being the borrower's age. Older customers are able to borrow more, with higher LTV limits. In the UK, many lenders will offer 15-25% LTVs to the youngest equity release borrowers, aged between 55 and 65, but maximum LTV limits can rise to over 50% for elderly borrowers.

The minimum lump sum under the mortgage lies between EUR 4 000 and EUR 55 000, while the average was about EUR 21 000. Two providers reported that there is no minimum loan for their Loan Model ERS. Twelve providers named a **minimum loan to value ratio** (LTV) for the Loan Model Equity Release product:

Table 11: Loan to value ratio (LTV)

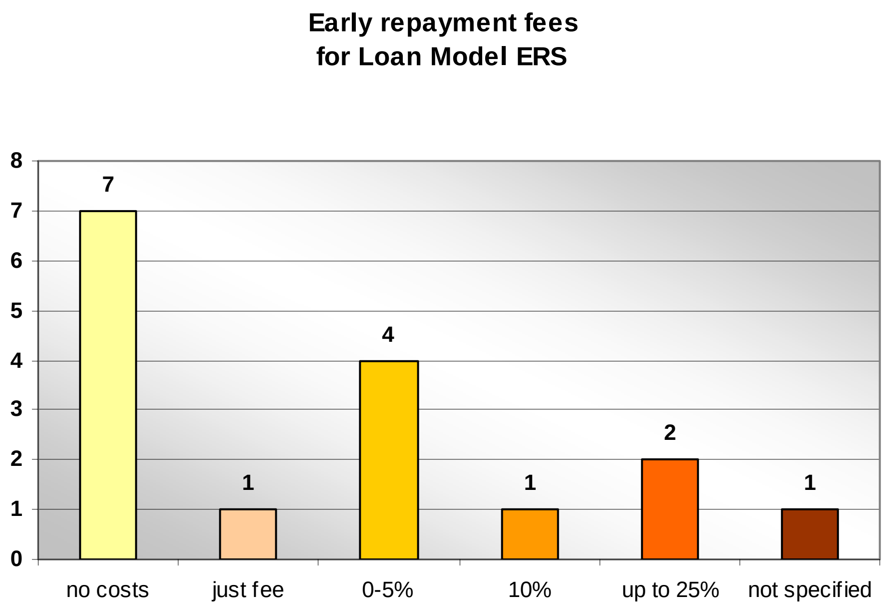
Minimum amount	Nominations
Minimum LTV 0-20%	2
Minimum LTV 21-30%	1
Minimum LTV 31-40%	2
Minimum LTV 41-60%	3
Minimum LTV 61+	4

Source: Results from survey

Six providers reported a **maximum amount** for the loan at between 300 000 Euros and 775 000 Euros. Two providers said that they set no maximum amount and three others reported that the maximum amount is covered by a maximum loan to value ratio of between 17% and 80%, depending on the provider and the age of the customer.

None of the providers reported that early repayment would be not possible. **Early repayment fees** differ widely, from no costs (Sweden, Finland, Spain, the Netherlands) and up to 25% of the original amount borrowed. In some Member States, such as Germany and the United Kingdom, early repayment fees differ from one to another provider: Germany 0% - 10%[64], UK 2% only in the first year up to 25%.[65] In some cases, the early repayment fee declines over time, for example 5% in the first year falling to zero after 23 years (UK). Only in one case, the answer was linked to the national legal provisions governing early repayment fees (Germany).

Figure 17: Early repayment fees for Loan Model ERS



Source: Responses from providers (n = 24)

Both fixed and variable interest rates are common for Loan Model ERS. In the contract, the provider and client may agree fixed interest rates for a specified period – e.g. for 1 - 30 years – or fixed interest rates for the duration of the contract. This contrasts with variable interest rates, which may be changed continuously by the provider, usually tied to a reference interest rate. In Spain, both types of interest rates exist, while in Germany and the United Kingdom respondents only reported products with fixed interest rates. In Ireland, the products reported were subject to fixed interest for the first 15 years, at which point the borrower has the right to choose between fixed or variable rates.

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64 Possible early repayment fee covered by the German Civil Law, estimated about 10% depending on interest rates and remaining fixed interest period.

65 UK provider: "Maximum early repayment charge of 25% of the original loan."

Table 12: Type of interest rates

Type	Provider	No. of providers
Fixed interest rate (without specification besides IE)	DE, ES, IE,[66] UK	7
Short term fixed interest rate (yearly)	DE, IT, UK	3
Variable interest rate (monthly, quarterly)	ES, FI, NE, SE, DK	8
No specific answer	UK	2

Source: Responses from providers

It must be stated that the nominal interest rates are not equal between EU Member States and not even similar inside the Euro Zone.[67]

If a **reference interest rate** for variable interest rates was cited for adoption of a variable interest rate, which occurred in three cases, it was the EURIBOR (Finland, Spain) and the 3-Month STIBOR (Sweden).[68]

Interest payments were rolled up in 9 out of 21 cases. If mentioned by the provider the compounding period could be monthly, yearly and quarterly. When asked about the price for ERS in June 2008, providers reported prices between 4.83% APR and 8.5% APR.

Table 13: Level of interest rate

	Nominal	APR	Examples
Low Level	4.74-5.5	4.83-6.0	Denmark, The Netherlands, Germany
Average Level	6.30-6.45	6.39- 6.98	Finland, UK, Spain
High Level	8.0-8.20	8.15-8.48	Sweden, Italy

Source: Results from survey

Other **reported charges** are upfront fees (EUR 50–1 927), valuation costs (EUR 90-343), money transfer fee (EUR 36), costs of notarisation (EUR 400) and for the land registry (EUR 106), together with rent insurance (EUR 5 000) and additional legal fees. There could be also an **annual** administration fee (EUR 50 p.a.) and additional costs for home insurance (EUR 200 p.a.). All costs may take the form of a single payment or be cumulative.

Sometimes providers impose a lump sum to cover their charges, from EUR 50 (Finland) to about EUR 2 000 (United Kingdom). Sometimes the provider does not charge any fees apart from the product price in form of interest payments (Germany, Netherlands, United Kingdom). In 80% of products, **transaction fees were financed** in this way.

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66 For the first 15 years, interest rates are fixed, and then the customer can choose between fixed and variable interest rates.

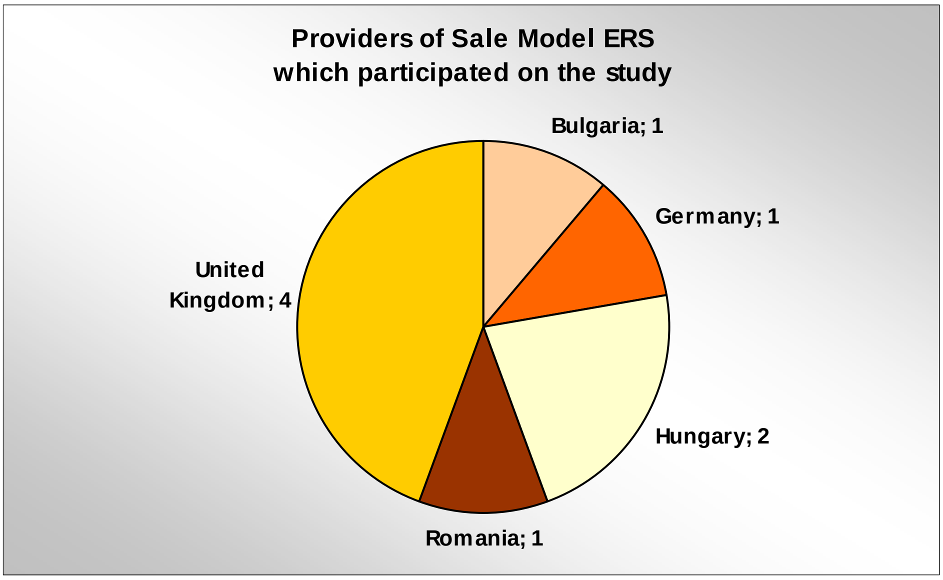
67 Fixed interest rates for home loans for private households in September 2008 differed from 4.53% (France) to 7.56% (Slovenia), the average was 5.15%.

68 STIBOR (Stockholm Interbank Offered Rate) is comparable with EURIBOR (Euro Interbank Offered Rate).

5. Sale Model products

Nine providers with additional sale-based products participated in the study.

Figure 18: Participating providers of Sale Model ERS[69]



Source: Responses from providers

A Sale Model Equity Release product is a sale-based product, in which the customer has a right to remain in the property until he leaves voluntarily or dies. Nine providers offering Sale Model products answered the questionnaire, four in the United Kingdom, two in Hungary, one in Germany and one in Romania as well as in Bulgaria. One provider is working in three Member States, Hungary, Bulgaria and Romania, through three distinct businesses.

The four providers in the United Kingdom said that only a **partial sale** of the property is possible through their products. In Germany and Hungary, two providers said that their products involve outright **sale.** Because the Bulgarian provider is a subsidiary of the same Group entity as one of the Hungarian Sale Model providers, we believe that their product is also based on outright sale of the property. Two providers did not answer the question. All had a minimum value for sale-based products.

All providers said that **transfer of the title** takes place on completion of the contract, irrespective of whether it is a full or partial sale. This is generally registered at the land registry. Lifelong occupation rights and annuity rights are guaranteed on the face of the title document. In four cases, the providers see themselves as without competition within their national market with their Sale Model product (Germany, Hungary, Romania and the United Kingdom).

Reported charges for Sale Model products were upfront fees (Euros), valuation costs (EUR 100-800), brokerage costs (EUR 1 500), notary/legal costs (EUR 300-1 000), advice fees (EUR 3 000), stamp duty (EUR 3 000-5 000) and administration fees (EUR 800). Cumulative charges amount to between EUR 1 500-7 600, while the tax duty was the highest item in almost all cases. One provider said that there are no additional fees in his product. In 5 out of 8 cases, the **transaction fees were financed**.

[69] It would appear that the Netherlands also have a provider of Sale Model ERS. However, the country is not represented in the pie chart above because no participation by the provider was possible.

IV. Summary

The markets in Loan Model ERS are not statistically monitored. The UK is the only Member State in which there is a private organisation of providers offering national data based on the activity of its member organisations. From estimates and statistics provided by national regulators and providers, we assume that currently less than approximately 0.1% of the overall mortgage market (EUR 6 147 billion based on EMF data) consists of ERS. According to our calculations, the overall volume of Loan Model ERS in the EU is EUR 3.3 billion, with an estimated number of close to 50 000 contracts in 2007.

The estimated volume of Sale Model ERS is EUR 1.4 billion, with just under 20 000 contracts. 13 Member States had some form of ERS, compared to 14 with none. Among Member States with an existing market for ERS, those who provided for a Loan Model scheme generally offered a Sale Model scheme as well. However, some countries have started by exclusively providing a Sale Model ERS.

Three countries, namely the UK, Ireland and Spain, have developed what may be seen as more significant ERS markets, while in the Netherlands, Denmark and Finland, providers report that overdraft facilities and credit lines are the preferred forms of what are considered to be similar products. In Germany, Italy, France, Belgium and Sweden, ERS are subject to wide-ranging debate, but have not yet been well developed. The nature of this process varies widely; in France, legislators have deliberately facilitated the development of Loan Model ERS; while in Belgium, the same products are not currently permissible. Although in Spain certain forms of ERS get tax privileges, in other countries on the contrary ERS do not qualify for general tax privileges for housing finance which would require building up equity instead of releasing it. In some eastern European Member States, Sale Model ERS have begun to appear alongside traditional private home reversion schemes, which are still in moderate use. Based on the experiences and lessons from more developed markets such as the UK, it may be assumed that the sequence of introduction of these schemes begins with traditional private home reversion, progressing towards gradual partial replacement by Sale Model ERS in the first instance, which in turn gives way to Loan Model ERS.

ERS are primarily issued by banks (40%), real estate investors (19%), specialist lenders (12%), insurance companies (12%), the remainder being marketed by intermediaries (15%) operating on behalf of these providers.

Products specifically designed for ERS were found in half of EU Member States. Based on the descriptions given by providers, we estimate using all available sources that at least 44 equity release products are in use within the EU, 14 of them in the UK alone. Responses to the questionnaires indicate that Loan Model ERS are more common. Of the 27 EU providers which completed the questionnaire, 18 offer Loan Model ERS and 5 offer Sale Model ERS exclusively, while three of the providers which participated in the survey offer both product types.

Several factors limit the eligibility of homeowners for these schemes. These include occupation of the home by a third party who is not a joint owner, a minimum age requirement and other factors such as an existing first mortgage, a poor credit history or even foreign nationality. These factors vary from one provider to another. Some property types are also excluded, such as high-rise flats, and some property uses are ruled out, such as business use. Products are typically designed for those mainly resident in the property, but some, such as the one product offered in France, can be sold on the back of a second home.

Most providers offer a variety of forms of payment, including lump sums, monthly payments and lines of credit. Some providers restrict the purpose of payments in order to avoid abuse. Some lenders use a loan-to-value ratio (LTV) and define the maximum amount of the loan available in relation to the LTV. Statistical information as to the factual reasons for termination of Equity Release contracts is limited. The most common is death, but cases of early repayment (about 10%) and default (about 20%) were also reported by some providers. Guarantee schemes covering provider insolvency were reported, but these are not very common and varied widely in form. Factors triggering cancellation also vary widely, and include payment default and default in respect of certain obligations such as repairs and maintenance duties.

Both fixed and variable interest rates were common in Loan Model ERS and ranged from 4.83% to 8.48% APR as of surveys conducted in Q3 2008. These must, however, be seen against the background of the different average levels of interest rates in individual EU Member States. Early repayment fees vary from no additional costs to up to 25% of the original amount borrowed, mainly dependent on the timing.

With regard to Sale Model ERS, all providers said that transfer of title takes place on completion of the contract, irrespective of whether it is a full or partial sale, and the guarantee of lifelong occupation rights and annuity rights is given on the face of the title document. Reported charges for Sale Model products amount to between EUR 1 500 and EUR 7 600, while the tax was the highest item in almost all cases.

D. Socio-economic analysis

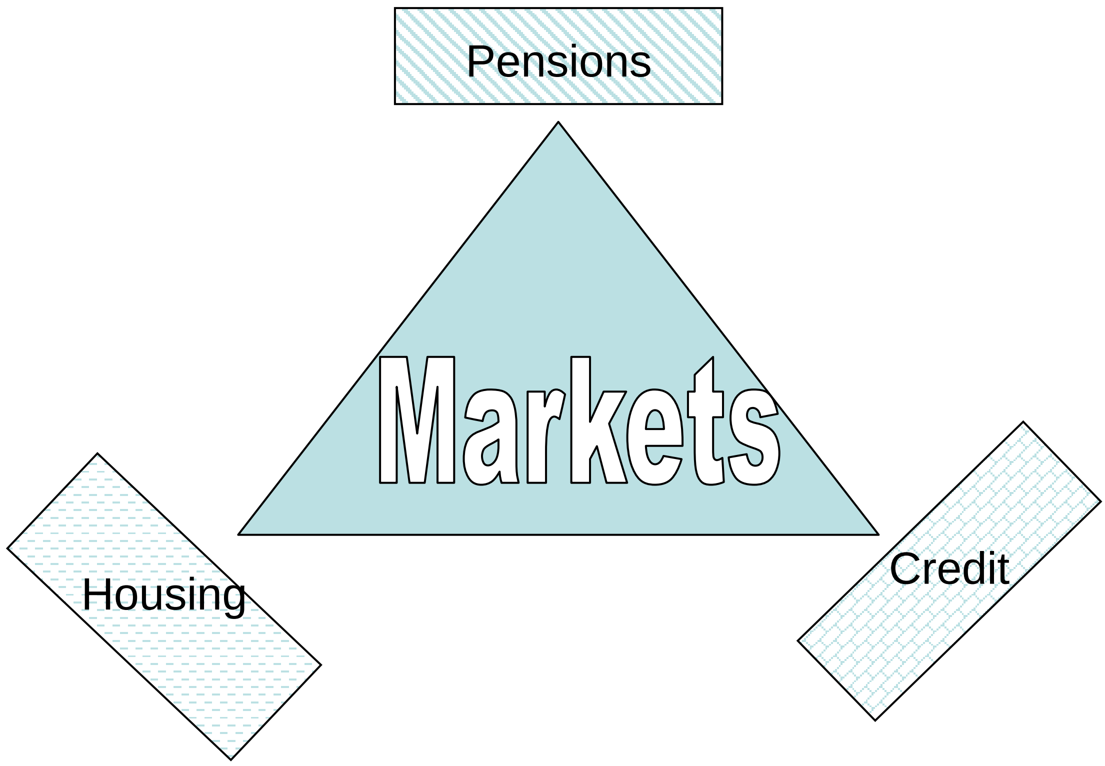
I. Market analysis: Housing, credit and pensions

1. Opinions of stakeholders

ERS offer a solution for housing and old age pension problems through the use of loans (Loan Model) or rent (Sale Model). They thus overcome the contradiction between the need for a home to live in and the need for cash to live on, which seems to be locked into the value of the home. As there are substantial differences in the distribution of ERS in the EU, one may assume that the factors which facilitate the development of ERS may be distributed unevenly.

If there are legal impediments preventing ERS[70], economic factors cannot play a role as there can be no market. But if, as is the case in almost all countries, the development of ERS is not hindered by the law, a comparison of market factors may suggest where initiatives to introduce ERS could have immediate effect and where conditions may not yet be sufficiently mature.

Figure 19: ERS markets



We will now describe the factors which define the three markets in which ERS operate, and try to provide a theoretical framework for relating these factors to each other by means of an informed hypothesis.

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[70] The legal framework for ERS and possible legal barriers are examined below under Section E of this report (on p.86).

We are not able to link the developments in these three different markets directly to the existence of ERS since there is currently insufficient information on ERS, their number is too low for thorough statistical analysis, and there are a number of intervening cultural and political variables, which are substantial enough to prevent quick conclusions. However, in order to give the reader at least the possibility of evaluating whether there is a potential relationship between these factors, we have grouped all Member States into four categories with respect to ERS[71]:

- Significant ERS market: the United Kingdom, Ireland and Spain (3 Member States).
- Less developed Loan Model market: Austria, Finland, France, Hungary, Italy and Sweden (6 Member States).
- Less developed Sale Model market: Bulgaria, Germany and Romania (3 Member States).
- No ERS: Belgium, Cyprus, Czech Republic, Denmark, Estonia, Greece, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Slovakia and Slovenia (15 Member States).

We find these ideas are mirrored in the responses to the questionnaires.

2. Quantitative data on market conditions for ERS

This section examines the relationship between ERS and property market indicators, market capitalisation and pension provision respectively.

a) Property market indicators

The study considers the following indicators: homeownership rates; the number of property transactions; and the development of house prices.

(1) Homeownership rate and ERS[72]

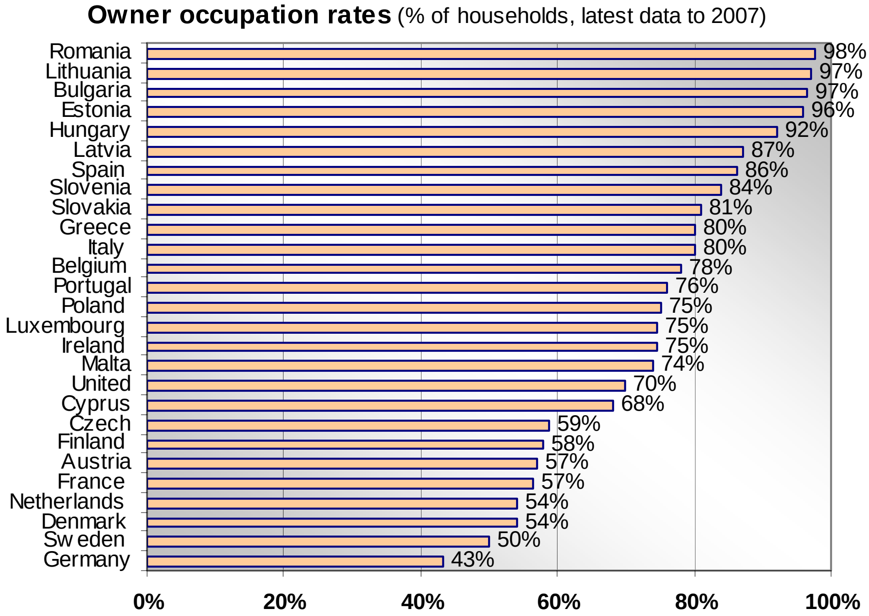
Nearly all stakeholder responses point to the fact that ERS requires homeownership in the first place, and as such, the most important factor for ERS is seen as homeownership. The following chart shows that levels of homeownership vary considerably in Europe. The countries of southern and eastern Europe, including most of the new EU Member States and Greece, Portugal, Italy, and Spain, where the vast majority of Member States are less industrialised have homeownership rates of more than 75%. In contrast, the traditionally more industrialised Member States have more significant tenant occupation[73].

[71] This country grouping is reflected in the structure of Part II: Country Reports.

[72] See Behring K.; Helbrecht I., Wohneigentum in Europa, (Wüstenrot Stiftung (ed)) Ludwigsburg 2002.

[73] Some reasons for the different homeownership levels are briefly mentioned in the respective country sections of Part II: Country Reports. E.g. the lower levels of homeownership in Malta can be explained by a third form of tenure between ownership and tenancy (‘freehold’ and ‘ground rent’).

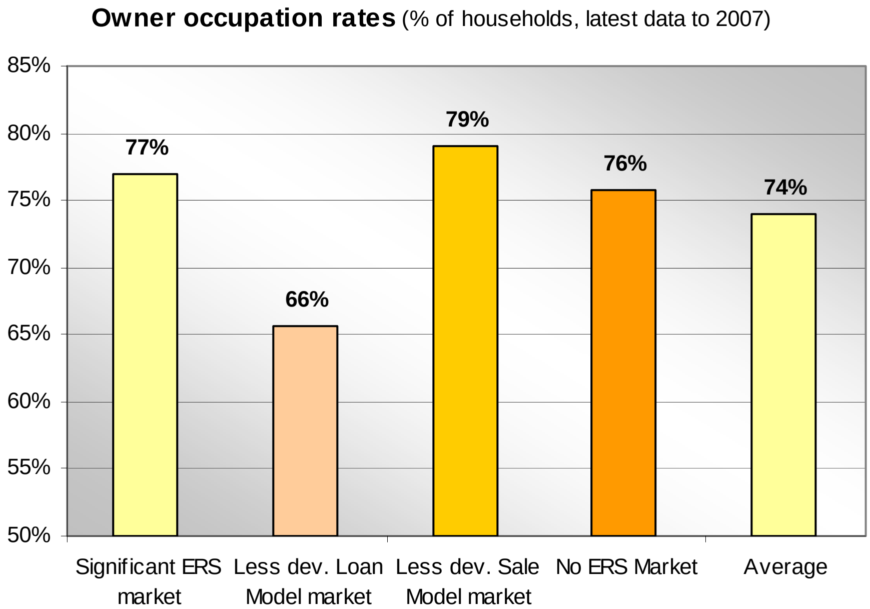
Figure 20: Owner occupation rates by country



Source: EMF/Hypostat 2007 A Review of Europe's Mortgage and Housing Markets, 11/2008, Statistical Tables

If we order homeownership rates according to the use of ERS, we can identify the following four groups.

Figure 21: Owner occupation rates by ERS Group



Source: EMF/Hypostat 2007, 11/2008, Statistical Tables, responses from the ERS survey, and own calculations

However, there is a slight overestimation of homeownership rates in some countries and a slight underestimation for others in Figures 19 and 20, since ERS concern homeownership for people in old age. The following table, taken from Turner & Yang[74], uses different sources for levels of homeownership derived from an empirical survey, so that these figures cannot directly be compared to the quasi-official statistics used in the charts above. They do, however, give an indication of the deviation for old age, since they offer age-related data. In groups of households aged over 70, Member States such as the Netherlands and Denmark, as well as Austria and the UK show significantly lower levels of homeownership rates than the previous data, while Greece, France, Ireland and especially, Finland, have significantly higher ownership levels. With respect to ERS, these adjustments would put the market conditions in the Netherlands closer to the German situation while Finland would join countries like Spain and Italy.

Table 14: Homeownership rates for over 70 year olds in selected countries

	Age 70+	Total	Diff.
Netherlands	26.4	47.7	-21.3
Denmark	51.2	62.2	-11.0
Austria	39.5	49.4	-9.9
United Kingdom	58.8	65.6	-6.8
Germany	32.3	35.1	-2.8
Belgium	69.9	71.3	-1.4
Sweden	57.9	58.7	-0.8
Italy	68.9	69.2	-0.3
Spain	84.6	84.5	0.1
Portugal	64.8	63.5	1.3
Greece	86.7	82.7	4.0
France	66.1	61.3	4.8
Ireland	86.7	79.3	7.4
Finland	83.4	64.3	19.1

Source: Turner & Yang p.282

Among the two groups of markets in which the modern form of Loan Model ERS prevails, the three developed markets of Ireland, Spain and the UK show a significantly higher level of homeownership. However, and conversely, for some countries which have no market for Loan Model ERS at all, Figure 19 actually shows that they may have high homeownership levels.

We can therefore put forward the hypothesis that, for the development of a larger ERS market, which is only possible through the spread of Loan Model ERS, there is a need first for a capitalisation of the housing market.[75] This means that homes not only have to be tradable commodities, but they also have to become tradable equity, which can be used for secured lending.[76] In such circumstances, the rural situation of total homeownership is gradually replaced by a split of the market into a capitalised rental market and a part which is capitalised through mortgages. If housing markets are capitalised in such a way (which seems to involve having homeownership rates of less than 70%), the development of higher levels of homeownership in highly capitalised countries indicates that the capitalisation process has further developed.

74 Turner, Bengt and Yang, Zan *Security of home ownership - using equity or benefiting from low debt?* in European journal of housing policy (2006) p.279 ff, 282.

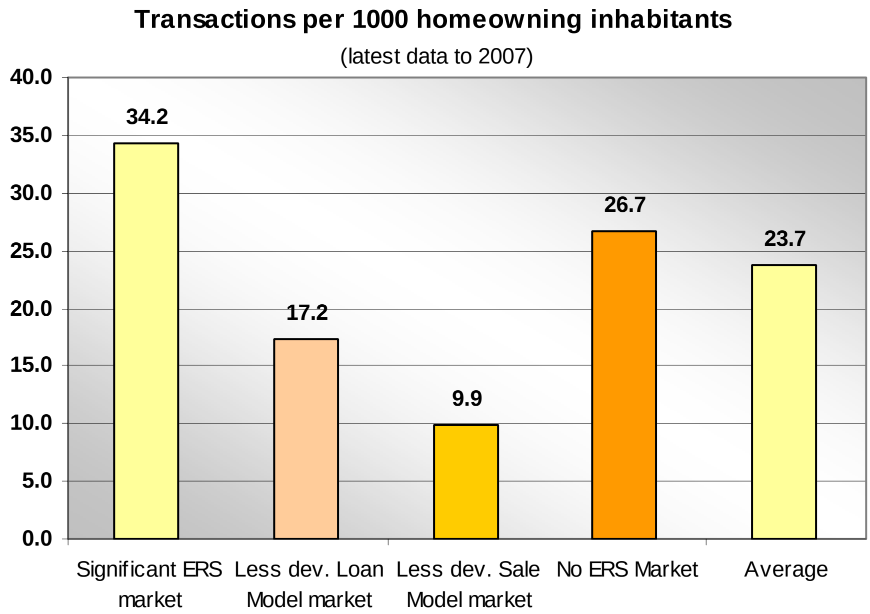
75 For a more detailed discussion of the relationship of capitalisation and ERS, see Section D.I.2.b) (on p. 55).

76 For further explication see Section D.I.2.b) below (on p.55).

(2) Transactions of homes by country groups

Mobility and the number of residential property transactions are said significantly to affect the feasibility of introducing ERS into the market. We have therefore taken the absolute number of home transactions for countries where they have been available.[77] In order to make this data comparable, we have calculated the number of home transactions per 1 000 inhabitants. As this is only comparable if we see how often the existing housing stock is transferred from one homeowner to another, we have multiplied this figure by the national homeownership rate. For creditors, this provides a safe expectation that they will be able to sell the home when the pensioner has died. The following table gives a clear answer for ERS markets but not however with respect to non-ERS markets.

Figure 22: Number of transactions per 1000 habitants



Source: EMF/Hypostat 2007, 11/2008, Statistical Tables and iff own calculations

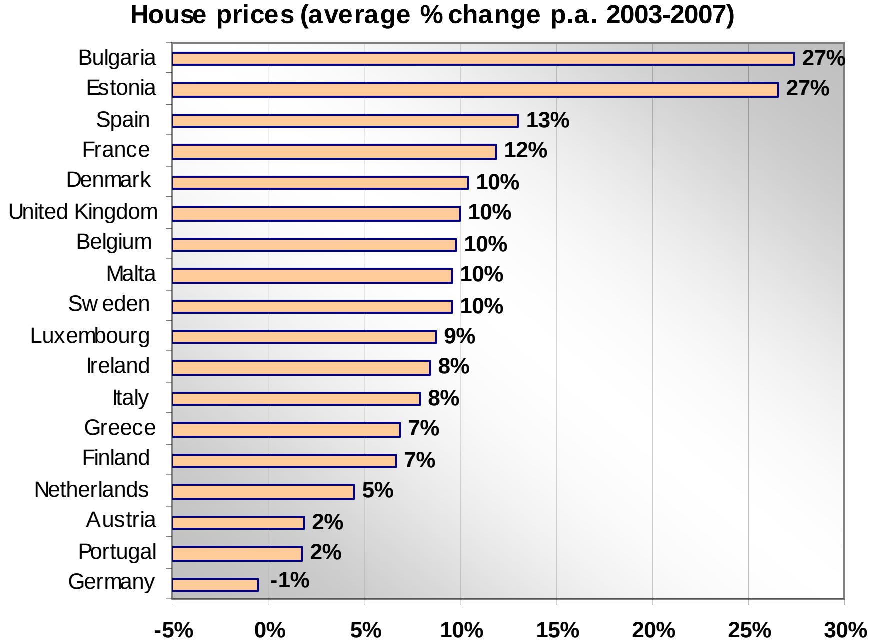
If we compare the significant ERS markets, represented by the first column, we find this hypothesis verified. The UK, Spain and Ireland have on average twice as many home transactions as capitalised markets in Member States where there is a low penetration of ERS.

(3) Development of house prices

In the survey conducted for this study, Swedish providers in particular have voiced the opinion that their clients were induced to release equity from their homes by rising house prices. If the 2006 change in house prices was used in the chart below instead of the 5-year annual average values, soaring Scandinavian house prices would have placed those countries even higher up the ranking displayed. As Germany, with the lowest level of homeownership, saw both the lowest increase in house prices (actually a decline) and an almost non-existent market for ERS, an increase in house prices may play a role which in itself is dependent on the percentage of mortgages existing in the relevant country.

[77] Germany, Sweden, Luxembourg, Belgium, Denmark, France, Italy, Finland, Hungary, Spain, Ireland, United Kingdom, Latvia, Estonia.

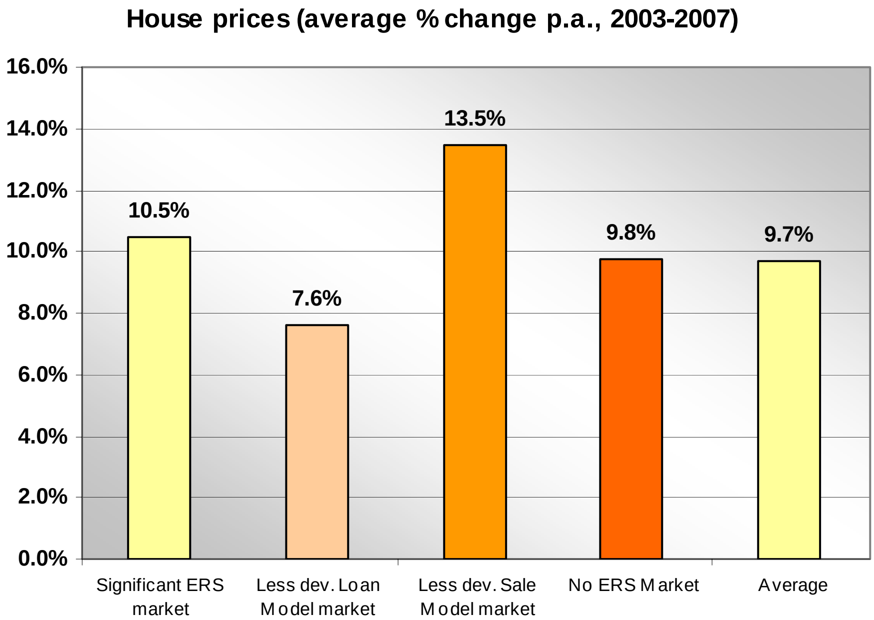
Figure 23: House prices



Source: EMF/Hypostat 2007, 11/2008, Statistical Tables and iff own calculations

If we compare this with our four groups of ERS markets in Figure 23, it looks as if, in countries where ERS is an established market, the increase in house prices and thus the use of this increase for cash expenditure and living costs are more significant than in the other ERS markets. However, it is not a sufficient condition, as the example of Bulgaria and Estonia show.

Figure 24: House prices by ERS Group



Source: EMF/Hypostat 2007, 11/2008, Statistical Tables and iff own calculations

The fact that the most significant increases in house prices have occurred in non-ERS markets seems to contradict this observation, which is only true within the sector of Member States where ERS is developing. But if we compare this to Figure 22, we find that the increase in house prices is due more to the size and functioning of housing markets, as represented by the number of transactions in the country concerned. The figures for non-ERS markets would of course be significantly lower if we looked at the amount of housing capital in currency units transferred nationally, since house prices are much lower in the undercapitalised non-ERS markets.

b) Capitalisation and mortgage markets

All the indicators mentioned above point to the fundamental importance of the capitalisation of housing markets in individual Member States. The main factor seems to be how much capital from banks and insurance companies has been introduced into the housing market. This is of course only true for Loan Model ERS. However, Sale Model ERS can be seen as a transitory equivalent for less capitalised markets and special interest groups.

One of the main factors favouring dominant Loan Model ERS products is a developed mortgage market in which banks are looking for opportunities to lend money, especially to homeowners with a debt free home. This interest may even increase after the home mortgage markets faced serious difficulties in countries which are leading ERS providers: the UK, Ireland and Spain have experienced enormous troubles with declining house prices and rising consumer overindebtedness.

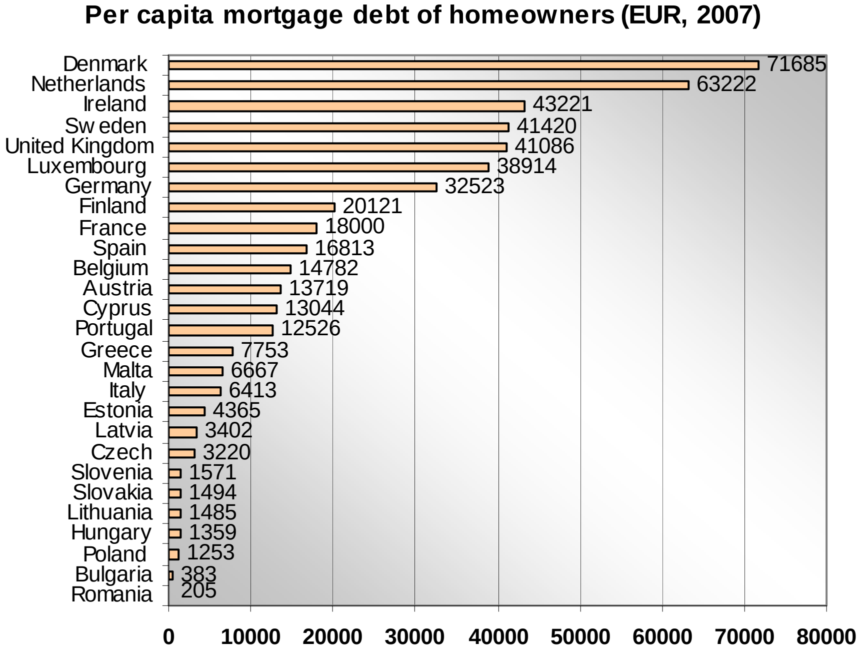
The following table shows a clear division between Member States which have a high capitalisation of the private housing market and those where this has not yet occurred. These figures could be biased by house prices. Member States with high house prices may show higher mortgage loans, which then influences the per capita debt load. The data for comparable average house prices in the EU is not available and certainly difficult to develop, since house prices depend on location as well as the way houses are built, including their age. It is therefore possible that, given similar economic conditions in the EU, differences in house prices only reflect different properties and locations for those who can be or are being marketed. From anecdotal evidence on house prices in the Netherlands, Germany, Italy, Spain and the UK[78], we find that the UK, with the highest house prices, followed by Spain and Germany, shows less capital per homeowner than the Netherlands and Denmark, where house prices seem to be lower on the average.

We can therefore distinguish four groups of capitalisation:

- Denmark and the Netherlands with capitalisation of EUR 59 000 and more euro per capita weighted with homeownership;
- UK and Ireland, Germany, Sweden and Luxembourg with around EUR 35 000;
- France, Belgium, Spain, Austria, Portugal with between EUR 10 000 and EUR 16 000, and Finland with EUR 23 000
- All other countries with below EUR 7 000 per capita weighted with homeownership.

[78] For the UK, Netherlands, Spain, Italy and Germany see: DB Research, *Entwicklung der europäischen Wohn- und Büroimmobilienmärkte*, 2004, available at http://www.dbresearch.de/PROD/DBR_INTERNET_DE-PROD/PROD0000000000177377.pdf.

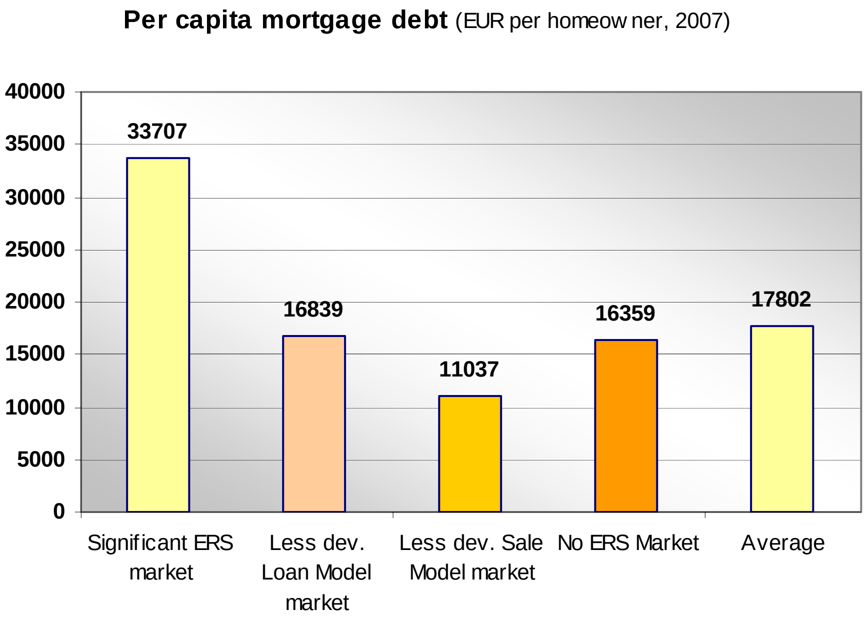
Figure 25: Per capita mortgage debt of homeowners



Source: EMF/Hypostat 2007, 11/2008, Statistical Tables, and Eurostat and U.S. Bureau of the Census total population 2007, own calculation

If we group this data according to our four groups of ERS and non-ERS Member States, the picture shows that a high capitalisation of housing markets and a significant use of mortgages is an important precondition for ERS.

Figure 26: Per capita mortgage debt by ERS Group



Source: EMF/Hypostat 2007, 11/2008, Statistical Tables, and Eurostat and U.S. Bureau of the Census total population 2007, own calculation

There is, however, a further significant factor in terms of the development of housing finance, which already plays an important role in the US and increasingly in the UK and Ireland. While on the continent, mortgages are overwhelmingly used to acquire a home, in the Anglo-Saxon world this kind of limitation is called into question.

There, the concept of residential mortgage lending encompasses a variety of different loan products, which are re-grouped into one common concept, i.e. home loans, which covers mortgage loans granted for housing purposes, mortgage loans granted for consumption purposes and housing loans, i.e. unsecured loans or unsecured loans granted for housing purposes.

- Mortgage loans, secured on real estate property (or equivalent) granted for housing purposes, i.e. buying an existing property, having a new property built or renovation. This is the oldest and most common category.

- Mortgage loans (still secured on real estate property or equivalent) granted for consumption purposes. These are much newer products, initially developed in the US and although appearing in a number of new national markets, but still represent a significant share of the market in a few EU Member States.

- Home loans not secured on land (such as loans secured by a personal guarantee) or unsecured loans granted for housing purposes. These loans are much less common, and are country-specific.

The first category is still the dominant form of 'Home Loans' as it is even used in the European Code of Conduct, where home loan is defined in a footnote "*[...] as a loan to a consumer for the purchase or alteration of the private dwelling he owns or aims to acquire, secured either by a mortgage on land or by a surety commonly used in a Member State for that purpose*"[79]. According to this definition, also loans of the third category, which are secured by a commonly used surety other than a mortgage, are covered by the Code. However, since the Code was negotiated at the end of the 1990s and signed in 2001, in a different context and under different market conditions, this may be outdated. In practice, the two Progress Reports published by the Industry in 2003 and 2005 show that lenders do, de facto, apply the Code of Conduct to the two other categories of loans, i.e. home loans and mortgage withdrawal. In the latter case, for example, in a large number of countries, the lender is not necessarily aware of the purpose of the loan, and therefore automatically applies the Code as soon as a charge against a residential property arises.[80]

However, in reality, ERS fall only into the second category. Member States, which do not have mortgage loans in this form will have greater difficulty in introducing ERS than those that have do. Techniques, as well as the ideology of home loan mortgages in most Member States, are still connected with the first form of mortgage loans, so that providers offering ERS have to overcome many more barriers in the market than those who find an existing market of second mortgages, where people are accustomed to mortgage loans which release equity from their homes to finance consumption or to refinance existing debt.

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[79] European Voluntary Code of Conduct on Pre-contractual Information for Home Loans. See: http://ec.europa.eu/internal_market/finservices-retail/home-loans/code_en.htm.

[80] Source based on published material from the European Mortgage Federation.

c) Pensions provision

There is a widespread international trend to replace public systems of retirement pensions by private capital stock based pension systems.[81] For this, capital has to be invested into capital stocks, which then serve as a resource for pensions. The necessity of increased savings contrasts with continuing duties to contribute to public social security systems in many Member States, as well as with a tradition according to which a debt free home was seen as a pillar of support in old age. These attitudes towards the home as a major object for savings left little room for contributions to retirement pension funds.

If on, the other hand, the contributions made to payment for the home or for the repayment of mortgage loans could be released, a significant amount of capital would be available to fund private pension schemes.

This question has been explored in different studies recently,[82] which thus clarify some of the conditions of equity release in general. Turner & Yang stated that "*Information on housing wealth and equity is not available for most EU countries*." They therefore analysed available data from Sweden. There they found that in 2002, 10% of homeowners had no debt, "*but 10 per cent had a debt in excess of 100 000 SEK. Whereas, for the distribution of housing equity, the wealthiest 10 per cent of households had an average equity of over 3 700 000 SEK, and 10 per cent of households who are the least wealthy hold only approx. 170 000 SEK in housing equity. The difference between the wealthiest and poorest households with respect to housing debt and housing equity were also significant in 1993. The wealthiest 10 per cent of the households had four times as much housing wealth of the least wealthy households, while the gap in housing equity between them was even greater*."[83] Given that houses perfectly mirror wealth and poverty, it can be assumed that these observations can be generalised.

As the figures provided in this research[84] assume that those with the lowest incomes and greatest need for additional pensions also have the lowest amount of unreleased equity available in their homes. They also found that those living in urban areas with high house prices have equity which is nearly four times higher than those living in low price areas, a situation which had significantly changed since 1994 when it was not even double.

Even if we assume that those who need additional pensions have the lowest equity in their homes, the amount, which would be available for private pensions if released through ERS, would add a few trillion euro to the old age pension system and probably would be able to help improve it.

The following figures show that the old age pension system will need this kind of improvement and that probably the form of fixed and unreleased capital contained in the homes of elderly people is something that in future will hinder the management of the demographic problems western civilisation presently faces.

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[81] See Holzmann, R.; Orenstein, M.; Rutkowski, M. (eds) Pension reform in Europe: Process and Progress, World Bank Washington D.C. 2003; World Bank (ed) Averting the Old Age Crisis – Policies to Protect the Old and Promote Growth, Oxford 1994.

[82] De Wilde, Caroline and Raeymaeckers, Peter,*The trade-off between home-ownership and pensions: individual and institutional determinants of old-age poverty* in: de Wilde, arolineC And Raeymaeckers, Peter (Eds) *Ageing and Society*, 28, 2008. pp.805-830; Turner, B. & Yang, Z. (fn 74).

[83] See Turner; Yang (2006) p.290 (fn 74).

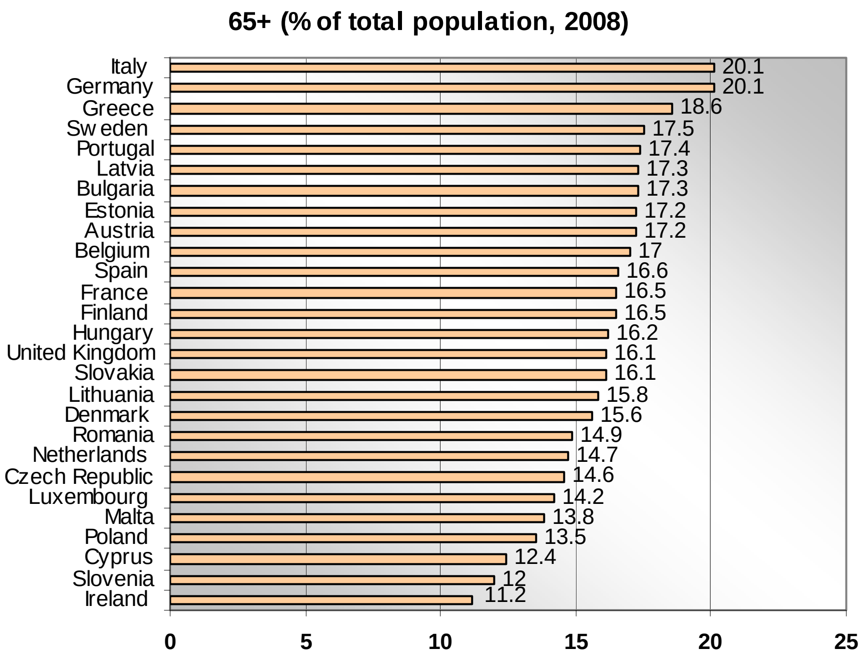
[84] See Op.cit. p.292 (fn 74).

(1) Need for ERS in an ageing society

The financial consequences of the demographic trend in society and the sustainability of pension systems across the EU are also a problem for the introduction of ERS. The population pyramid and age dependency ratio projections predict a weakening position for future retired persons who will have proportionately fewer working persons providing them indirectly with a pension. Of course, the financial repercussions of these long-term figures will be very different depending on policies and reform paths chosen by the Member States. Very simplistically, assuming no changes in the general characteristics of the pension systems and assuming sustainability issues and public finances force a reduced level of state pension for all (assuming no change in other parameters such as extension of the legal retirement age etc..), a resulting 'pension gap' is to be expected.

The EU27 as it is in 2008 has a population of 495 million, of which 17.1% are currently aged 65 years or more (4.4% for the 80+). If we crudely assume that a very conservative 10% of these 65+ are living in institutions such as retirement or care homes and not in ordinary households, this still leaves over 75 million elderly people living in a home in the EU. The demographic trend we are witnessing in Europe means that the next decades will see this number rise. Using the latest population projections by Eurostat published in August 2008, and ignoring the effects of the clear phenomenon of people entering institutionalised homes at a later and later age, which would have a direct impact on the number of elderly people occupying their principal residence, a similar simple calculation would mean that for the EU, in 2035, of the total population of 521 million (25.4% of 65+, and 7.9% 80+), 120 million elderly people over 65 years of age will be living at home. The following chart mirrors the unequal distribution of children in the EU where 'young nations' like Ireland and Slovakia on the one hand and 'older nations' like Italy, Germany, Greece, Sweden on the other hand need to save more capital for their elderly people.

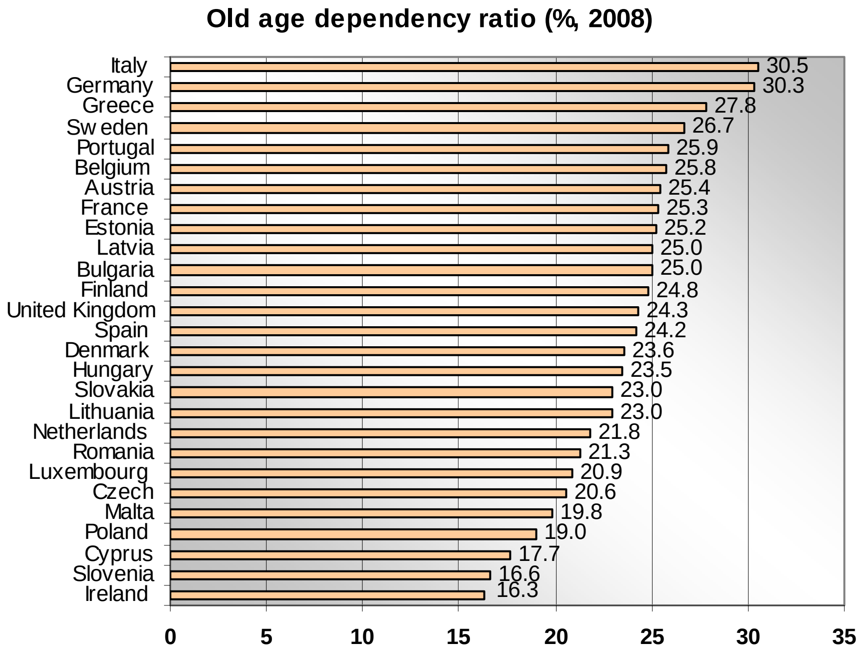
Figure 27: Population over 65



Source: Eurostat press release 26.8.08

The old age dependency ratio for 2008 shows the relationship between active and retired populations and thus gives basically the same incentives for countries like Italy, Germany, Greece and Sweden either to release additional equity from their homes or to use other resources to supplement pensions especially current income.

Figure 28: Old age dependency ratio



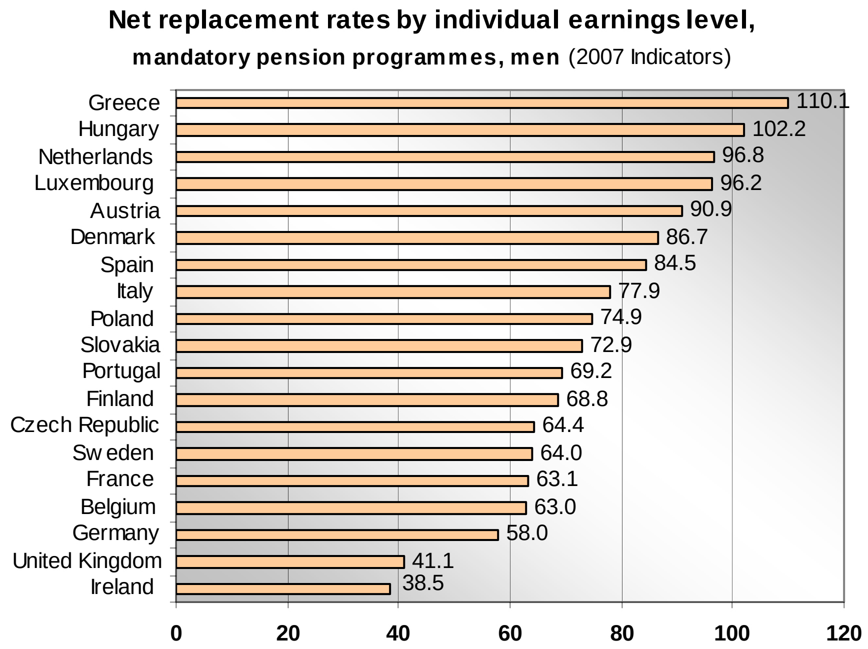
Source: Eurostat press release 26.8.08

(2) The growing need for cash in old age

As the level of own capital directed at and fixed in accumulating the wealth contained within the housing asset becomes ever greater for the majority of EU citizens, the need for liquidity will also become ever greater for future elderly people.

The OECD has some data available on pension levels, which can be used to compare the adjustment shock that can affect pensioners with regard to lifestyle choices following an income drop on retirement. Measured as a proportion of the average person's final salary at the end of his working life, the level of pension, compared to the previous level of income he/she was previously accustomed to, will also have a bearing on the demand for ERS as a complementary source of income.

Figure 29: Net replacement rates



Source: Pensions at a Glance: Public Policies Across OECD Countries, 2007 Edition - Selection of OECD Pensions at a Glance indicators: how does your country compare?

In countries with relatively small public pensions, individuals will need to make additional, voluntary private savings to ensure that their living standards do not decline sharply as they move into retirement. We have already shown the gross replacement rate – pension in retirement relative to earnings when working – for average earners in OECD countries.

The projected gross replacement rate from mandatory pension schemes for the average earner with a full career ranges from 31% of individual earnings in the United Kingdom to 96% in Greece. An OECD briefing[85] says the following:

> *"The 11 countries at the bottom of the chart, which have below-average mandatory replacement rates, are the focus of this briefing. What level of voluntary, private pension savings would be needed to deliver an overall gross replacement rate in these countries to equal the OECD average? This is obviously an arbitrary target, but it is useful to set a benchmark relative to all OECD countries, including those with mainly mandatory retirement provision. The difference between the national mandatory replacement rate and the OECD average is here called the 'pension gap'. Along with all six of the mainly English-speaking members of the OECD – Australia, Canada, Ireland, New Zealand, the United Kingdom and the United States – mandatory gross replacement rates are below the OECD average in four continental European countries – Belgium, the Czech Republic, France and Germany – and in Japan.*
>
> *In the United Kingdom, private pension savings would need to deliver a replacement rate of 28% to bring the overall pension up to the level of the OECD average. France has the smallest retirement savings gap of the 11 countries analysed: 7.5%. For the 11 countries as a whole, the replacement rate from*

[85] The OECD 2007 briefing *Private pensions – a growing role* is available under: http://www.money-advice.net/media.php?id=3297. See (fn 19).

> *mandatory pensions is 40.6% for average earners, giving a retirement-savings gap of 18.2% on average."*

Because the full impact of the baby boom will only be felt in a decade or so, the need for substitute income for these deficits in the state pension will be a progressive one.

Alongside this demographic trend, spurred on by the increase in life expectancy, comes a second source of future expenditure for the retired that is expected to grow, namely spending on dependency and care.

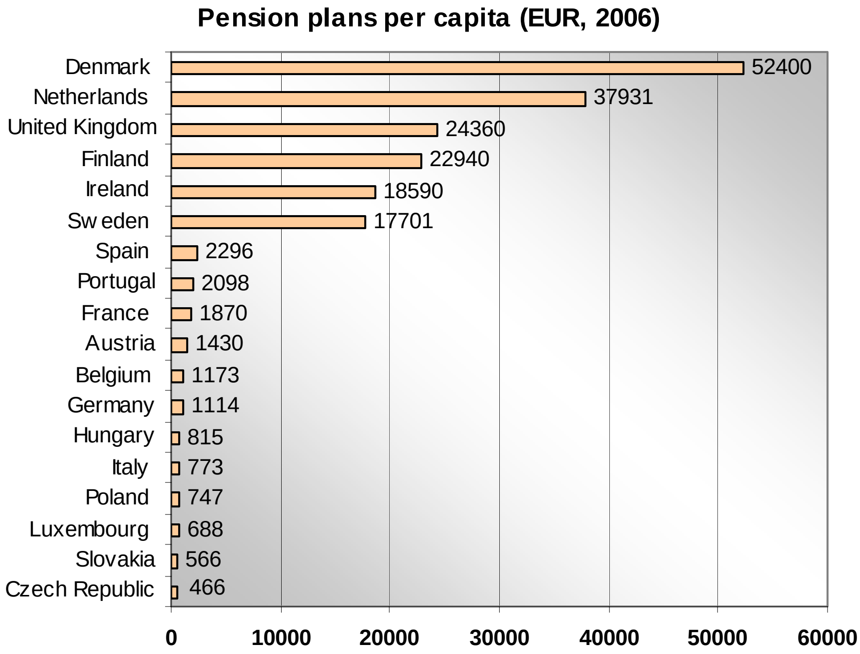
Another factor affecting countries to different degrees is the decline in birth rates and the general increase in the average age at which a child inherits from his parents. Both of these have a huge impact on decision-making and the conditions surrounding transmission of wealth through generations. Attitudes towards inheritance are one of the fundamental factors underlying the potential development of the ERS market. Any existing cultural predisposition to using the ERS mechanism, or fiscal or other incentives to allow donations and access to early inheritance, will receive the support of an increasing social effect, whereby older heirs are already settled in their lives and are even owners of their own property when their parents die. Identifying countries where it is becoming less and less common for parents to plan to pass on their property to children who are planning to live there in the future will give us an indication of the countries in which these elderly homeowners are likely to be increasingly inclined to want to mobilise their housing wealth and thus be in a position to consider ERS as a solution. More sociological research on the subject of inheritance would be useful and some concrete national preferences from responses to our survey are outlined in a later section.[86]

(3) The pension gap

The increasing need for citizens in the EU to add private pensions to their retirement income is not reflected equally in the distribution of pension systems in the EU. In countries where much of private assets remain frozen and illiquid, such pension schemes can only develop with difficulty. ERS could contribute to a solution, especially in countries where homeownership levels are very high and the prospects of a tenancy market are low. The following diagram makes a clear distinction in private pensions between the top six Member States - Denmark, Netherlands, UK, Finland, Ireland and Sweden - and the rest of the EU. Here again, we find the UK and Ireland, as the two most developed ERS markets at the top, while Spain does not fit into this pattern. Again, it is interesting to note that Denmark and the Netherlands, which are in many respects the countries with the greatest amount of privately administered liquid assets for old age, are not the countries which have also done most to develop the ERS market.

[86] See Section D.III (on p.71).

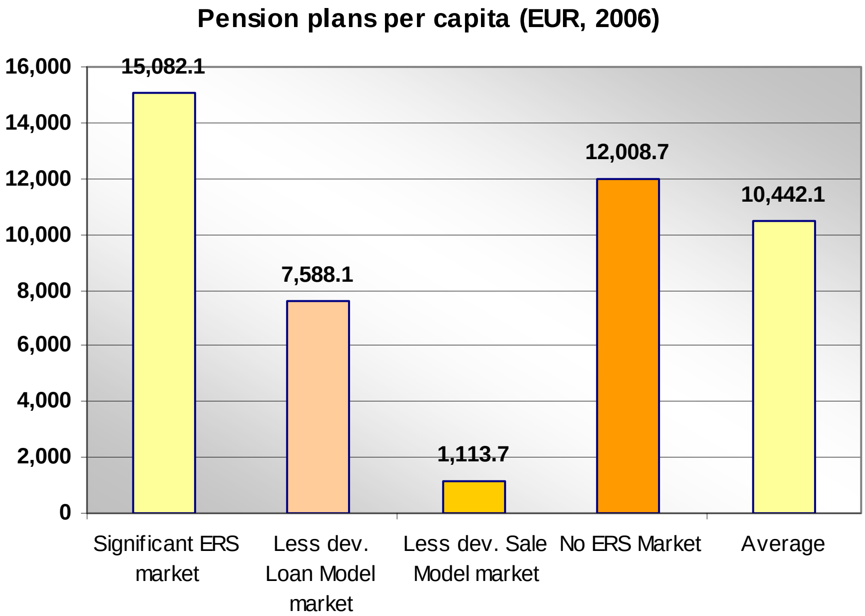
Figure 30: OECD data set on pensions



Source: Pensions at a Glance: Public Policies Across OECD Countries, 2007 Edition

If we relate these figures to our four groups of ERS and non-ERS countries, we find quite a clear relationship with the amount of private pension schemes available in these countries and the development of ERS.

Figure 31: OECD data set on pensions by ERS Group



Source: Source: Pensions at a Glance: Public Policies Across OECD Countries, 2007 Edition, ERS survey and own calculations

II. Market barriers

1. Cultural barriers

Acceptance of ERS by the consumers constituting the potential market is a critical factor for providers in deciding whether to offer such products. As we have seen from the empirical part of this report (section B II.), there is a widespread belief on the supplier side that these barriers are low, especially in countries where credit has not yet reached a similar level to that reached in Anglo-Saxon countries.

Irrespective of a person's basic beliefs, attitudes and predisposition, ERS will require a minimum set of ideas or beliefs relating to the accumulation and then the mobilisation of housing assets, and the lifestyle choices of people when they are no longer economically active. In the context of retirement provision, the various resources to which retired people may have recourse are part of shared experience passed on from one generation to another. Myths and attitudes relating to old age generally refer to the need to save and to care for the elderly.

Research into retirement provision has distinguished between liquid assets, homes, family, friends, health and income opportunities. These assets have been categorised into liquid, fixed, social, health and employment capital assets respectively. In order to overcome the barrier separating homes from money, providers of ERS and politicians who advocate such products must use a language that comes close to the ideologies developed around the home and retirement provision. Transforming a home into a pension requires the acceptance of three concepts:

- The home is a capital asset, and not merely shelter and a consumer asset to be passed on to the next generation;
- Capital can be made liquid without giving it up completely, and liquidation is neither sale nor bankruptcy;
- This process can be brought forward by means of credit.

While UK customers find all three steps easy to understand, rural Greek families, for example, may fail even to grasp what selling a home means. Each nation and, within each nation, different social groups may have to be addressed differently. As equity release concepts are closely related to marketing activity, the use of the right words is core business in this area. This is why empirical research, unlike scientific research, must closely adhere to the relevant wording.[87]

As explained earlier, the variations in terminology applicable to ERS reflect differences in understanding, experience and culture, and should not be seen merely as linguistic equivalents.[88]

This use of language is revealing. It shows how far consumers may have to travel in order to accept that their homes are mere capital to be traded and 'liberated' ('freed' in the second Dutch term) through credit – an insight which is routine for investors, who buy real estate in a variety of forms, from closed to open real estate funds, Real Estate Investment Trusts or directly in the form of ownership.

A summary of surveys concerning the introduction of ERS in various countries concludes that cultural barriers dominate the process. The conclusion reads as follows:[89]

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[87] The protestant reformer Luther called this marketing prerogative for his translation of the bible into German "Dem Volk aufs Maul schauen."

[88] See Section A.I above (on p.1).

[89] See Turner & Yang (2006) p.287 (fn 74).

> *"However, most research does not support the hypothesis that the elderly are likely to release their housing wealth. They rarely move out of their home and sell it to enable a higher level of non-housing consumption during retirement. Venti and Wise (2001) studied 1980's Health and Retirement Study data and indicated that, in the absence of changes in household structure, most elderly families are unlikely to move. They concluded that 'on average, home equity is not liquidated to support general non-housing consumption needs as households' age'. Hurd (1990) also points out that even those elderly, who spend their non- housing financial assets during retirement, apparently choose to maintain housing equity wealth. A study by Skinner (1989), Levin (1998) and Engelhart (1996) also observed that housing wealth does not seem to impact consumption and savings decisions of elderly homeowners. The nature of housing equity of the elderly has been discussed from several aspects. First, most elderly do not regard housing wealth as fungible wealth. The house for them is simply regarded as a place to live and they do not make any consumption decisions based on that wealth (Walker, 2003). Second, a home is an emotional and psychological resource for the elderly and older homeowners have a strong attachment to their home (Gibler & Rabianski, 1993). Third, high transaction costs associated with the selling of a house and moving also discourage the elderly from transferring housing wealth into consumption (Gibler & Rabianski, 1993). However, these studies examined housing decisions of the elderly household from non-economic factors and less from economic causes. It is possible, that the elderly homeowner has no economic motivation to sell the house. It is not necessary to use home equity to supplement their retirement income to fund consumption as a consequence of decreasing income, as this loss is easily offset by decreasing housing expenditures. Elderly households can be in an advantageous position, relative to those who are tenants, in weighing up the consumption decision. For the elderly household, outstanding housing loans are likely to be finished of and their owner-occupied house may be used as an equity which enables them to live rent-free (Doling & Horsewood, Risk and Benefits 2003). Therefore, homeowners might have no incentive to leave their homes for the sake of further consumption*."

It appears that elderly people see their home as the most stable and visible pillar for their consumption needs in retirement, which must therefore be completely secure, and hence debt free. If ERS could, however, be structured in such a way as to guarantee this security, so that a decline in house prices will not affect the loan and that there is no risk of repossession, the proportion of households willing to use the equity in their homes may increase.

With regard to the responses from the various Member States, there seems to be a clear distinction between Protestant (Scandinavia, UK, Netherlands) and Catholic countries, especially those in southern Europe. While the reports from the former indicate that rather loose family structures have diminished the cultural factors obstructing the liquidation of the home, reports from the latter group convey major reservations in those countries, especially with regard to Loan Model ERS.

In **Spain,** the acquisition of a house is seen as a family's primary objective. Enormous efforts are devoted to keeping it and freeing it from any encumbrances. Using the home as an asset is a major departure from this social and cultural norm, and only severe economic hardship is likely to change these attitudes. As Spain is still a society in which families are close and, particularly in rural areas, the home as such is seen as the centre of the family, to be inherited by the children.[90]

In rural **Germany**, the word *Stammhaus* suggests that the house is the centre of the clan (*Stamm*) and its purpose is therefore not confined to the lifetime of one family.

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[90] See Part II: Country Reports II.6.d) Spain (p.49).

Houses more than 100 years old are not replaced by modern buildings, but retained as the incarnation of the family. In Germany**,** bankers report that consumers are very interested in ERS in general, but very reticent when they learn the amount of funds the scheme would produce from their home. Traditionally, Germans pay off all borrowings secured on their home before retiring and usually aim to be completely debt-free by that time.[91]

In **France,** considerable stigma is associated with overindebtedness and, as a result, people are very conscious of the dangers of excessive indebtedness and how this may affect them socially. Reactions and general negative attitudes on the part of consumer organisations in France towards ERS (a factor which was mentioned by one respondent as undermining the likelihood that this type of product will be accepted by the public), testify to this.

With regard to Sale Model ERS, although the old *viager* system has existed for a long time, the moral dimension of the transaction, whereby a buyer gambles on the sellers' early death, has meant that it has lost considerable appeal over the years. This is something that can be avoided should the transaction be conducted by a business as opposed to an individual. The French are generally aware of the sale and lease-back concept, but media reporting on extreme cases will have served as a warning to prospective home reversion providers. The famous case of Jeanne Calment, a Frenchwoman who lived to 121 years of age and survived her buyer is now world famous. Though these occurrences are extremely rare, the added fact that she also smoked a pack of cigarettes a day, highlights the unpredictability and uncertainty for potential providers of Sale Model products.[92]

Italians are not keen to sell the home in which the children grew up and which is connected to cherished family memories. Furthermore, the home is the major asset, which is expected to be handed down to the children on the decease of the elderly.[93]

Portuguese people are wary of indebtedness and new financial/banking products. With regard to ERS specifically, cultural and sociological reasons associated with passing on the home to the next generation are the main obstacle to an ERS market.[94]

In **Greece,** few elderly people live in residential care, because family relationships are traditionally strong, and the elderly move in with their children when the need arises. Traditionally, an elderly homeowner in Greece would prefer to sacrifice quality of life in order to leave an inheritance to his children rather than use an ERS. Nevertheless, it is the view of consumer representatives from Greece that there is potential significant consumer interest in ERS.[95]

In general, the responses to the questionnaires suggest that cultural barriers have to be seen in relative terms. If there is a financial need for liquid assets and if the home can be secured for life, the cultural obstacles can be overcome if the amount of equity released is seen as adequate. On the one hand, growing mobility within the EU has already had the effect that, while parents retain their homes for the benefit of their children, the children may well never live in them. On the other hand, support for parents aged over 70 with insufficient income is becoming a much more pressing concern for young people than is the future loss of their family home.

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[91] See Part II: Country Reports IX.5.c) Germany (p.101).

[92] See Part II: Country Reports IV.6.c) France (p.68).

[93] See Part II: Country Reports VI.6.c) Italy (p.86).

[94] See Part II: Country Reports XVI.4.a) Portugal (p.136).

[95] Response by EKPIZO.

2. Economic barriers

a) Credit and elderly people

The economic barriers to development of ERS markets have already been examined in depth in the analysis of favourable market conditions.[96] If these findings were reversed, low capitalisation in the housing market, low levels of homeownership, low levels of mortgage debt and no second mortgage systems, combined with a state pension system sufficient for all income needs on retirement, would amount to economic barriers to ERS. Over and above those barriers are the barriers confronting elderly people in the credit market, in which ability to pay is still assessed on the basis of income from employment and the number of years over which the borrower will have sufficient income. Although these barriers are not based on logic where repayment is solely from the home itself, which will not 'die', existing credit sales practice will have to be adapted to meet this new challenge. Indeed, a survey of German banks revealed that consumer credit is not made available to applicants over 70 years of age including mortgage credit.[97]

There has been wide press coverage of this problem in the past. Elderly people have been directly excluded from access to credit, and age limits of 71 or 73 have been reported.[98] The national TV programme WiSo[99] tested the access of elderly people to credit. It did not discover many outright refusals, but it did of a credit contract conditional on life insurance, which is not available at a reasonable price for this age group. Others told the applicant that, because of their age, the loan would be restricted to EUR 25 000, against an application for EUR 30 000.

Such barriers are addressed by European anti-discrimination legislation[100] but, as the law allows unequal treatment if there are good reasons, including statistical ones, these barriers may persist.

If providers request additional security, elderly people most in need of additional income in old age may be excluded from the ERS market. The survey, however, did not disclose a significant rejection rate. As reported in the chapter on users[101], the 'asset rich and cash poor' aged 70 and over, with homes valued above the average, are clients who do not appear to present these problems in the foreseeable future.

b) Credit crisis and ERS

The present credit crisis has added additional concerns for consumers. There has been a sharp drop in house prices, especially in the two advanced ERS markets of the UK[102] and Spain. The general fall in house prices is not evenly spread across those countries, and may imply a fall of 30% or more as occurred, for example, in the case of flats in Eastern Germany in the late 1990s, when people left that part of Germany for jobs in the west.

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96 See Section D.I.2 Quantitative data on market conditions for ERS (on p.50).

97 See Reifner, U., *Altengerechte Finanzdienstleistungen - Herausforderungen der gesellschaftlichen Alterung für die Entwicklung neuer Finanzdienstleistungen und den Verbraucherschutz*, Expertise for the Chapter on *Wirtschaftliche Potenziale des Alters* of the Fifth Report on Ederly People, Federal Government of Germany 2005.

98 See *Immer mehr Rentner kriegen keinen Kredit* http://www.rp-online.de June 17, 2004; Hamburger Abendblatt November 15, 2003.

99 Broadcast from September 29, 2003, see: http://www.zdf.de/ZDFde/inhalt/24/0,1872,2069880,FF.html.

100 Directives 2000/43/EC (29 June 2000); 2000/78/EC (27 November 2000); 2002/73/EC (23 September 2002); 2004/113/EG (13 December 2004).

101 See Section C.II.2 above (on p.28).

102 BBC News Channel October 9, 2008 *Further decline in house prices* (12.8% in 2008) http://news.bbc.co.uk/1/hi/business/7660695.stm; The Guardian, Friday November 30 2007: *Biggest drop in house prices for twelve years*.

The general trend in EU house prices shows that the average price is less and less significant in calculating the equity in a particular house. Suburbs differ from the city centre, rural areas from urban areas, high energy homes from newly erected low energy homes. This trend gives rise to great diversity in house prices, as the example of Sweden has shown, where price differences between poor and wealthy homes doubled between 1994 and 2002.[103]

These developments may create negative equity in relation to mortgages previously seen as secure. Providers will probably react by lowering LTV margins, which now average approximately 60% in ERS, thus creating an additional economic barrier.

The actual increase in interest rates and the problems in refinancing mortgages following the credit crisis will add additional barriers to the distribution of ERS.

The following points were drawn up with the help of SHIP, the trade association for Equity Release providers in the UK.

- Drivers for equity release have increased as the credit crunch and recent economic climate has had a negative impact on the value of pensions and savings/shares etc, leaving many in retirement with far less income than they either anticipated or actually need to have a reasonable standard of living.
- Increase in inflation is also having a negative impact on people’s savings.
- The rising cost of living is making it more difficult for people to maintain an acceptable lifestyle.
- Rising debt, a consequence of the current climate, is leaving people with unaffordable monthly commitments which are being consolidated via equity release.
- Those coming off previously cheaper fixed interest rates have had difficulty remortgaging due to lack of available cheap mortgage rates, which has led to increases in monthly mortgage repayments, often unaffordable for those in retirement. Some of these have now looked to equity release to free up their monthly commitments.
- Falling house prices will reduce the overall amount that people can take on equity release, however as the average amount taken is relatively low (GBP 54 000). It is clear that there is still plenty of equity in the average property.
- There is no evidence that people are postponing decisions to release equity due to the current climate, whilst the figures are down slightly on the previous year – approx 7% down on 2007 compared with 2006. This is insignificant compared with the normal mortgage market.
- There may be a reduction in providers over the coming months; however, the array of products available to clients still offers a huge choice.

The first repercussions of this crisis have already reached the general attitude to use equity release for personal consumption. As The Times reports on October 4, 2008[104]

> “*(the Bank of England’s) latest figures show that Britons have abruptly abandoned the habit of borrowing against their houses and flats through mortgage equity withdrawal, bringing to an end a decade-long era of the nation using its homes as cash machines. Second-quarter figures (2008 iff) for equity withdrawal showed that, rather than raising borrowed cash against their properties, homeowners*

103 See Section D.I.2.3) on house prices (on p.55).

104 Times online October 4, 2008, *Homeowners steer clear of equity release while climate still uncertain* http://www.timesonline.co.uk/tol/money/property_and_mortgages/article4878566.ece.

> *injected a net £2.8 billion of new equity. This was the first such injection of cash since 1998 and the biggest such move in cash terms since 1970. … House prices tumbled by another 1.7 per cent last month, taking their annual rate of decline to almost 13 per cent – their fastest year-on-year fall since 1991, the Nationwide Building Society reported this week. 'Higher mortgage rates, markedly tighter credit conditions and falling house prices have increasingly reduced the attractiveness of, and scope for, equity withdrawal,' Howard Archer, of Global Insight, said. The end of equity withdrawal will come as a severe blow to struggling retailers in the run-up to the crucial Christmas trading season*."

It will therefore be increasingly important to distinguish ERS properly from what in this article is called "*a decade-long spree of cashing-in on the value of their properties to pay for big-ticket consumer spending and paying off debt*".

III. Risks and benefits

1. Benefits of ERS

The general growth of aggregate wealth, together with the constant search for new products and new business by financial institutions and intermediaries, had led to an increased use of the EU's housing stock as collateral for borrowing. However, not all Member States are affected by this trend to the same extent. Though almost all EU homes are used as collateral for a mortgage loan (with the notable exception of practices in Member States where home loans are extended without real estate as security), use of the home as collateral for a loan for other purposes varies from country to country[105]. The existence of this type of lending is seen by many as the necessary precursor to widespread introduction of a more developed and packaged product in the form of an ERS.

In the context of consumer credit in the form of instalment loans or a line of credit, a shift in lending practices towards a focus on the value of the collateral, irrespective of the income of the prospective consumer, may cause problems with respect to the principle of responsible lending. This principle is laid down for example in Article 8 of Directive 2008/48/EC, which however does not apply to loans secured by a mortgage, but is also part of national mortgage law in some Member States. As this principle creates responsibility for the lender to make sure that the credit will be paid back from the income of the customer ERS introduces a new element that has not yet been legally discussed in consumer credit. It is important to understand, however, that the balance shifts in terms of the legitimacy of this approach where there is an agreement that no repayments are due until the home is no longer needed. Older homeowners are thus the appropriate customer group for ERS, because many are likely to own their property outright, and most face a reduction in their income expectations and, consequently, reduced access to credit, on retirement.

Because the home is the most valuable asset owned by ordinary consumers, and because consumers are more afraid of losing their property as they get older, equity release providers have designed their schemes to provide an additional source of liquidity without putting the home and the consumer's sense of security of living in their own home. The main reasons for older households to consider an ERS could range from a desire to improve quality of life, insufficient income or the need to meet either special items of expenditure (such as the need for care or major property repairs). They may also be motivated by the wish to minimise eventual inheritance tax liability.

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105 See section on Surety law (on p.115) for more detail, and Part II: Country Reports IV.6.b) France (p.65) for an example of a country with an alternative form of a home loan not based on a mortgage.

The social benefits of ERS may be illustrated with Modigliani's Lifecycle Hypothesis[106], which indicates when an ERS could be most useful. However, it may be argued that the theoretical dis-saving (consumption of what had previously been saved) does not actually take place as predicted because of a host of factors which do not feature in economic predictions based on simplistic assumptions behind utility maximisation by homo economicus. Altruistic factors, such as a desire to leave as much as possible to inheritors, and the desire to build something to be of use to others after the owner's death explain why development of the equity release market may be slower than its anticipated potential.

ERS and the use of homes to supplement the income of the elderly and disabled has now become an important subject for discussion in over a quarter of EU member states[107]. Furthermore, this proportion is likely to grow as public policy develops in this area. Reasons for interest in ERS is anchored in the existence of a number of key factors supporting the emergence of ERS in the long term in most EU countries. To name but three by way of introduction, the ageing of the EU's population pyramid, the uncertainty of the sufficiency and sustainability of state social welfare and care, and certain social and cultural changes relating to family structure and relationships.

a) Benefits for the providers of ERS

The sustained rise in house prices over the past decade, currently readjusting sharply downwards, has without doubt played a major role in encouraging innovative lenders, in Ireland, for example, to take the risk of granting ERS to a steadily growing group of customers which has benefited from an increase in their asset wealth, without a corresponding improvement in their income position. Providers could use this demand to enter the niche-market for ERS in order to:

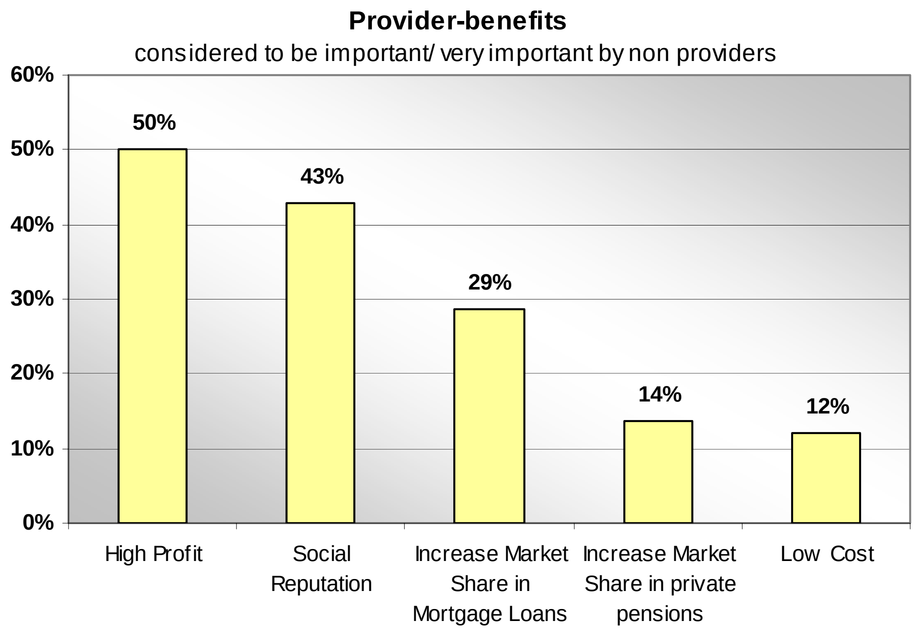
- achieve market share while expecting significant market growth;
- achieve high profit from ERS sales;
- increase market share in private pensions;
- increase market share in mortgage loans;
- use contacts with elderly people to cross-sell other products such as current accounts or insurance;
- build social reputation.

From the point of view of consumer organisations and bank supervisors, high profits and social reputation are highlighted the most frequently as benefits. When asked what benefits they see from entering this niche market, French stakeholder responses agreed that high profits were the most important motivator. The respondents from the provider side said that social reputation had the highest priority. In Spain, the BBVA announced in the mainstream press in January 2008 that the Bank aims to achieve a 25% market share in ERS in Spain, suggesting that there is money to be made in serving elderly populations these types of products.

[106] See explanation below (on p.75).

[107] According to responses from our stakeholder (non-provider) survey.

Figure 32: Provider benefits as seen by non-providers



Source: iff Survey on ERS 2008

b) Benefits for consumers of ERS

The life cycle theory of Modigliani[108] describes how households set their consumption patterns in line with their expected income. They adapt their income cycles to their consumption cycles. Individuals aim to maintain their levels of consumption on a consistent level for their lifetime. Households save in times of higher income in anticipation of leaner times ahead. Saving for retirement is therefore most important. In order to keep income at a constant level, consumers want to liquidate property such as real estate in old age. ERS are services which enable consumers to do this, without forcing them to lose their home.

ERS enable residential owners to remain in their home while gaining an additional monthly income in retirement. This has become more and more important in the context of the growing importance of private retirement pensions. Private retirement pensions are now replacing family care for older people because of demographic and sociological changes. Families are much smaller, and the proportion of elderly people in the population is increasing. A decline in birth rates, accompanied by steadily rising life expectancy, is leading to an increasingly ageing population. As a result of cuts in state pensions and increased expenditure on health and care services, pensioners are becoming more and more dependant on other sources of income. Above all, the right to remain in the home is often the main benefit of the product, even above the benefits of providing the consumer with more income. A provider in France confirmed that the main reason consumers were turning to their ERS was a lack of cash to cover current household expenditure. The typical user of this product was described by a respondent of French regulation as a couple with an average age of 76 at the point of taking out the

[108] See Modigliani, Franco, *The life-cycle hypothesis and intercountry differences in the saving ratio*, in W. A. Eltis, M. FG. Scott, and J. N. Wolfe, eds., *Induction, growth, and trade: essays in honour of Sir Roy Harrod*,. (1970) pp.197–225; *The life-cycle hypothesis of saving twenty years later*, in Parkin, Michael, ed., *Contemporary Issues in Economics*. (1975) pp.2–35.; Modigliano, F. *Life-cycle, individual thrift, and the wealth of nations*, American Economic Review, 1976(3), pp.297–313.

ERS agreement[109]. According to one French source, women were a significantly higher proportion of the clientele, representing 65% of all customers[110].

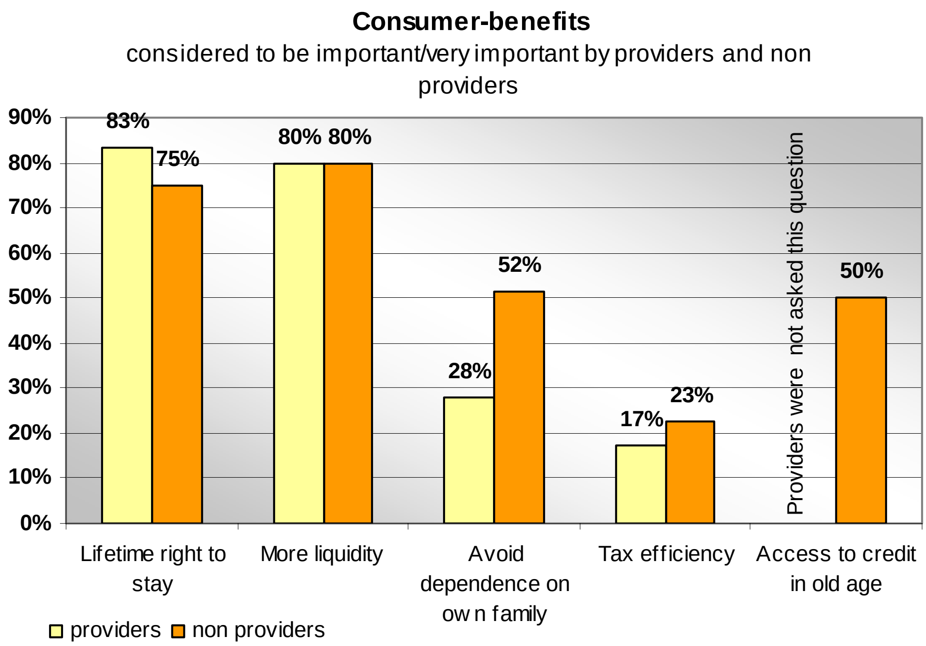
In December 2007, iff[111] pointed to the following benefits for retirees in relation to reverse mortgage products (Loan Model ERS): (1) higher liquidity for retirees; (2) capital for unplanned expenses (home care); (3) security of lifelong payments; (4) repayment at any time; and (5) no loss of home during lifetime.

From the non-provider point of view, the following benefits for consumers are important:

- access to credit in old age;
- the right to stay in the home;
- increased liquidity in old age;
- avoiding dependence on the family;
- tax reduction.

Greater liquidity in old age and the right to stay in the home for life are the most important benefits from both providers' and non-providers' point of view. More than 75% consider these factors to be 'very important' or 'important'.

Figure 33: Consumer-benefits as seen by providers and non providers



Source: iff Survey on ERS 2008

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[109] See response from Questionnaire SQ32.

[110] See response from Questionnaire PQ9. This figure is in line with observations for France on private home reversions (not covered by the scope of this study) made in a 2008 report by the Conseil économique et social entitled *Les viagers immobiliers en France* (see http://www.conseil-economique-et-social.fr/rapport/doclon/08280308.pdf). In Europe more generally, the higher longevity of women (+7 years for life expectancy at birth) and the fact that men in couples are on average about 3-4 years older than their wives, means that nearly 70% of women that are 80+ are widowded compared to only 30% for men. According to the sample used by the Survey of Health and Retirement in Europe (SHARE) under http://www.share-project.org/t3/share/fileadmin/pdf_documentation/selected_results/CH4.pdf. A further 1999 study for the Joseph Rowntree Foundation found that single elderly people, but particularly women, were acutely worried about maintaining their home, increasing the risk of anxiety-related illnesses ('To Have and to Hold: The Bond Between Older People and the Homes They Own', http://www.jrf.org.uk/knowledge/findings/housing/939.asp.

[111] Based on a presentation given by Achim Tiffe from the iff at a German conference on reverse mortgages.

2. Risks of ERS

a) Risks for the providers of ERS

Concerns expressed by providers are non-recovery of capital outlay, unpredictable follow-up costs and reputational concerns.

(1) Credit failure risks

The main risk for the **providers** is non-recovery of their capital outlay and failure to earn any interest on it (failure risks). The failure risks generally apply equally to Loan Model (reverse mortgage) and Sale Model (home reversion) products. Main failure risks are:

- the uncertain longevity of the occupier;
- the risk of increasing interest rates;
- developments in real estate prices; and
- the value of the property.

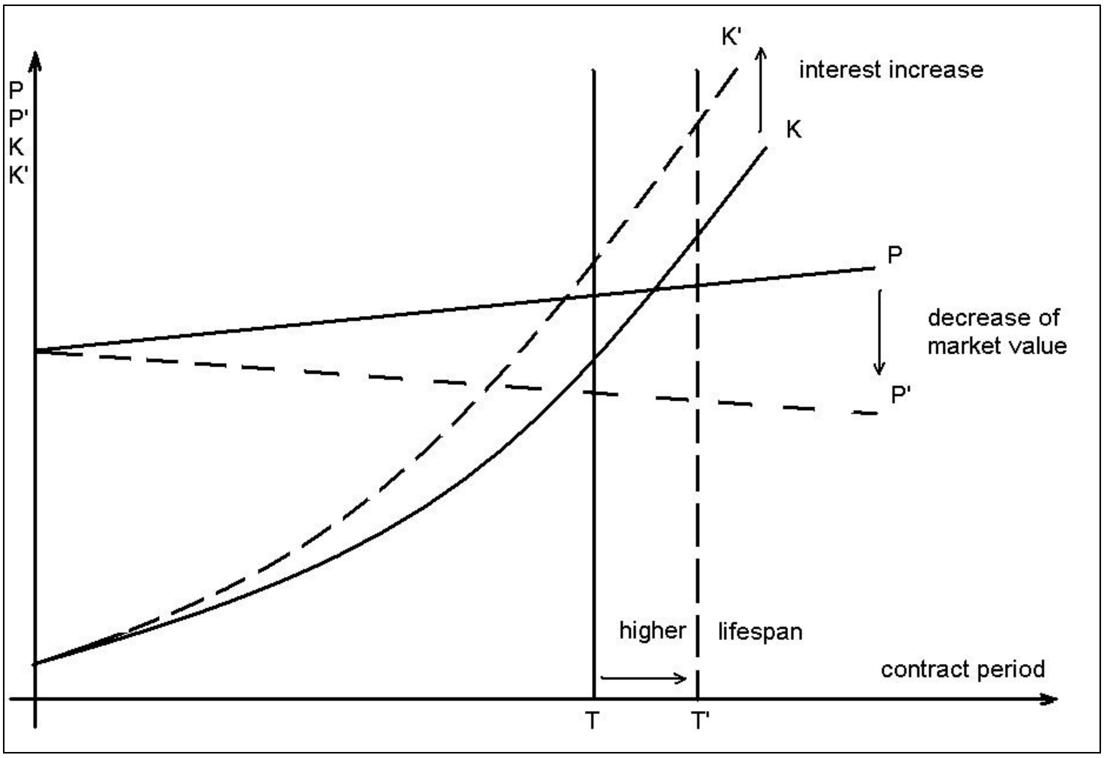
Loan Model products (reverse mortgage) in particular carry a longevity risk for providers. If the debtor lives longer than expected, the contract term will be prolonged. As a result, the loan could exceed the value of the property and result in a loss. Lifespan is the maximum contract duration and influences all the other failure risks, e.g. the risk of increasing interest and the valuation risk. In particular, in models where pensions are paid periodically, the risk is clearly quantifiable, because the loan account increases with every payment as the interest accumulates. In models where only a lump sum is paid, it is only the interest on the loan that increases as the contract term is extended.

The magnitude of the risk relating to changes in interest rates depends on whether a fixed interest rate or a variable interest rate is agreed with the creditor. On the one hand, variable interest rate agreements mean that the amount of the loan will increase more quickly when market rates rise. This can cause the loan to exceed the value of the property when the contract expires. On the other hand, the borrower takes the risk where s/he wishes to buy back the property and, if interest rates rise, pays back more than originally expected. The provider bears the risk of changes in interest rates in fixed interest agreements because the loan amount and term are fixed.

One significant risk for providers in Loan Model ERS is that the property could fall in value. This can result from either a fall in market prices or an inaccurate valuation at the outset. Again, this may give rise to a loss for the provider at the end of the contract term. If the loan is not repaid by the borrower's heirs, the provider relies on the proceeds of sale. The provider may sell the property on the open market or put it into auction. The price risk can be diversified across a large portfolio of properties based in a number of regions. However, the effects of a systemic fall in prices are not manageable in this way. Of course, there are the risks involved in understanding, anticipating and predicting the future price of a housing asset from a purely housing market perspective, but beyond these fundamental economic calculations, there is the risk that the property will depreciate in value because of the occupants' behaviour in relation to it. Unrestrained, either by law or by the provider's own contractual terms, there is always the possibility that the occupants affect the condition of the property either by letting it out or simply by granting occupancy of the premises to a third party. Maintenance of the asset will also determine its future value, so management of this aspect is crucial.

The above risks of credit failure may also be concurrent and lead to an accumulation of risks. The following diagram shows risk impact:

Figure 34: Credit failure risk model[112]



Initially, it is expected that the property value (P) will rise slightly. At the same time, the capital account (K) increases through the monthly payments and accrued interest. The contract term ends on the death of the borrower (T). If the predicted outcome occurs, the value of the property is higher than the loan at the time the contract expires. Then the intersection of lines K and P lies on the right of the contract expiry line T. If the intersection lies on the left of line T, the provider incurs a loss.

(2) Follow up costs and reputational risk arising from irresponsible products

In addition to the risks referred to above with regard to the design of the product (failure risks), providers could face unforeseeable additional costs. These could result from failure to comply with duties to provide information to the borrower, in countries where they are punishable by fines. In France, for example, if the lender does not comply with the formalities required on presentation of the credit offer, the judge may impose a partial or total loss of entitlement to interest.

Negative press is a risk that providers and the industry must consider, as has been seen in the UK where reputational damage was caused by mis-selling[113]. The example of warnings to the public on the risk of losing one’s home through an ERS was evident in a

[112] Picture taken from Lang, G., *Reverse Mortgage als Alterssicherung in Deutschland*, Baden-Baden, Nomos 2008 p.59.

[113] This is primarily a consequence of the Home Income Plans sold in the UK by financial advisers in conjunction with certain building societies during the late 1980's. They involved the owners mortgaging their homes to secure advances, at enhanced rates of interest, which were then invested in equity-linked bonds. The subsequent fall in equities and house prices and the rise in interest rates caused the owners severe losses, which when the financial advisers had become insolvent, left the investors only able to make a claim for compensation. A brief history of the development in the UK is available under: http://www.retirement-plus.co.uk/downloads/570-2-7-2008-HistoryER-050608-v2.pdf. The risk of damage to reputation is a constant threat however, especially when media reports on bad practices e.g. http://www.telegraph.co.uk/finance/personalfinance/2916580/Elderly-mis-advised-on-equity-release.html.

Spanish Newspaper article[114] which warned of UK expatriates living in Spain who may be tempted by the aggressive promotion of ERS to raise capital from their property.

ERS have even been labelled "*the lifestyle dream that can turn into a nightmare*"[115]. Raising even a comparatively small sum could leave pensioners owning hardly any of the value in their home. There is a real risk that there will be nothing left to pass on to family members. A magazine report[116] published in January 2006, shows that if a 60-year-old borrowed an £ 80 000 lump sum with a typical equity release lifetime mortgage, it could cost them £ 256 570 by the time they were aged 80, and £ 343 350 if they reach 85. Which?, the UK consumer body, also claims equity release mortgages are advertised irresponsibly, with the suggestion that "*its scheme could pay for a trip to New York or 'something for the family'*". In the UK for example, the consumer association Which? said: "*If you're over 60 and worried your pension won't be enough to live on, an equity release scheme might seem like a good idea. However, think long and hard before committing to one of these high-risk products. 'Lenders want to sell you a lifestyle dream, but the reality can be very different. These schemes could turn into a financial nightmare which can stay with you for the rest of your life.'*"[117]

(3) Stakeholder views

From the providers' point of view, house valuation and reputational risks are the most serious risks. More then 70% of providers consider the risk that the house loses value over time to be 'very high' or 'high'. In countries such as Spain, where house prices are now falling, house valuation is considered by providers as the major risk. 65% of the providers who answered that question considered reputational risks to be 'very high' or 'high', among them nearly every provider from the UK. Conversely, 40% of providers consider longevity and only 29% the interest rate change to be an 'average' risk. It therefore seems that providers think that those risks are easier to quantify. The answers from non-providers show a great amount of agreement between both sides. The most significant differences lies in the valuation of longevity as a problem which, understandably, consumers see differently from providers, since they profit from it and cannot judge this as a risk. The following diagram shows the results of the questionnaire.

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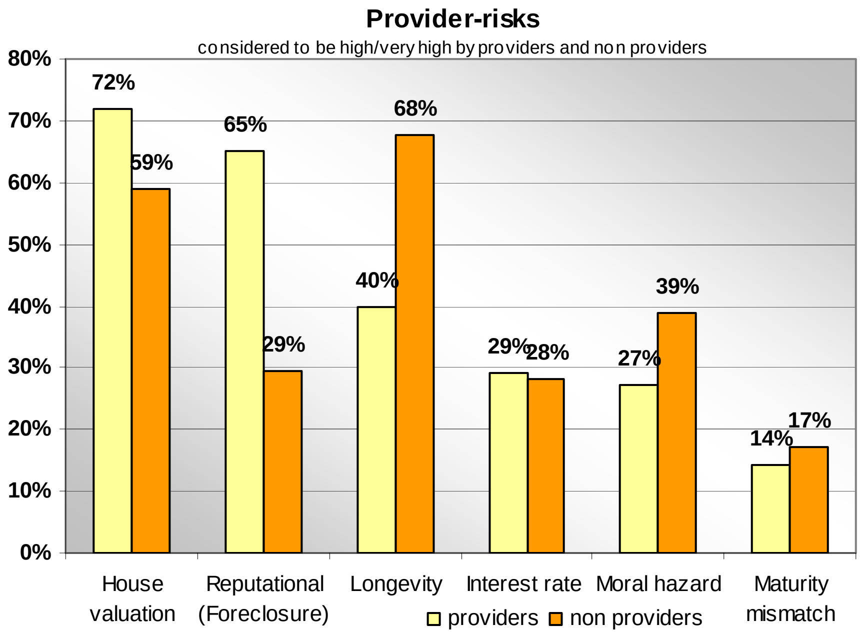
114 See Tenerifenews June 9, 2008; http://www.tenerifenews.com/cms/front_content.php?idart=2946.

115 See Lambert, Simon, *This is Money*, 5 January 2006; http://www.thisismoney.co.uk/mortgages/article.html?in_article_id=406052&in_page_id=8.

116 Report by Which? In January 2006, see: http://www.money-advice.net/media.php?id=3162, and media report on http://www.moneyweek.com/personal-finance/equity-release-is-a-last-resort.aspx. See (fn 19).

117 See (fn 116).

Figure 35: Provider risks as seen by stakeholders



Source: iff Survey on ERS 2008

b) Risks for the consumer of ERS[118]

Risks for consumers may be divided into two groups: risks causing restrictions in ability to use the property as an owner (ownership restriction risks) and risks with a negative effect on liquidity causing shortage of income, over-indebtedness and poverty (poverty risks). The classification partly overlaps.

Ownership restriction risks can cause restrictions in the personal and social life of the borrower and his family as explained below. Examples of such risks are:

- Consumer is forced to move out;
- Barriers to mobility and risks of health;
- Barriers to household type;
- Liabilities in care for the property;
- Property cannot or must be inherited.

Poverty risks include:

- Changes in tax and benefits in the future;
- Inflation eroding the value of the payments over time;
- Changes in interest rates in the future;
- Consumer does not understand the products and chooses the 'wrong' product;
- Consumer is induced into the contract;
- Provider bankruptcy;
- Longevity of the consumer;
- Product is too expensive;
- No restrictions in use of the money.

These risks are explained in more detail in the following sections.

[118] This section combines the theoretical risks with the empirical evidence collected from our survey and other articles, however more specific information is available under the 'Risks and Benefits' sub-sections of the respective country section of Part II: Country Reports.

(1) Ownership restriction risks

Ownership restriction risks prevent the owner doing as he wishes with his property. This is first a disadvantage for the consumer, but can easily turn into a risk for others, when the owner is forced into action with negative effect on his social and private life.

(a) Consumer is forced to move out

The biggest risk for the consumer would be to be forced to leave the property. If a Loan Model ERS is arranged, say, for only a five- or ten-year period, after which time it can be renegotiated or recalled, external developments such as changes in the property valuation can lead to an unforeseen premature cancellation of the credit contract imposed on the consumer. The unexpected immediate repayment obligation would systematically lead to the consumer having to sell his/her home in order to pay off the outstanding mortgage loan if the amount due had accumulated over time or if the housing market had changed unfavourably. With fixed term contracts, where the repayment of the loan is not contractually linked to the sale of the house, the 'danger' of these schemes becomes greater if one's age and health are such that one is likely to live far longer than the predetermined number of years. Therefore, one of the reasons for providers who want to exclude fixed term contracts is precisely because ERS is supposed to minimise the risks of losing the safety and security of the home.

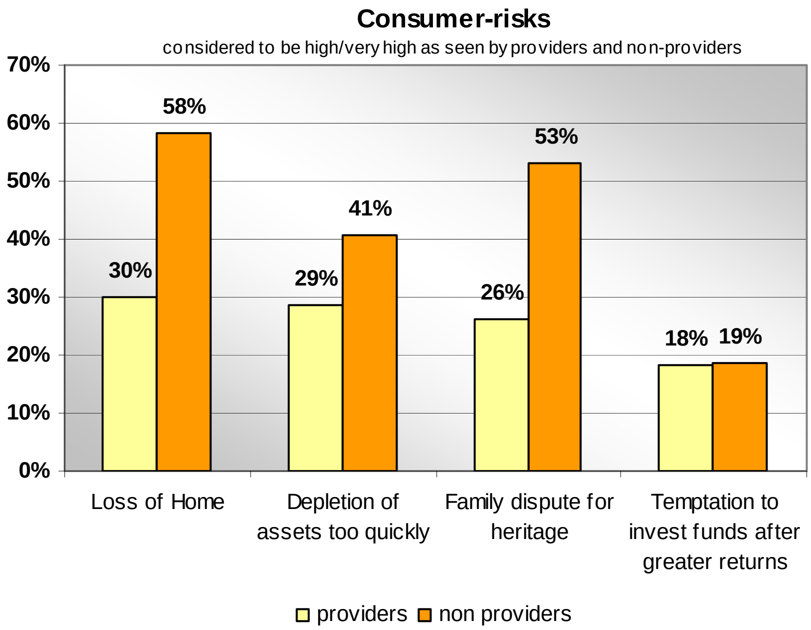
Furthermore, some contracts contain provisions that the mortgagee may exercise the power of sale even where when the mortgage itself is not affected. Two Irish examples come to mind. One mortgage provided by S.H.I.P., which was taken off the market in recent months, enabled the mortgagee to exercise the power of sale if "*an encumbrancer takes possession of or exercises or attempts to exercise any power of sale or a receiver is appointed over the whole or any part of the mortgaged property or any other property, assets or revenues of the mortgagor*".[119] In the case of the Bank of Ireland's 'Life Loan Mortgage', the offer provides for repayment "*in the event of any undertakings given by the borrower's solicitor not being complied with in a manner satisfactory for the bank"* (clause 4(a)(x)). The fact that the bank reserves the right to call for repayment of the loan during the borrower's lifetime in circumstances such as these, could ultimately result in the forced sale of the house, and the eviction of the consumer.[120]

This fear is also mirrored primarily in the consumer risks identified by non-providers. These responses focus on the risk of losing the home and family disputes over inheritance as the most serious risks for consumers with regard to ERS. They do not view the risk of consumers investing funds in order to achieve greater returns as very high. Providers see less risk for consumers than do non-providers surveyed (primarily regulators, legal experts, academics and consumer organisations).

[119] See clause 7.1. (f).

[120] This has been criticised by the Law Society of Ireland, see: Proposed Regulation of Home Reversions and Lifetime Mortgages, pp.5-7.

Figure 36: Consumer risks as seen by stakeholders



Source: iff Survey on ERS 2008

(b) Risks to mobility and risks of health

Loan Model ERS potentially hinder borrowers' mobility. There are economic and contractual reasons for this. Economic reasons relate to the risk of financial losses as a result of a sale of the property. In some schemes, the borrower is penalised by means of a redemption fee payable on early repayment of the loan. Early repayment fees are often charged when the house is sold, except where the borrower has died or leaves the home to enter long-term residential care. For example, the Bank of Ireland's 'Life Loan Mortgage' offer provides in clause 7: *"In case of a fixed rate loan, in the case of the early repayment of the loan in whole (…) the borrower will be liable to pay a sum to be calculated in accordance with the following formula (…)."* As a result, owners may conclude that the sale of the property is so financially disadvantageous that they have no option but to remain in occupation.

Contractual barriers include provisions such as "*leaving home for a period of six months or over triggers repayment action*".[121] This may prevent even temporary absences, because of the risk of cancellation by the provider and loss of the home altogether.

In this context, ERS may interact badly with the potential for health problems later in life. Consumers may be inclined to stay in an inappropriate environment rather than leaving home for a period in order to obtain treatment or to convalesce. To that extent, ERS may present a risk to the consumer's wellbeing.[122]

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[121] Provision of an Irish provider. See Section C.III.3) on Products above (on p.37).

[122] Caplin, A., *The reverse mortgage market: Problems and Prospects*, (2000), p.13. See http://www.money-advice.net/media.php?id=3318. See (fn 19).

(c) Risks to household structure

Contractual barriers exist as to the type of household allowed to live in the home mortgaged by the provider. As mentioned above, two providers said that they would not accept residence in the home by a person other than the homeowner/s.[123] While a change in the nature of the consumer's household and a decision to live with someone else may have beneficial financial consequences ('economies of scale') or be desirable for the physical, emotional or social welfare of the consumer, such a change could give rise to credit cancellation by the provider and loss of the home.

(d) Liabilities in terms of property maintenance

While there is technically no risk of payment default by the consumer, default is possible in the form of failure to fulfil obligations under its terms and conditions. In many of the products we have researched for this study, there is an obligation not to leave the property vacant for more than a certain amount of time in the course of a year. In France, there is a specific legal obligation to carry out necessary maintenance of the property in a responsible manner[124]. There will also be an obligation to insure the property against damage from fire etc, and, outside the EU, payment of local taxes is compulsory. In Australia, for example, before self-regulation reacted to modify this in 2007, failure to comply with one of the default conditions could lead to a demand for full repayment of the loan, sale of the property, or enforcement costs and loss of the no negative equity guarantee.

(e) Property cannot or must be inherited

Another risk in terms of restrictions of the owner's rights is a family dispute over inheritance. That risk occurs especially with Sale Model products, because the owner sells the home to the provider. Family disputes may also occur in relation to Loan Model products, because a sale upon death of the owner (if the heirs do not / cannot pay back the loans) under the mortgage may be time and/or cost intensive. Better statistics on household economics, such as the number of elderly homeowners with no children or close relatives, would help in assessing the complicated family dynamics around inheritance. It would be interesting for studies on inheritance issues to be conducted at EU level, as this would help better to differentiate between possible cultural barriers in the different countries. Concern has been expressed about the restriction on inheritance in general as described above, and also about products where the borrower is required to make a will and to appoint an executor. For example, condition 10(iv) of the *Bank of Ireland's 'Life Loan Mortgage'* offer states, that the borrower is obliged to make a will as a condition of the loan. This has been criticised by the Irish Law Society's Conveyancing Committee as an unjustifiable intrusion into the private affairs of the borrower. In Ireland, the borrower might for example wish not to make a will so that his estate will fall under the intestacy rules. He might do so in order to prevent a child from bringing a section 117 application[125] after his death.

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[123] These were providers from Germany and the UK. See Section C.III(3)(d) on Products (on p.37) for more on Question No. 3.11 "Can a third person live with the owner or co-owner of the property?".

[124] The French consumer code refers to this duty in a relatively vague way by calling upon the homeowner's responsibility as 'father or head of the household' (see Part II: Country Reports IV 5.c) (p.64)). The product brochure for the sole Loan Model ERS currently offered in France as of November 2008, lists three obligations on the part of the consumer, all of which revolve around preserving the value of the housing asset serving as collateral to the loan. These are conducting the necessary maintenance works, keeping its use purely for habitation, caring for the home as a "good father of the family", and to allow the Crédit Foncier or selected third parties chosen by them, to verify that the housing asset is being correctly maintained. See p.9 of the brochure under http://www.money-advice.net/media.php?id=3317. See (fn 19).

[125] Art. 117 of the Irish Succession Act: (1) Where, on application by or on behalf of a child of a testator, the court is of opinion that the testator has failed in his moral duty to make proper provision for the child in

(2) Poverty risks

Poverty could result from the various risks causing a mismatch of liquidity needs on the part of the consumer on the one hand, and the liquidity supplied by the ERS on the other. Poverty risks may result from the products themselves where the products do not meet the needs of the consumers. Those risks may also result from choice of the wrong product due to aggressive marketing and/or little understanding of the products by consumers. Furthermore, poverty risks could be caused by unforeseeable changes in circumstances after signing the contract, such as provider bankruptcy, changes in interest rates, etc.

(a) Changes in tax and benefits in the future

Changes concerning income taxation and/or social security charges regarding payments received from ERS may cause consumer poverty. This will not apply to models where payments are made upfront as a lump sum, because changes in legislation will not normally have retrospective effect. However, changes in legislation could effect ERS models based on regular income payments: those payments may not be taxable at the time the ERS is established, but could become taxable as a result of fiscal changes at some point during the subsistence of the contract.

(b) Inflation eroding the value of the payments over time

Price rises for goods and services generally over the term of the ERS contract may cause a decline in the purchasing power of the money received under the scheme. This is especially true for ERS models where monthly payments do not allow for payment adjustments. The problem also arises, however, in ERS models with a fixed line of credit that does not allow for increases based on changes in the value of the property. The problems associated with high inflation are also likely to affect ERS models that provide for an upfront lump sum payment where the customer invests the money in goods, the value of which does not rise in line with inflation.

(c) Changes in interest rates in the future

As already described above[126], the risk relating to changes in interest rates depends on whether a fixed interest rate or a variable interest rate has been agreed with the creditor. Poverty risks for the consumer arise where consumers bear the risk associated with fluctuating interest rates. This would only apply to models in which the level of monthly payments depends on the variable interest rate or models in which the amount of the line of credit depends on the interest rate and could be reduced during the term of the contract. We did not find evidence of such products. However, the borrower will face

accordance with his means, whether by his will or otherwise, the court may order that such provision shall be made for the child out of the estate as the court thinks just.

(2) The court shall consider the application from the point of view of a prudent and just parent, taking into account the position of each of the children of the testator and any other circumstances which the court may consider of assistance in arriving at a decision that will be as fair as possible to the child to whom the application relates and to the other children.

(3) An order under this section shall not affect the legal right of a surviving spouse or, if the surviving spouse is the mother or father of the child, any devise or bequest to the spouse or any share to which the spouse is entitled on intestacy.

(4) Rules, of court shall provide for the conduct of proceedings under this section in a summary manner.

(5) The costs in the proceedings shall be at the discretion of the court.

(6) An order under this section shall not be made except on an application made within twelve months from the first taking out of representation of the deceased's estate.

[126] See Section C.III.4 on Products (on p.45).

considerable risk if he wishes to buy back the property, and the rise in interest rates causes him to pay back more than originally expected.

(d) Consumer does not understand the products and chooses the 'wrong' product

It is worth repeating that the choice of ERS cannot be made independently from the alternatives available to consumers, and that different methods of releasing equity may be more suitable depending on individual circumstances. The importance of good advice has been emphasised as key to sustainable development of any ERS market[127]. Product unsuitability is among the biggest risks because it will restrict all other options at a later date. Without safeguards ensuring that both financial and legal advice is received, there will be a risk of inappropriate products being sold; the vulnerability of the target consumer group considerably enhances this risk[128].

In terms of financial education, risks are high because the product is complex. This is true especially in countries like the UK, where the provider market-led experimentation to find the right product is leading to a market that is becoming considerably more complex. This increased complexity means that advisers face the burden of research and are responsible for keeping abreast of the latest products etc. This applies to providers as much as to consumers. Arguments for special safeguards regarding ERS are based on the realisation that understanding the product terms is difficult and an illustration of how the cost of the product can evolve over time (in the case of Loan Model) is not easy for the consumer. The FSA in the UK has identified two priority areas for focus: interest compounding and unfamiliarity with terms and conditions. There is a need to highlight risks such as future restrictions on occupancy of the property, and the consumer must think about and understand the long-term nature of the transaction. (This is not a typical approach in the UK because extensive use of remortgaging means that most consumers are used to thinking of products over shorter time horizons of 2 or 3 years, which the UK regulator has said is the consequence of a heavy intermediary market).[129] Consumers must also deal with mortality projections. Stakeholder responses to the question "*Is the level of financial education especially relevant for ERS compared to other financial services?*" were not overwhelmingly one-sided, but over 50% of those who answered this question agreed with the statement and in only France, Hungary and Ireland did a respondent say that ERS required the same level of financial education as other products. Another risk, which also exists in the sale of other financial services, is that customers do not read or understand the small print. This is particularly dangerous with ERS, because the consequences are so much greater.

(e) Consumer is induced into the contract

Poverty risks may also result from terms and conditions that provide for financial inducements, leading to contracts unsuited to the needs of the customer. Some offers provide for the payment of a bonus, in the event of contracting within a certain (short)

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[127] See Part II: Country Reports for examples, such as II.7(b)(2)(A) UK, for risks for consumers in the UK.

[128] Whether older persons are more vulnerable or not, decision makers are subject to psychological biases that may be particularly important to be aware of in the context of ERS. Examples which could inhibit good decision-making include: the element of long-term planning (looking into the future and predicting when the need to leave the home for residential care will arise), long-term calculations (estimating the effects of compound interest and level of equity that will be left), difficulty in budgeting when given access to a large amount of credit, and even potential vulnerability to exploitation by family members. Other examples are provided in the Australian Security and Investments Commission (ASIC), *'All we have is this house' Consumer experiences with reverse mortgages (REPORT 109)* (2007) (see http://www.money-advice.net/media.php?id=3310). See (fn 19).

[129] See Part II: Country Reports I for details on the ERS market in the UK (p.4).

period of time from the date of the ERS offer.[130] Those offers may cause a conflict between the solicitor and the client, especially where the solicitor might advise the client not to choose an ERS which he considers not to be suitable. In terms of aggressive marketing, it is reported from the UK that providers may mislead customers as to the value of their property or the security they have as tenants. Furthermore, some providers impose substantial rent increases or even evict tenants.

(f) Provider bankruptcy

Bankruptcy of the provider could give rise to poverty, especially in ERS models involving monthly payments[131] and where the provider has the benefit of the mortgage. The worst case for the customer would be losing ownership of the home and the right to stay in the property, without having received any money in return. In the case of bankruptcy, the provider would stop making monthly payments. This would leave the household with an unexpectedly reduced income, which could lead into indebtedness and even overindebtedness and poverty. This problem would not arise when customers receive a lump sum upfront, because there is no legal obligation to repay the money upon bankruptcy of the provider. Conversely, there is no provision for reversion of ownership of the property to the consumer once a provider, having obtained legal ownership of the property, becomes bankrupt. As already described above[132], only four providers reported that homeownership automatically reverts to the consumer if monthly annuity payments cannot be made. Presumably, this is based on a specific contract clause. However, it is uncertain whether these regulations are compatible with the insolvency law of the various EU countries.

(g) Longevity of the consumer

The lifespan of the customer may also become a poverty risk. Although normally the provider bears this risk[133], there are ERS models where the longevity risk is borne by the customer. A number of providers offer products in which the monthly payments terminate at a certain age.[134] If the customer lives beyond this date, his income will fall. At the same time, it is likely that expenses for medical costs and health care will rise with age. A similar problem may arise with products involving lines of credit, where the homeowner exhausts the line of credit before he/she dies and has no right to extend it.

(h) Product is too expensive

It has been reported from Ireland that interest rates within the ERS market applied to Loan Model ERS are a number of points higher than the fixed rates offered to other borrowers in the general mortgage market.[135] In addition, providers charge early redemption fees on credit cancellation by the borrower. High fixed interest rates will thus lead to high early repayment fees where the calculation of these fees is based on the contractual interest rate in comparison with current market rates.[136]

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[130] E.g. the ERS offer of the S.H.I.P "Senior Finance" Mortgage states: In the event of contracts beeing executed within eight weeks of the date of this letter of offer, S.H.I.P. will furnish a bonus of € 1 500 (one thousand five hundred euro) to you which may be used towards your legal fees or otherwise as you wish."

[131] Monthly payments are offered by about 50 % of providers, see above (on p.37).

[132] See Section C.III.1 on Products above (on p.29).

[133] See Section D.III.2 (on p.73) and Section A.II.2 (on p.7).

[134] See Section C.III.3.d) on Products (form of payments) (on p.37).

[135] See Law Society of Ireland, *Proposed Regulations of Home Reversions and Lifetime Mortgages*, 2007 p.11.

[136] Example of formula based on contractual interest rates: Redemption fee = Present value of remaining flows under the original interest rate hedge – present value of remaining flows based off current market rates (S.H.I.P "Senior Finance" Mortgage); Example of formula not based on contractual interest rates:

(i) No restrictions on use of the money

Though ERS are intended to provide elderly people with money for consumption in a wide range of areas, some purposes do not fit with the borrower's situation and may cause him/her to lose money, an example being, when the consumer uses the money for speculative financial investments. The risk of losing the money becomes far greater when the funds are taken as a lump sum, which, according to the results of our EU survey[137], is the most common form of payment offered by providers overall. Despite this risk to consumers, only 6 out of 30 products actually control the use made of the funds obtained from either Loan Model or Sale Model ERS.

IV. Summary

The dominant form of Loan Model ERS is related to the size of the real estate and mortgage markets and depends on the level of need for supplemental private pensions. In this study, data on homeownership, loans, ageing, private pensions and home sales for all countries have been collated to identify four groups of Member States: those with a significant market; those with only some Loan Model ERS; those with some Sale Model ERS; and those with no ERS at all. However, none of these other factors showed a particularly significant and direct relationship with the spread of ERS. Instead, only combinations of these other factors which coincide with a developed mortgage market indicate that ERS is feasible. The findings nevertheless show that ERS could have a major impact in many Member States where equity release has the potential to improve retirement pension provision, but where mortgage markets are not sufficiently developed to enable this to happen.

Whereas in Finland, Spain and the UK, high levels of homeownership, together with a developed mortgage market, are key elements facilitating ERS, the lower levels of homeownership in Germany and Malta are seen as factors which are less favourable to ERS. In a number of countries, such as Sweden, the increase in house prices since 1998 has incentivised equity release. Even in the UK, a 'nation of homeowners', and despite the recent reversal in house price changes (along with lending and the economy generally), the ERS market has nevertheless managed to grow and even showed an increase of 14% in the first quarter of 2008.

The example of the Greek housing finance market shows that the financial conditions could evolve very rapidly. In 1988, total residential mortgage loans accounted for only 2.5% GDP, compared to 20% now.

The sustained rise in house prices in many EU countries over the past decade, currently readjusting sharply downwards, has without doubt played a major role in encouraging innovative lenders to take the risk of granting ERS to a steadily growing group of customers who have benefited from an increase in their asset wealth, without a corresponding improvement in their income position.

Providers could use this demand to enter the niche market for ERS in order to achieve market share while expecting significant market growth. Their objectives would be to achieve high profits from ERS sales, increase their market share in private pensions, increase their market share in mortgage loans, use contacts with elderly people to cross-

redemption fee = (amount x (R-R1) x time) divided by 36500. Variables are defined as follows: Amount means the average balance of the amount repaid early or converted from the date of repayment or conversion to the end of the fixed rate term. "R" means the cost of funds for the bank for the fixed rate period as incorporated in the existing interest rate applying to the loan. "R1" means the interest rate available to the bank for funds placed in the money market on the data of early repayment or conversion for the remainder of the relevant fixed rate period (Bank of Ireland Life Loan Mortgage).

[137] See Section C.III.3.d) on Products (form of payments) (on p.37).

sell other products such as current accounts or insurance, and finally to build their social reputation.

Consumer organisations and regulatory authorities, when asked about the benefits to providers in marketing these schemes, pointed almost exclusively to high profits. When providers were asked what benefits they see from entering what is in all countries a niche market, they agreed that high profits were the most important motivator.

For consumers, the most significant benefits available include access to credit in old age, the right to stay in the home, increased liquidity in old age, avoiding dependence on the family and a tax reduction.

The main risk for providers is non-recovery of their capital outlay and failure to earn any interest on it (credit failure risks). The main credit failure risks are the uncertain longevity of the occupier, the risk of increasing interest rates, developments in real estate prices and depreciation in the value of the property. The failure risks generally apply equally to Loan Model ERS and Sale Model ERS

ERS also entail a number of reputational risks. Some providers have damaged the image of the product, as occurred in cases of mis-selling in the UK. Press coverage has characterised this risk as, for example, "the lifestyle dream that can turn into a nightmare."

The system requires intensive advice because of the vulnerability of and risks for prospective customers. Most of the assets of older people are tied up in their home, and they have no prospect of compensating for any loss of equity in the future. Supervision of ERS is therefore crucial. Other significant risks inherent in these schemes relate to clients' longevity, the depreciation of house prices, the emergence of negative equity and whether the property will be adequately maintained by residents. The 2008 credit crisis and the decline in house prices in Spain and the UK have accentuated these risks.

In their responses, consumer organisations and providers broadly agree about most benefits and risks but differ significantly as to whether longevity is a risk (which it obviously is for the provider while it is a benefit for the consumer), and on the question of moral hazard, namely the risk that consumers may take advantage of the loan while failing to maintain the property.

Additional consumer risks relate to ownership restrictions, which may relate to the health and wellbeing of the borrower, his family and his social life generally. Examples of such risks emerging from responses are that the consumer may be forced to move out of the home, that barriers may be created to mobility and healthcare arrangements, or the exclusion of certain household types. There are also risks for consumers in terms of the cost of and liability for maintenance and repair of the property, and whether property can be inherited, or conversely whether a will must be made, impacting on the consumer's freedom in terms of testamentary provision.

The cost of ERS may also rise in the future, which creates poverty risks. For example, future changes in tax and benefits; inflation eroding the value of the payments over time; changes in interest rates in the future; a consumer may choose the 'wrong' product or be induced against his interests to enter into the contract. If the ERS is not covered by a bank guarantee scheme and if security is independent of the loan, the insolvency of the provider may also deprive the consumer of both home and pension. Longevity may have the same result if income is not provided for life or if the product is too expensive.

Economic and cultural barriers to development of the ERS market are associated with the special significance of its 'reverse' character.

Cultural attitudes towards homeownership may amount to a long-term barrier and deter consumers, especially in rural areas, from using ERS. Transforming a home into a pension requires the acceptance of three concepts:

- The home is a capital asset, not merely shelter and a consumer asset to be passed on to the next generation.
- Capital can be made liquid without giving it up completely, and liquidation is neither sale nor bankruptcy
- This process can be brought forward by means of credit.

An example given of for such a barrier is the dowry system in Mediterranean countries. Until as late as 1983, this system even formed part of Greek law. Daughters were given the family house when they married. While that law has now been repealed, the culture remains. However, even in Italy and Spain, countries where there was no dowry system, a similar strong bond between the family and the ownership of property exists. In many countries, high homeownership rates coincided with insignificant mortgage markets; for example, in Italy the mortgage market represented only 3% of GDP in 1985.

Another cultural barrier is the lack of experience of the elderly in using credit. As the 'normal' credit system is built on the ability of the borrower to repay the loan during his/her lifetime, this system tends to exclude the elderly. Some banks, as reported from Germany have even employed strict age limits in the past. The reverse character of the Loan Model ERS therefore presents a problem where providers develop ERS only as an addition to their general, conventional lending operations.

In addition to these structural barriers, the present financial crisis has added short-term barriers to the emergence of ERS. On the one hand, 'equity release' has been blamed for the rising numbers of non-performing loans and accused of making the refinancing of mortgage loans more difficult. The fall in house prices in the UK, Ireland and Spain has led to calls for less equity release and more caution in the use of second mortgages for private consumption purposes. While many consumers in the EU were previously able to increase their consumption on the back of the 'wealth effect' of rising house prices, whether intended or unintended, a newspaper congratulated UK citizens for having stopped this "*decade-long era of the nation using its homes as cash machines. Second-quarter figures (2008 iff) for equity withdrawal showed that, rather than raising borrowed cash against their properties, homeowners injected a net £2.8 billion of new equity*".

From the consumer perspective, debt in old age, combined with abandoning the family home to strangers rather than giving it to their children, is a cultural issue. Much depends on whether the property is seen as family wealth spanning generations, or an individual asset to be used as a supplemental income on retirement and for the owner's care needs. However, as the average age of clients is around 70 in both types of ERS, and as the vast majority are lifetime schemes where the debt is repaid solely from the mortgage, no evidence for systematic abuse has been found.

E. Legal analysis – legal framework and legal barriers

I. General Overview

1. Historical background

Using property in the form of real estate to help meet the needs of elderly citizens and to increase the funds available to them on retirement is not an unknown concept in Europe. Civil Law has provided for concepts such as 'life rent', which are found in nineteenth century Civil Law Codes, such as the Spanish Civil Code arts. 1802 to 1808, Art.1199 of German Civil Code, Art 1706 of the Maltese Codes. Under Common Law, the provision of trusts for the lifetime of a beneficiary is not an equivalent of present day ERS, but in some instances they were conceived with a similar aim[138]. The development of a universal Social Security mechanism at the end of the 19th century in Germany and in many other countries following World War II put those life rent schemes, designed in accordance with the needs of 19th century traditions, into the shadow of pension schemes as a residual possibility to cater for financial needs in old age.

The progressive dismantling of traditional family structures, which took place in the XXth century, occurred more rapidly in northern and central European countries, and more slowly in southern Catholic and Orthodox states. By the end of the twentieth century new forms of family structures and relationships (monoparental, homosexual, distance living, etc) coincided with an increase in life expectancy, and in cultural, social and therefore financial needs of populations in old age, particularly those in the middle and lower classes. Economic cycles of prosperity and crisis, variable rates of inflation, etc., have prompted the development of private means to ensure enough financial resources for the retired population, as well as for members of society who are unable either to earn a regular income or are in need of continued care for a variety of reasons (illness, mental or physical handicaps, age, accidents, etc).

In addition, in the second half of the 20th century, modern financial services markets have developed sophisticated products capable of becoming instruments to cater for financial needs, providing that they are linked to appropriate controls and supervision.

Meanwhile, property, real estate and particularly homes continue to be the main asset (equity) that middle and upper working classes use as collateral to obtain liquidity, depending on size and spread and on cultural, ideological and other circumstances. While the culture of an untouchable, debt-free home is changing and family structures make it ever more necessary to have recourse to paid pensions in old age (with less family support for elderly citizens, longevity, and higher expectations in terms of consumption) the release of equity into liquid assets has become an interesting but still undeveloped response.

Against this background, we find that during the last 10-20 years a number of schemes have been created and developed with general aims very similar to 19th century life rents, or trusts, although they are now based on the value of homes combined with modern legal and financial instruments. These schemes provide externalities that have been taken into account by a number of Member States, which have either regulated some of them (as in UK or Ireland) or given incentives to create types of ERS (as it is the case in Spain). While most Member States do not acknowledge these possibilities within their existing legislation, or may even be sceptical as to this kind of alternative use of homes, others actively favour the use of the home for liquid pensions.

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138 For a general view see: Harding, Alan, *A Social History of English Law,* (1966).

2. Legal framework of ERS and legal definitions

The term Equity Release Scheme, derived from economic reasoning, has not yet been defined precisely in legislation.

General legislation in relation to ERS as such is still uncommon in Europe. However, experts consulted show that for years some schemes have been provided for by private contract law, particularly in countries such as Hungary, Portugal or Spain. Some credit institutions, notably in Spain[139], Denmark, Finland and the Netherlands[140], have offered schemes to liquidate part of the real estate equity for homeowners, profiting either from a lack of or a loophole in legal regulation[141] or from using existing mechanisms (second mortgage regulations, sale contract regulations, credit regulations, credit lines etc).

In the questionnaire addressed to non-providers, respondents were asked first to describe the relevant laws applicable in their country (item 5.5) before identifying typical restrictions imposed by law on the consumer in relation to the various ERS (item 5.7). The following ten multiple choice options were offered: (1) form of payment, (2) amount of funds released, (3) lifelong annuity payments, (4) ownership, (5) lifelong occupancy right, (6) use of the funds, (7) use made of the home, (8) surety, (9) combinations with an investment product, (10) other. The issue of legal barriers was raised again in the form of another multiple-choice question "Which of these legal barriers apply?" enabling quantitative analysis (item 7.2) providing for the following answers: (1) Treatment of annuities under insurance law, (2) unfavourable tax law, (3) prohibition of schemes, (4) restricted use of real-estate surety, (5) other.

In addition to responses to the questionnaires and more in-depth reports on the legal situation in Italy, Spain, UK, Ireland, Germany and Belgium, where ERS have already given rise to legislative activity or where such activity is presently under broader discussion, we have also included a table showing potential information rights typical for credit and pension law, in order to identify its compatibility with ERS.

a) Loan Model ERS

There is presently no binding EU regulation harmonising national mortgage law and private pension schemes. Although the EU Treaty provides the basis for the creation of a single market and the abolition of obstacles to free movement of goods, persons, services and capital, the single market for mortgages is far from integrated. The European Commission *White Paper on the Integration of EU Mortgage Credit Markets*[142] shows that obstacles exist restricting the level of cross-border activity on the supply and

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[139] For instance, in Spain Reverse mortgages (Loan Model ERS) were offered by major banks and financial institutions; however it was not until 2007 that a Law was passed by the Spanish Parliament that recognised this type of mortgage and offered incentives by granting tax (stamp duty type) relief, reduced fees and other benefits (Law 41/2007 that modifies Mortgage Law). Even in that context, however, no homogeneous legal regime was provided for "all equity release schemes". ERS of the Sale model are usually referred to as linked to the "Renta Vilaticia of Civil Codes (please see counties reports). However, there are some recent samples of regulated private law contracts which serve to the effect of ensuring life care for elderly people on exchange for the handing over to the rent/care/maintenance provider of a property (any property, this is: it does not need to be immovable, though immovables are not excluded). This property can be transferred either by the recipient or by a third person (Law 2/2006 of Civil Law of The Autonomous Region of Galicia).

[140] The Dutch "opeethypotheek" ("Eat-away Mortgage") provides a credit line secured by a mortgage that allows to withdraw either a rent or a lump sum from the account. It lies outside the scope of the Dutch mortgage law since this law applies only if a loan is taken out for the "purchase, renovation or improvement of homes" (Filott, W., *The Dutch "opeethypotheek" ("Eat-away Mortgage")* in Forum Financier/Revue Bancaire et Financière (2007/6) p.347 ff. Similar schemes are in use in Denmark and Finland.

[141] See for the Netherlands op.cit. (fn 140).

[142] COM (2007), 807 final, p.3.

demand sides, which reduce competition and choice in the market. This White Paper identified a number of areas where further investigation and analysis is necessary.

As a reference in EU law, the new Consumer Credit Directive 2008/48/EC has been used as a model for information rights. Although it does not apply to mortgage loans, some Member States, including Germany, Finland and Sweden, have extended the application of the previous Consumer Credit Directive to mortgage loans while others, like France and the Netherlands, have regulated their mortgage loans similarly using special legislation. The Voluntary Code of Conduct on Pre-contractual Information for Home Loans can be seen as a first effort to standardise existing information requirements which, with regard to the extensive regulation in the Consumer Credit Directive, is still quite limited.[143] The discussion which led to the continued exclusion of mortgage loans in the new Consumer Credit Directive is indicative of the differences in attitude in this area.[144]

The ERS legal framework is built around three main areas of law: credit, mortgage and sales. Insurance law is also relevant. In addition, there are other special laws with an impact over one or both types of ERS (tax, consumer, housing, etc). Credit law is one of the most complex legal areas, both because of the large number of players involved and because of the variety of technical forms to be evaluated and/or regulated. In respect of mortgage law, and sales laws (both relevant to both types of ERS) they are closely related to the macro-economy, credit law, and a number of sector-specific regulations. In the absence of harmonised ERS, the legal framework in the Member States of the EU is rather heterogeneous. Having analysed legal background documents provided by legal experts and by the iff team, and having revised replies to all questionnaires, we have not found specific harmonised ERS legislation at the planning stage or about to be drafted.

In order to commence the analysis of ERS from a legal standpoint, the first question is that of legal definitions, including definitions provided specifically within primary and secondary legislation. In this respect, and from a legal standpoint, there is:

a) neither a general definition of ERS for all countries across the EU;
b) nor a homogeneous definition applied in the same way and with the same limits and consequences to each and every country in the EU for each given commercialised product. This means:
    a. Not all countries have a legal definition for Loan Model schemes;
    b. Not all countries have a legal definition of Sale Model schemes;
    c. Not all countries' legal definitions are linked to a particular regulatory regime, i.e. Italy[145];
    d. Existing definitions in some countries are rather open and leave space for further sub-types of either Loan Model or Sale Model schemes to be introduced by commercial operators, or even privately.

In relation to the above, a variety of legal frameworks and methodologies for defining ERS exist across the EU:

Whilst in the UK the FSA's regulation and secondary legislation, as well as some special legislation (Social Security, Housing, etc) contain detailed descriptions of both Loan Model and Sale Model ERS, in Hungary there is no legal definition either for either Loan Model ERS or Sale Model ERS, even though both schemes are known in the country and

143 See iff, *Monitoring the uptake and the effectiveness of the Voluntary Code of Conduct on Pre-contractual Information for Home Loans – Final Report for DG SANCO* (2003), Contract Reference No. B5-1000/02/000552.

144 Official documentation that sustains the said debates can be consulted from the relevant site of Prelex (http://ec.europa.eu/prelex/detail_dossier_real.cfm?CL=en&DosId=176090, seen for the last time on December 9th 2008.

145 See Part II: Country Reports VI.2 Italy (p.79).

both are regulated by the Civil Code.[146] Similarly, Romania's legal system does not provide for a full definition of the existing ERS (Sale Model).[147] In France, Ordonnance no 2006-346 of 23 March 2006 relating to Sureties defines a Loan Model Agreement "*prêt viager hypothécaire*" by which a credit institution grants a loan to a physical person, which is guaranteed by a mortgage claim on a property of the borrower which is exclusively used as a place of residence, and the repayment of which can only be demanded when the borrower either dies or leaves the property vacant.

The situation becomes even less clear in countries that provide for 'incentives' for some of these schemes where, as with subsidies for private pension schemes, sophisticated criteria must be met. A good example is Spain[148], where various sub-types of Loan Model ERS are possible under private law, and are known to have been offered in the market, but only the Loan Model ERS, as regulated under Law 41/2007, qualifies for such subsidies. It applies to a credit contract guaranteed by a mortgage. This credit must be provided by a financial institution that fulfil the requirements of any other mortgage provider in Spain, and must be signed before a public Notary and registered as a charge over the property at the Land Registry. Under general mortgage Law, the mortgagee holds a priority claim over the mortgaged asset upon personal bankruptcy of the debtor. These "*hipotecas inverses*" (inverted or reverse mortgages) are contracted following requirements listed in Additional Dispositions 1 and 4 of Spanish Law 41/2007 of 7 December. The mortgaged property must be the permanent residence of the applicant, insured against damages, providers must be credit institutions and insurers authorised to operate in Spain and provide independent information (taking into account the applicant's financial situation as well as risks associated with this product) which according to No 4 of article 1 of this Law still (as of December 2008) must be detailed by the Spanish Ministry of Economy. Applicants must be 65 years of age or more, and/or be affected by severe dependency or great dependency.[149] Credit can consist of funds accessed either as a lump sum of money or through various instalments and is supposed to be for life but may be cancelled by the mortgagor, who must in this event, satisfy the provider with a refund of capital plus interest or upon the sale of the property[150] There are a number of benefits provided for such schemes: reduction in the Taxation of Public Documents Drafting (notarial documents),[151] a reduction in Notary and Registrar fees similar to pension funds.[152]

In Italy, a legal definition of Loan Model ERS is contained in a Law of 2005 enacting miscellaneous rules on urgent measures against tax evasion and provisions in tax and financial matters. This Law however, does not contain a full regime, leaving – to date - the development of reverse mortgages to the creativity of credit institutions.

b) Sale Model ERS

Sale Model ERS have received little legislative attention in private law in recent years since they have a longstanding tradition in the history of real estate legislation.[153] They tend to be construed on the basis of traditional Civil Law in countries such as Spain (with a 19th Century Civil code), Romania, Malta or Hungary. This recourse to traditional Civil Law tends to set regulations outside the realm of supervision. In France, private sale and

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146 The closest legal institution for Type 2 is the lifetime annuity contract (életjáradéki szerződés), is found in Section 591 (1) Act IV of 1959 on Civil Code (under a life-annuity contract).

147 Romanian Civil Code does not provide for a definition. See Part II: Country Reports XI.5 Romania (p.115).

148 For more information and references, see Part II: Country Reports II.5. Spain (p.44).

149 See Law 39/2006, for the Promotion of Personal Autonomy and care of persons with a dependency.

150 Additional Disposition 1 of Law 41/2007.

151 Tax on Actos jurídicos documentados, similar to Stamp Duty.

152 Article 51.3.b of Law 35/2006.

153 See Section E.I.1 on legal Historical background (p.86).

lease-back arrangements (*vente en viager*) which fall under Sale Model ERS are governed by contract law and are analysed as a traditional sale transaction with specific payment modalities attached to it, but without a specific legal definition which links it nominally to ERS as such.

However, where ERS is entitled to subsidies like in Spain, Sale Model arrangements may also benefit under personal tax Law (IRPF) if they fulfil the basic requirements set out in Law 41/2007[154]. This creates some uncertainty, since Law 41/2007 contains no general all encompassing definition of ERS but is focussed on loan models.[155]

Conversely, countries such as the UK have modern regulation on ERS of both types (and both are described and placed under authorisation and supervision)[156].

3. Main barriers pointed out by national legal experts

While obstacles or barriers which have been raised by the legal experts and the respondents to our questionnaires will be included where applicable, a number of comments are of a general nature and will be set out below.

Legal experts in all countries agree that the lack of a uniform definition and the proliferation of schemes, contract types and modalities make contract drafting, risk assessment and entry into the equity release market generally difficult. Equally, a relatively formalised mortgage and sales market involves high legal costs and other expenses, which also impedes the development of ERS.

In relation to both ERS Models:

- A first barrier – as perceived by legal experts - is directly related to the lack of a common definition of ERS in general and of Loan Model ERS in particular. Varied products that are available from time to time in the market (whether they are offered for a long time depends on each product's success[157]). The specific features of each product found make it difficult to define a common legal basis for the contract, even within a single country.

- The efficiency of using property as collateral, which is at the core of any mortgage-based lending activity, and is paramount to contracts where a transfer of ownership takes place, is of great importance for the development of both Loan Model and Sale Model ERS. As a result, different systems and conditions surrounding mortgage collateral (e.g. simplicity, transparency, speed, costs) will have implications for the propensity of the market to offer ERS:[158] in the Loan Model concerning the procedure from constitution of the mortgage collateral to its

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[154] See Part II: Country Reports II.5 Spain (p.44).

[155] Even some experts as Property Registrar Silvestre, consider that Law 41/2007 leave many questions unanswered. See Silvestre, JA Miquel *Hipoteca inversa, algunas hipótesis de conflicto*, Diario la ley n. 6924, 14 April 2008, ref D-116.

[156] These regulations are outlined in detail in Part II: Country Reports I.5 UK (p.9).

[157] From time to time new schemes are brought to the market. One recent example, which falls near to the Loan Model ERS, was launched in Germany in 2006 with fixed interest rates for a maximum term of 15 years. There is no repayment during the term of the credit. Due to regulatory restrictions (*Bausparkassengesetz*), the credit can be used only for nursing, help and medical treatment of people in need of care. The difficulty for providers is that this requires verifying the needs of customers for long-term care before the provider can extend the product.

[158] Including the importance attributed by the Capital Requirements Directive to mortgage sureties in connection with risk minimisation. As rating agencies will testify, however, success in this area depends on national procedures and cross-border enforceability. The realisation of the Single Market and improvements in electronic means of communication also bring this issue to the fore, as does the EU White Paper on the integration of EU mortgage credit markets, which has identified this area for special attention.

registration and execution, and in the Sale Model from the drafting, completion and efficiency of duties set against the transfer of title.

In relation to Loan Model ERS:

- Differences in the regulatory frameworks are a barrier to the cross-border provision of residential mortgage loans by non-credit institutions regarding "regulated activities." These differences relate to how financial activities are regulated and supervised, and the different compulsory provisions for credit risk. But no non-credit institutions surveyed in a study published at the end of 2008 on the role and regulation of non-credit institutions providing mortgage credit indicated that the requirement of a banking licence amounted to a barrier[159]. A special inquiry in Finland revealed that, even in a country which neither provides a licence nor special supervision, there are no known examples of non-banks offering such credit. This may relate to refinancing problems, since all Member States must require a licence for taking deposits or other repayable funds from the public.
- Another barrier to cross-border ERS activities consists of the differences in mortgage law among EU Member States. There are some basic features common to EU Member States, such as that persons entitled to grant a mortgage over a property must always be owners of the property (and always the holder of a legal right in the mortgaged property – a right in rem), and that the consequence of a mortgage is always that the lender is protected by a legal charge over the property, providing a priority in claims against the property (a privilege which is maintained until cancellation and repayment in full). Differences exist, however, in the characteristics of the mortgage: Germany, Hungary[160] and Sweden stand out, for instance, as Member States where certain types of real estate collaterals are not an accessory[161] to the main credit contract. These countries distinguish themselves by instead providing mortgage collateral instruments based on a system of contractual accessoriness/independent collateral. Under this system, the collateral is independent by law of any main contract or debt. In practice, however, in Germany the 'security agreement' creates an obligatory/contractual link between the real estate collateral and the debt secured. As a result of the contractual-accessoriness, once a loan guaranteed by the surety has been repaid, the surety may be re-used to guarantee other contracts without limitation. In Germany, this is the main system used to guarantee real estate loans, while the accessory *Hypothek* is rarely used in practice. Other jurisdictions, such as Bulgaria, have specific schemes such as "*mortgage reversion arrangements*"[162] (which also differ from normal mortgages).

- In relation to the cross-border provision of Loan Model ERS products, the European Mortgage Federation has stated[163] that differences between Member

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[159] See: London Economics, Study on the role and regulation of non-credit institutions in EU mortgage markets, 2008 (http://ec.europa.eu/internal_market/finservices-retail/docs/credit/non_banks_report_en.pdf).

[160] Hungarian law provides for an independent mortgage lien called önálló zálogjog. It is non-accessory mortgage collateral and exists alongside two other, accessory mortgage collateral tools, namely the hypothec and the limited security lien. See Part II: Country Reports XI.5 Hungary (p.75).

[161] "Accessoriness" means that the mortgage does not exist on its own but only in relation with the main contract (or debt).

[162] Under the Law on Obligations and Contracts (art.152) an agreement is void that if the obligation is not performed the creditor shall become owner of the property, nor it is any other agreement allowed which stipulates in advance a manner for satisfying the creditor other than the one provided for by the law. See Part II: Country Reports XII.4a) Bulgaria (p.112).

[163] European Mortgage Federation (2007a). The study covered the legislation of 16 of the EU27 countries and assessed the extent of collateral differences between the Member States' legislation and their possible impact on the mortgage sector.

States' national legislation in terms of constitution of the mortgage are not the main difficulty with regard to establishing an effective mortgage-based system. It is rather the lack of transparency in registration systems and the uncertainty associated with enforceability that is seen as disrupting the system.

- Other barriers relate to the use of the proceeds of Loan Model ERS. In France, several specific provisions restrict certain uses of the lifetime mortgage and impose obligations on both parties. Firstly, in terms of the use to which the funds must be applied (lifetime mortgage receipts cannot be used to finance a business activity). Secondly, the use made of the home must remain private and, according to article L314-8 of the consumer code, "*the borrower must bring to the mortgaged property all the care and attention of a good pater familias*"[164]. The debtor also loses all claims to any surplus value when he/she has either: a) changed the use of the mortgaged property, typically restricting the use made of the housing asset (i.e. it must remain residential); or b) refused access to the mortgaged property to the creditor when the creditor wants to check the maintenance and repair of his security.[165] There is thus an obligation to maintain the property on the part of the customer.[166] There are also limits derived from general law: under Article 1188 of the French civil code, as the debtor is not entitled to any surplus upon termination of the contract when, from his own action or non-action, he/she has diminished the value of the property. In contrast, the Dutch national report[167] reveals that restrictive mortgage law is not applicable where the loan is not invested into the home.

- Other barriers preventing full development of the market are based on consumer protection laws. For instance, in France the Loan Model ERS is clearly not flexible as they are based on a lump sum payment in the form of a single payment. The law in France does not allow for the existence of either monthly payments or drawdown products. A reform is however currently being suggested which, if successful, would help providers compete more easily with one another on product features that may be more appealing than those of their competitors.[168]

It is beyond the scope of this research to go into further detail about general obstacles affecting all mortgages, although these different approaches may indeed have a significant effect in the context of ERS, and the Loan Model type in particular. These aspects of mortgage law have, however, been subject to EU research in their own right.

In relation to Sale Model ERS:

- The threat that, upon breach of contract or bankruptcy of the annuity provider, the vendor is left with no property and no pension would appear to be a relevant deterrent to the development of ERS. This opinion has been expressed mainly by Scandinavian experts, but information received from other countries also points in the same direction:

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164 In French: « L'emprunteur doit apporter à l'immeuble hypothéqué tous les soins d'un bon père de famille ». The term "good father of the family" is an interesting definition which would deserve deeper investigation.

165 Response from Questionnaire SQ32.

166 Response from Questionnaire PQ21.

167 See Part II: Country Reports XX.4. Netherlands (p.147).

168 The Ordonnance no 2006-346 on sureties from March 23 2006 can be found under: http://www.legifrance.gouv.fr/jopdf//jopdf/2006/0324/joe_20060324_0071_0029.pdf. For details on this Modernisation law: see http://www.senat.fr/rap/l07-413-1/l07-413-15.html (more details also in the French national report in Part II: Country Reports IV.2.a) France (p.59).

- In Spain, if Sale Model ERS are construed following Art 1808 of the Spanish Civil Code ("*Renta Vitalicia*"); or in Malta (art 1706 Maltese Civil Code, "*life annuity*"), it is understood that the vendor cannot recover ownership even in case of breach by the provider. A regional Law of the region of Galicia (Law 2/2006) introduced – through a "*contract to provide maintenance*" – a different regime which is detailed in the Spanish national report[169] and which is limited in its geographical scope to the Region of Galicia.

- In France, private sale and lease-back arrangements (*vente en viager*) are governed by contract law and are analysed as a classic sale transaction with specific payment modalities attached to it. As mentioned in the national report[170], products offering a lifelong annuity payment are not currently sold commercially in France and there is no specific regulation of such activities. These Sale Model ERS would nevertheless be regulated by contract law under the legal framework as it stands.

The respondents ticked the answers to our question "Which of the following legal barriers apply?" as follows, including some comments which we have documented in the footnotes:

1. *General or Special Legal Prohibitions*: one Belgian respondent, one Austrian respondent[171];
2. *Insurance law*: one German respondent;
3. *Tax law*: one Belgian respondent, one French respondent, two Hungarian respondents[172], one Austrian respondent[173];
4. *Surety Law*: one Austrian respondent;
5. No legal barriers: one Austrian respondent[174], one Irish respondent[175], one Cypriot respondent, one Finnish respondent;
6. other or no answer: all others.

The importance of tax law becomes visible when these are put into the form of a chart.

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[169] See Part II: Country Reports II.5.b) Spain (p.47).

[170] See Part II: Country Reports IV.6.a) France (p.65).

[171] "*Restricted use of the funds (for purposes of nursing, help and medical treatment of people in need of care).*"

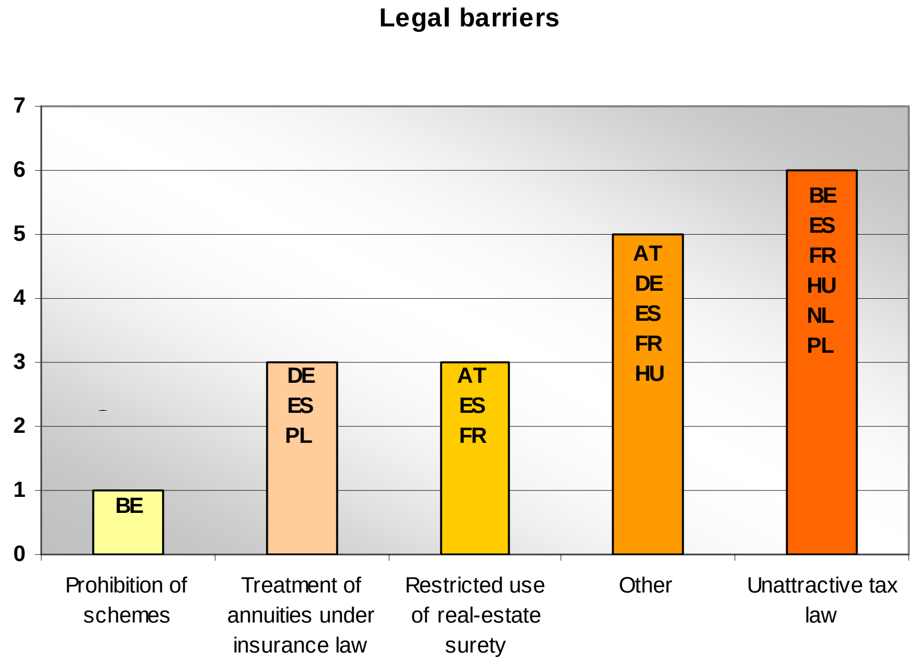
[172] "*There is no legal regulation at the moment, it is for sure can be considered as a barrier.*"

[173] "*Only 'Leibrente' is subject to taxation (income tax), other tax laws do not apply to our knowledge.*"

[174] "*Cannot be proved, because no regulatory framework concerning ERS exists in Austria.*"

[175] In Ireland, the State provides a means tested non-contributory old age pension. If somebody who is entitled to this pension takes out an equity release product, their liquid assets would increase and they may lose their entitlement to this State pension.

Figure 37: Legal barriers



Source: iff-survey on providers and non-provider stakeholders

II. Authorisation and Supervision[176]

1. General licensing and notification required for credit provision

Notwithstanding that few European jurisdictions such as UK, Italy, France or Spain have specific legislation on ERS, Loan Model and Sale Model ERS are permissible in almost all EU countries, with the exception of Belgium.[177]

Permission to operate Loan Model ERS first follows the general licensing requirements for offering mortgage loans in the Member State concerned:

- In Austria, France, Germany, Greece, Portugal, Slovakia, institutions must be registered and authorised as credit institutions in order to provide residential mortgage loans (or ERS Loan Model products);
- Poland allows a special type of domestic non-credit institution, namely "Credit Unions" as defined in Polish Law, to provide residential mortgage loans, but not foreign institutions;
- All other Member States allow domestic and foreign non-credit institutions to provide residential mortgage loans:
    - Of these other Member States, 14 require that other mortgage lenders undertake some form of notification, registration or authorisation in order to provide residential mortgage loans. In Sweden, for example, registration with the FSA is required.
    - Six Member States (Cyprus, Czech Republic, Denmark, Estonia, Finland, Latvia) do not require any notification, registration or authorisation. General consumer protection laws do apply in these Member States.

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[176] See: London Economics, Study on the role and regulation of non-credit institutions in EU mortgage markets, 2008 (http://ec.europa.eu/internal_market/finservices-retail/docs/credit/non_banks_report_en.pdf).

[177] See Part II: Country Reports XIII.3. Belgium (p.117).

We can therefore distinguish the following groups of suppliers for our survey:

- "Credit Institutions" within the meaning of Art. 4 Directive 2006/48/EC[178];
- "Insurance Companies" within the meaning of the life and non-life Directives (Directive 79/237/EEC and Directive 2002/83/EC) which, in some Member States and according to national law, are allowed to provide residential mortgage loans on a commercial basis;
- "Other Mortgage Lenders" active in the financial sector without being registered as a credit institution or an insurance company according to domestic regulatory and supervisory frameworks which provide residential mortgage loans on a commercial basis.

Funding mechanisms available to non-credit institutions vary across the Member States. They include own shareholder funds, loans from credit institutions and financial institutions, general debt securities, mortgage-backed securities and mortgage-covered bonds.

However, the market share of non-credit institutions in the Member States' national mortgage markets is, with the exception of the UK and Ireland, still very small in relation to banks and insurance companies. As a special inquiry into the Finnish situation revealed, no non-banks could be identified which used this leeway to offer mortgage loans. We can therefore assume that there may be an indirect effect from the general licensing requirement for banks which take assets. Since non-banks need a resource to refinance their loans, they need either to access the mortgage backed securities (MBS) - or its German and Danish homologue the '*Pfandbrief*' - market, or obtain the cooperation of a bank, which creates factual barriers for this business. Such access often encounters similar access conditions as does taking deposits or other repayable funds from the public. Banks, on the other hand, may be reluctant to create a possible competitor through the provision of refinancing facilities to non-banks. The situation in Europe differs in this area from that in the US. This explains why in the survey many respondents assumed that their country would also require a licence for non-banks to provide Loan Model ERS.

2. Special admission rules for ERS

The main difference in the legal regime for providing ERS lies not so much in variations among countries but between the two types of ERS, the Loan Model and the Sale Model.

A minority of countries impose specific compulsory authorisation procedures for providers of both types. For instance, in the UK[179] and Ireland[180], specific requirements have been

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178 See: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:177:0001:0200:EN:PDF.

179 The supervisory requirements are set out in the FSA Handbook, (http://fsahandbook.info/FSA/html/handbook/) Financial Services and Markets Act 2000 as amended by the Regulation of Financial Services (Land Transactions) Act 2005.

180 In Ireland, non-credit institutions are permitted to provide residential mortgage loans. However, non-credit institutions that make retail credit loans, including mortgages, or home reversion loans (i.e. equity release loans) must be authorised and subject to ongoing supervision by the Financial Regulator. This requirement was introduced into law as an amendment to the Central Bank Act 1997 in November 2007 and came into effect on the 1st February 2008 In Ireland, the Central Bank Act of 1997 regulates the provision of residential mortgages by (both) credit and non-credit institutions. As already noted, a November 2007 amendment, which came into effect on 1st February 2008, and called the Markets in Financial Instruments and Miscellaneous Provisions Act, requires that all non-credit institutions that make mortgage loans be registered and authorised as a "retail credit firm" or a "home reversion firm".

In addition, since 1st February 2008, non-credit institutions that make retail credit loans are subject to the Consumer Protection Code, Minimum Competency Requirements and the Consumer Credit Act 1995. These legal requirements apply to credit institutions in the same way. The prudential requirements that apply to credit institutions do not, however, apply to non-credit institutions as these prudential requirements are to protect deposits and non-credit institutions do not take deposits.

imposed for the operation of both Loan Model and Sale Model ERS. The FSA's regime[181] requires that commercial providers, managers, brokers and advisers involved in equity release transactions[182] comply with a licensing regime. This imposes either the need for authorisation to operate, or qualification for an exemption from such authorisation. Failure to comply with authorisation regulations can amount to a criminal offence.

Specifically in relation to the equity release market, the FSA maintains a regular reporting system and conducts site visits. It has published findings from two mystery shopping studies, which show widespread non-compliance with disclosure and advising standards;[183] the FSA also has published a good practice guide and a letter addressed to mortgage advisors with low levels of equity release business, alerting such firms to the regulatory requirements for advisory work in this sector.[184] Lifetime mortgages have been incorporated into the FSA's thematic review of the effectiveness of mortgage regulation. The FSA has taken disciplinary action against at least one small intermediary for failings in relation to advising equity release consumers[185] and the FSA has negotiated changes to the standard contract terms of a major equity release provider using its powers under the Unfair Terms in Consumer Contracts Regulations[186].

In relation to Loan Model ERS:

- Most countries impose some kind of licensing, authorisation or registration requirement, which is not specific to ERS. Reverse mortgages must be provided by a Financial Institution[187] (Austria, France[188], Germany, Greece, Portugal, Slovakia), or by an institution operating under an insurer's licence (such as Germany), or by credit and non-credit institutions (as in Finland, Sweden, Spain, Hungary, etc.).

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181 See Part II: Country reports I.5.b) UK (p.11).

182 The Regulated Activities Order in fact specifies six regulated mortgage activities that require authorisation or exemption when carried on in the United Kingdom. Explanation of these activities can be found in Part 4 of the Perimeter Guidance Manual, available at: http://fsahandbook.info/FSA/html/handbook/PERG.

(1) Arranging (bringing about) regulated mortgage contracts (article 25 A (1) (Arranging regulated mortgage contracts));
(2) Making arrangements with a view to regulated mortgage contracts (article 25A(2) (Arranging regulated mortgage contracts));
(3) Advising on regulated mortgage contracts (article 53A (Advising on regulated mortgage contracts));
(4) Entering into a regulated mortgage contract as lender (article 61(1) (Regulated mortgage contracts));
(5) Administering a regulated mortgage contract where that contract is entered into by way of business on or after 31 October 2004 (article 61(2) (Regulated mortgage contracts)); and
(6) Agreeing to carry on any of the above (article 64 (Agreeing to carry on specific kinds of activity)).

183 Mystery Shopping Exercise, Briefing Note BN005/2005 (24 May 2005) (2005) BN005/2005; Financial Services Authority, *The sale of lifetime mortgage products--- mystery shopping results*, (2006).

184 The good practice guide is referenced in the annex to the letter to mortgages advisors: *Lifetime Mortgages: Letter addressed to firms carrying out low volumes of business*, available at http://www.fsa.gov.uk/pubs/other/letter_lifetimemortgages.pdf.

185 Final Notice to The Minel Group 2007, available at:.http://www.fsa.gov.uk/pubs/final/minel_group.pdf. The FSA found that the firm's procedures were inadequate to control the quality of advice it provided to consumers interested in lifetime mortgages; and in particular that the advisors were unable to show that they adequately determined customers needs and objectives and provided suitable advice. The FSA found also that the firm did not adequately train its staff about the risks of lifetime mortgage products nor did the firm put in place systems for monitoring staff competence in the sale of lifetime mortgages. The Minel Group was fined £10,500 for exposing customers to the risk of being sold an unsuitable equity release product; it was required to review its sales of lifetime mortgages since it had been FSA authorised with a view to compensating customers losses caused by unsuitable advice, and required to withdraw from the lifetime mortgages market.

186 In Retirement Services (Reversions) Ltd undertaking in relation to Equity Advance Plan terms and conditions http://www.fsa.gov.uk/pubs/other/undertaking_irs.pdf, August 05, 2008.

187 As defined in Directive 2006/48/EC.

188 In France before commencing activities, credit institutions must obtain approval from Credit Institution and investment firms committee. For more, see the Ordonnance no 2006-346 on sureties from March 23 2006 at http://www.legifrance.gouv.fr/jopdf//jopdf/2006/0324/joe_20060324_0071_0029.pdf.

- In some countries, such as in Spain or Finland, whilst commercial providers are banks and other financial institutions and are therefore bound by the regulations governing credit institutions, it is understood that both Loan Model and Sale Model schemes can be arranged privately[189]. Also in Spain, for borrowers to obtain the tax benefits available for reverse mortgages, the lender must be a registered credit institution or a registered insurance company.

In relation to Sale Model ERS, in most countries from Hungary to Spain, there is no need for authorisation and products can be offered privately, although banks and financial institutions are known to have entered the market[190].

National reports further reveal that ERS often require either contractual cooperation with insurers or the provider's own insurance licence, as homes need to be insured in commercial ERS. This relates both to Loan Model ERS (i.e. Spain, UK, Ireland) and to Sale Model ERS (i.e. Spain, UK, Bulgaria[191]). Also, in some jurisdictions, mortgaged homes must be insured in commercial ERS, for example in Spain, Malta, Romania and the UK.[192] ERS products therefore require either contractual cooperation with insurers or the provider's own insurance licence.

3. Supervision

a) Providers

In relation to Loan Model ERS, most countries place providers under the supervision of Financial Authorities, as is the case with other Financial Institutions.

One of the countries where this supervision is more developed is the UK. The FSA's supervisory activities in the UK include regular reporting by providers, documentation review, site visits, mystery shopping, education and training, circulating documentation such as good and bad practice guidance and thematic reports on particular aspects of financial services markets and the exercise of disciplinary powers. The FSA has powers to censure and fine finance companies and to cancel permission to carry out regulated activities or terminate authorisation. In Ireland, the Financial Regulator has been responsible for the supervision of credit and non-credit institutions since February 2008. In France, supervision by the banking authority, the *Commission Bancaire*, applies to commercial Loan Model ERS. Some countries, such as Finland, do not impose specific supervisory requirements regarding providers of either type of ERS, however, consumer credit lending by both non-credit and credit institutions is regulated under the Consumer Protection Act 38/1978, including amendments up to 29/2005. Chapter 7, of the Act stipulating that the provisions governing consumer credit also apply to credit for the purposes of acquiring a residence.

In relation to Sale Model ERS, most countries (Spain, Hungary, etc) do not have a specific supervision procedure or authority for providers. Supervision is linked to the fact that – as stated above - financial institutions have a major share of the market, therefore supervision for Sale Model ERS is linked to general licensing requirements of provider's institutions. There are however some exceptions, in particular in the UK where, since

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189 Mortgages (as credit in general) are not a reserved activity and can be granted by any company or individual.

190 Replies to stakeholder's questionnaires (regulators) show that some 10 to 8 years ago, Sales Model ERS were offered by major banks such as BBVA and some Cajas de Ahorro. This product was not successful and is not offered any longer.

191 Art 230 of Bulgarian Insurance Code (title "Retirement or annuity insurance") regulates contracts concluded by trade and containing operations for acquisition of real rights in real estate through payment of life or term pension or rent. The Code presumes that transfer of ownership rights be accepted as payment of insurance premium. See Country Report.

192 See Part II: Country Reports, for Romania XII.3.c); Malta XIV.4.b); UK I.3.b); Spain II.5.a).

April 2007, Sale Model ERS are governed by the same special regulatory system as Loan Model ERS.

b) Intermediaries

Intermediaries include brokers, agents and advisers. This is a wide group of players. The legal framework for their supervision is very much dependant upon the country's legal traditions and regulations applicable to these professions. The role of intermediaries in ERS, when they intervene, is linked to providing clients with adequate and correct information, and where necessary, advice. From this standpoint, it is therefore advisable that legislators care about the regulation of their information and care duties in ERS trading.

Most countries lack special requirements for the brokerage of Loan Model schemes, and have no requirements at all for Sale Model schemes. However, differences can be found among Member States of the EU. For instance, regular recourse to intermediaries (in all three groups) is best known in the UK, where they are regulated and placed under FSA supervision powers, as well as in Ireland. On the opposite side, recourse to intermediaries is low in Sweden and almost non-existent in France.

As mentioned above, the most regulated regime for intermediaries in both types of ERS is that of the UK. In the UK, an authorisation by the FSA is compulsory for intermediaries actively selling ERS (both types). It involves both registration in a list held by the regulator, and the acceptance of a Code of Conduct. It also includes both prudential and conduct of business requirements (in much the same way as the regulation approaches providers), supervision and appropriate redress arrangements.

The authorisation scheme outlined above governs the activities of "arranging for" and "advising on" (and agreeing to arrange or to advise on) and as such, it applies to equity release intermediaries as well as to providers. There are, however, two caveats or clarifications to consider in relation to intermediaries:

> (a) Section 39 of the Financial Services and Markets Act 2000 creates a category of "appointed representative" of an authorised person, who is exempt from authorisation and thus from direct regulation and supervision by the FSA. An appointed representative is not exempt from FSA requirements, for example in relation to disclosure, advice standards and other conduct of business regulation, but the responsibility for the securing of compliance by the appointed representative lies with the authorised person (principal) who made the appointment and who is subject to FSA discipline and penalties. In relation to equity release and other home finance transactions, appointed representatives may engage in arranging and advising activities.[193]
>
> (b) The regulatory scheme excludes the activity of "introducing" from the regulated activities of "providing", "arranging for" and "advising on" financial products and services including home equity transactions. The FSA regulates "introducing" by requiring disclosure of relationships between introducers and the person or firm to whom the consumer is referred and of the fee or any other financial benefit received by the introducer.

Spanish Law 41/07 establishes the obligation for the providers of (a) subtype of "Loan Model ERS", to give independent advice to their clients, but this provision – which might include obligations imposed upon intermediaries - has not yet been developed by the Ministry of Economics, competent to implement secondary legislation in this respect.

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[193] See PERG 4.12.3: http://fsahandbook.info/FSA/html/handbook/PERG/4/12.

Not many intermediaries operate in France, where banks tend to prefer to market their products themselves. This choice seems to be a matter of corporate image, as the relevant questionnaires indicated that using intermediaries is seen as likely to create a (sic) “bad image”. Although intermediaries have not so far been involved in the sale of this product, the legal requirements they would need to meet is for recognised status as an IOB (*Intermédiaire en Opération de Banque*). In France, an intermediary acts by virtue of a power of attorney granted by that institution. That power of attorney specifies the types of transactions that the intermediary is empowered to carry out, and the conditions applicable to them. In France, intermediaries are not subject to special requirements.

Recourse to intermediaries in Sweden is reported to be non-existent. In Germany, intermediaries have recently appeared as Internet firms linking their clients to a best buy. Apart from this, they have no direct involvement in negotiating the contract.

III. Insurance law

ERS of both types are usually linked to an insurance product. This requires either a contractual arrangement with an insurer or for the provider to issue its own insurance.

In relation to Loan Model ERS, potential providers in Germany must offer a secondary insurance product from a different provider in order to comply with insurance legislation, as well as to provide lifelong cover. These requirements introduce complexities and costs that contribute to the creation of barriers. The Bulgarian Financial Supervision Commission (FSC) recently concluded that Sale Model ERS in that country requires an insurance license, although the FSC did not provide further details.[194]

IV. Taxes and Benefits

1. Tax law

Tax law is a relevant element of ERS regulation since it is often involved in facilitating private pension schemes and increased access to individual homeownership. Tax laws and regulations can act either as a deterrent or as an incentive to ERS. For example, in Greece and the Netherlands mortgage interest may be deducted from the customer’s income[195] while in other countries, like Ireland, loan payments are exempt from income and increased value tax. But, as in the Netherlands, these exemptions may be linked to mortgages used for purchase of the property itself, thus discriminating against ERS.

Loan Model ERS raise tax concerns in relation to stamp duty and taxes due on completion of the agreement, as well as notarial and registration fees, the high levels of which are seen as critical in the Belgium national report.[196] The regime of regular instalments received by the mortgagor (which are either treated as loans and therefore not taxable as income, as occurs in Hungary, Ireland and Germany, or treat as income that under certain circumstances may be tax exempt, as in some cases in Spain) requires legal attention[197].

Sale Model ERS involve stamp duty and other costs related to the sale of immovable property, as well as tax on the surplus: taxation upon equity release profits can be

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[194] See Part II: Country Reports XI.4.a) Bulgaria (p.112).

[195] See Part II: Country Reports XV.2.c)(6) Greece; XX.1 Netherlands; III.4.d) Ireland; II.1. Spain.

[196] See Part II: Country Reports I.5.e) UK; III.4.d) Ireland; II.4 and 5.a) Spain; IV.5.b) France; V.5 Hungary; XIII.2.a)(1) and 3.a)(4) Belgium.

[197] See Part II: Country Reports II.5a) Spain (p.44).

imposed at the time the house is sold if it reflects an increase of the house value since its purchase. As increases in house prices are seen as an incentive to enter these schemes, consumers should be aware that such profits may be taxed – unless an exemption is granted.

Taking into account that most national reports (UK, Spain, Finland, etc) show that it is common for homeowners to have a mortgage-free home on retirement (mortgages having previously been paid off), it is easy to deduce that ownership has been held for a number of years during which a rise in value has taken place. Our research has ascertained that some countries, such as Hungary[198] or Spain[199] offer tax deductions or exemptions from taxation; and that in others, such as Ireland, any money received under home reversion agreements (Sale Model ERS) is tax free, providing the property involved is the person's principal private residence (otherwise capital gains tax may apply).[200] We have also found that whenever there is no tax exemption, barriers can exist for the development of Sale Model ERS products.

When either Loan Model or Sale Model ERS are linked with an insurance product and annuity payments, the payments may be taxed as income, as they are in Germany[201] if the payments into the scheme or the home had been tax exempt before.

Tax law can act either as an incentive or as a deterrent to ERS:

- The UK Home Income Plan illustrates how tax incentives can help an ERS market to develop. A fixed interest lifetime mortgage is raised against the property and the proceeds are used to purchase an annuity. The annuity payments are used to pay interest on the mortgage and the customer receives the balance. On death, the original mortgage advance is repaid from the proceeds of sale. These schemes were more attractive when the government allowed tax relief against interest on the first GBP 30 000 of the mortgage.

- Another example of how taxation may incentivise (or at least not deter from entering into ERS) is found in Hungary. In that jurisdiction, Loan Model products are treated as loans, not as income. Income Tax Law is therefore not relevant. For the customer's heirs, there may even be tax advantages if inherited property is encumbered. A similar classification of proceeds received by customers of Loan Model schemes is also found in Germany.

Some countries are encouraging Loan Model ERS. The leading example is Spain. The 2007 reform of the Mortgage Law introduces a stamp duty exemption (together with subsidies for notary fees and Registrar's fees). In addition, a personal taxation law (Law of IRPF) allows the proceeds received from the mortgagee to be used to buy a pension scheme (annuity) and these annuities to benefit from tax exemptions.

A good example of how tax can act as a deterrent is found in Belgium[202], where two barriers related to tax law have been identified in relation to Loan Model schemes. On the one hand, the tax charges on Loan Model ERS are high:[203] a registration tax of 1% is due

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[198] Hungary: tax incentives exist regarding the taxation of profit based on the years between the acquisition and the sale (after 5 years, no profit is taxable) (Act on Income Tax). Part II: Country Reports V.4. Hungary (p.74).

[199] See Part II: Country Reports II.5a) Spain: tax exemption on home sales for over 65 years of age (Act on Personal Taxation *IRPF*) (p.44).

[200] See Part II: Country Reports III.4.d) Ireland (p.54).

[201] See Part II: Country Reports IX.4 Germany (p.100).

[202] See proposed legislation in Belgium in Part II: Country Reports XIII.3 Belgium (p.117).

[203] Op. cit. (fn 202) Code on registration and mortgages taxes and court fees.

when a mortgage is granted,[204] furthermore there is a mortgage tax of 0.3%, and notary fees (taxes and fees are normally determined on the basis of the amount secured). On the other hand, setting the precise taxable amounts is problematic as the amount to be secured cannot be determined in advance.

Further policy implications arise in relation to social benefit payments and the impact of a sudden source of extra income:

- Tax laws in force in countries such as Spain contribute to retirement pension schemes by granting them tax deductible and/or tax-free status. This has now been extended in Germany to mortgages where the borrower accumulates frozen equity for his or her old age. However, this tax benefit is only available under certain circumstances. For instance in Germany, if the equity which will be released in old age has been built up through regular payments under a subsidised private pension scheme ("Riester-Rente"), the income derived from its release in old age will be taxable. If the repayment of the loan occurred outside such schemes or if the owner had full equity from the beginning, the pension payments remain tax exempt[205].

2. Benefits law

If low-income households entitled to social benefits use an ERS, this may affect the amount of benefits they may obtain.

- In the UK, the Social Security (Housing Benefit, Council Tax Benefit, State Pension Credit and Miscellaneous Amendments) Regulations 2004, no. 2327 Reg. 2(10) (b) insert a definition of an "Equity Release scheme" into the Housing Benefit Regulations. This is done in order to include income received under ERS in other amounts defined as income under the Social Security Contributions And Benefits Act 1992 (s. 4).

- In Ireland, money received under either form of ERS would appear potentially to be taken into account for the purposes of entitlement to a means-tested State pension.[206] In Ireland, many people (particularly older people and formerly self-employed people) would not have an entitlement to a contributory pension and would be subject to a means test.

- Also in Ireland, public health care entitlements for those up to the age of 70 is also subject to a means-test. Persons over 70 currently receive full public health care without a means test, but the government has recently proposed reintroducing a means test for that group as well. This implies that using equity release could have serious implications for people obtaining means-tested benefits or health care.

V. Consumer Law

Contracts for Loan Model schemes are based on substantive and formal requirements under mortgage law. Civil Law countries such as France or Spain require a Public Deed to be witnessed by a Notary Public and registered in the land registry. Insurance Law is also

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[204] Op. cit. (fn 202).

[205] For two examples, see Part II: Country Reports III.4.d) Ireland (p.54) and II.4 Spain (p.43).

[206] Guidelines on the website of the relevant agency state that: "*If you sell all or part of your home to a financial institution or to another party, e.g. under an equity release agreement, and you are permitted as part of this arrangement to continue to reside in your home, the amount you receive from this sale will be fully taken into account in calculating your means for pension purposes*."

relevant to the Loan Model, in particular when an insurance product (i.e. temporary or lifelong annuity) is linked to the scheme. Both consumer contracts in general and especially insurance and credit contracts have over the years been subject to increasing consumer protection legislation. However, as stated in the first part of this legal section, only a limited number of countries include mortgages in the protection provided by general consumer credit law.

Sweden, Finland, France and Germany apply consumer credit law to mortgage credit. In others, such as in Belgium, consumer protection law is not applied to regular mortgages, but is granted to Loan Model ERS[207]. In the Netherlands, such contracts do not qualify for mortgage loan protection because of its different purpose.[208] In Ireland, the provisions of the Consumer Credit Act apply to the Loan Model ERS. In Spain, a Bill is presently being discussed at the National Parliament to regulate consumer protection in mortgage credit contracts.[209]

Contract Law for Sale Model schemes is based mainly upon legislation governing the sale of real estate and conventional life annuities (i.e.: *"renta vitalicia" "lifelong rent"*). In relation to the Sale Model (involving the sale of property), countries such as Spain make it compulsory for intermediaries, such as notaries, to inform consumers of the content of the contract and not to include clauses which have been declared unfair by a court decision registered in the Registry of Unfair Clauses. This duty is extended to advice in France.

Much of the protection that all ERS can provide for consumers is linked to the quantity and quality of the information to which they are entitled. These types of information can be categorised as follows:

1. Information and advice

a) Consumers information and advice

Consumer information and advice have been incorporated into the heart of European consumer protection law. EU Directives on consumer credit, payment services, distance marketing or insurance are primarily concerned with the asymmetric information problem in consumer contracts.[210] Only the UK and Ireland, where an indigenous ERS market has

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207 The Act of 4 August 1992 on Mortgage Credit applies to credit contracts secured by a mortgage or similar security on immovable property and primarily intended for the acquisition or retention of rights in immovable property. An ERS would normally not fall under the provisions of the Act as the aim of the credit will often be other than the acquisition or retention of rights in immovable property. The Act of 12 June 1991 on Consumer Credit applies to credit agreements granted to a consumer. Credit agreements secured by a mortgage, but not (primarily) intended for the acquisition or retention of rights in immovable property (e.g. health related expenses, travelling, etc.) – as will often be the case in an ERS – would thus fall within the scope of application of the Consumer Credit Act. Certain provisions of the Act do not apply to credit contracts above EUR 20 000 and for which a notary has drawn up a deed (art. 3 Consumer Credit Act). These provisions also have as a consequence that second mortgage loans may well fall under the scope of application of the Consumer Credit Act. The Consumer Credit Act has detailed provisions on publicity, pre-contractual information, responsible lending, prior consultation of the credit register, unfair contract terms, early repayment, etc.

208 See above (fn 140).

209 For the latest draft (26th November 2008, see the Official Bulletin of Lower Chamber of Spanish Parliament at http://www.congreso.es/public_oficiales/L9/CONG/BOCG/A/A_007-06.PDF.

210 See **Consumer Credit Directive 2008/48/EC:** (19) In order to enable consumers to make their decisions in full knowledge of the facts, they should receive adequate information, which the consumer may take away and consider, prior to the conclusion of the credit agreement, on the conditions and cost of the credit and on their obligations; **Distance Marketing Directive 2002/65/EC:** (23) With a view to optimum protection of the consumer, it is important that the consumer is adequately informed of the provisions of this Directive and of any codes of conduct existing in this area; **Life assurance Directive 2002/83/EC:** (52) In an internal market for assurance the consumer will have a wider and more varied choice of contracts. If he/she is to profit fully from this diversity and from increased competition, he/she must be provided with whatever information is necessary to enable him/her to choose the contract best suited to

developed, have paid specific attention to these forms in their consumer legislation. In relation to pre-contractual information, detailed prescriptive rules as to the form, content and timing of information disclosure prior to conclusion of a financial services contract have been a central element of the UK's FSA's regulatory technique since the agency's inception. Both the Loan Model and the Sale Model ERS have been covered since 2007.[211]

While ERS are a specific product in economic terms, legally they consist of well-known and regulated elements such as credit and loan agreements, mortgages and life insurance (Loan Model) or sales agreements together with mortgages and insurance contracts (Sale Model); rights and duties in relation to the provision of information therefore also apply to ERS.

(1) Loan Model

The fact that mortgage law is, however, generally excluded from consumer law protection (except in countries such as Germany, France, Hungary, Finland and Sweden) diminishes consumer information rights in relation to pre-contractual information on Loan Model ERS. There are, though, also a number of special regulations on mortgage loan disclosure, which integrate information and advice.

- In France, specific pre-contractual advice and information is required of providers under art L 314-3 du code de la consommation and failure to comply is punishable by fines, and /or by loss of entitlement to interest[212]. Especially noteworthy under the framework governing the French market for ERS is a mandatory consultation with a notary. The notary will thus exercise a duty to advise, which the consumer will receive having benefited from information communicated by his banker. Specific measures were introduced into the French Consumer Code to protect the elderly people at whom this product is targeted, and who may sometimes be vulnerable.

- In Sweden, the specific pre-contractual advice or information provision requirements are stipulated under the Consumer Credit Law, while advertising restrictions are stimulated in Art 6-8 Consumer Credit Law[213].

- In the UK, initial disclosure documentation, which must be provided in writing or another durable medium and reissued when relevant information changes, must include a number of issues which are detailed in the National report:[214] (a) establish whether the transaction will entail the provision of advice or information; (b) establish how much the consumer will pay or the basis on which the firm is paid; and (c) and provide the customer with an initial disclosure document (IDD)

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his/her needs. This information requirement is all the more important as the duration of commitments can be very long. The minimum provisions must therefore be coordinated in order for the consumer to receive clear and accurate information on the essential characteristics of the products proposed to him/her...; **Payment Services Directive 2007/64/EC:** (21) This Directive should specify the obligations on payment service providers as regards the provision of information to the payment service users who should receive the same high level of clear information about payment services in order to make well-informed choices and be able to shop around within the EU. In the interest of transparency this Directive should lay down the harmonised requirements needed to ensure that necessary and sufficient information is given to the payment service users with regard to the payment service contract and the payment transactions; **Insurance Mediation Directive 2002/92/EC:** (19) This Directive should specify the obligations which insurance intermediaries should have in providing information to customers.

211 For more details see Part II: Country Reports I.5.g) UK (p.17) and III.4.c) Ireland (p.54).

212 See Part II: Country Reports IV.5.b) France (p.63). Also further details are available at http://www.legifrance.gouv.fr/affichCode.do;?idSectionTA=LEGISCTA000006161882&cidTexte=LEGITEXT000006069565&dateTexte=20080922.

213 See Consumer Credit Law (1992:830).

214 See Part II: Country Reports I.5.g.(3) UK (p.21).

or combined initial disclosure document and (d) information about the firm and its FSA regulated status, the nature of the service offered by the firm and the scope of any advice it provides[215]. According to the FSA, the purpose of pre-application disclosure requirements for home finance transactions is to "*ensure that, before a customer submits an application for a particular home finance transaction, he is supplied with information that makes clear: (a) (in relation to a regulated mortgage contract) its features, any linked deposits, any linked borrowing and any tied products; and (b) the price that the customer will be required to pay under that home finance transaction, to enable the customer to assess whether it is affordable to him.*"[216] The disclosure rules also are intended to ensure that information "*is disclosed in a consistent way to facilitate comparison between products of different providers*".[217]

- In Spain, under the Mortgage Law[218], mortgage providers are obliged to offer full information (provider, product, interest, etc). A Decree detailing the duty to offer independent advice is expected to be passed by the Ministry of Economy in 2009.[219]

- The Belgian Mortgage Act and Consumer Credit Act[220] establish an obligation to hand over a binding written offer to the borrower with all contractual conditions including the information as to when this offer will expire. A proposal by industry to the government establishes that this is also to be provided for ERS and that current provisions of the Mortgage Credit Act should be amended so that they accurately reflect the different nature and modalities of ERS. The proposal also introduces a cooling-off period for ERS (currently non-existent for mortgage credit).

- In Finland, there are no specific rules on pre-contractual advice or information relating to ERS. General rules relating to credit offered to consumers (in Loan Model ERS) are applicable. In particular, in relation to reverse mortgages (Loan Model ERS), before conclusion of the contract, the consumer must be notified of the contract terms and any other information referred to in section 11 Consumer Credit Act Chapter 7, in addition to which he/she must be provided with an opportunity to peruse them in writing.

(2) Sale Model ERS

Sale Model ERS are linked to the sale of immovable property. In countries such as Spain, Portugal or France, this implies that notaries must be involved in the contractual process and have a general duty to provide information to the parties concerned. This duty derives from Consumer Law (when applicable) and from notaries' professional rules. However, only countries such as the UK and Ireland require pre-contractual information

[215] See http://fsahandbook.info/FSA/html/handbook/MCOB/4.

[216] See MCOB 5.2.1(2).

[217] See MCOB 5.2.1(3) and http://www.fsa.gov.uk/pubs/handbook/keyrules_mhr.pdf

[218] See Order of the Ministry of Economy of 5 May 1994 (*Orden de 5 Mayo de 1994. Transparencia de las condiciones financieras de los Préstamos Hipotecarios - BOE de 11*). This Order introduced the obligation for any financial institution providing residential mortgages to give potential borrowers requesting information on loan conditions, an information booklet with detailed information on the applicable conditions for a given type of mortgage, as well as the obligation to provide the consumer with a binding offer (once the appraisal of the asset has been done). Article 1 of Law 41/2007 has provided the basis for an enhancement of pre-contractual information, which needs further development by the Ministry (by means of a Ministerial Order) that has not yet been accomplished.

[219] From conversations and published information gathered by the study's legal expert for Spain and responses from the Questionnaires SQ6 and SQ28.

[220] See *Loi du 12 juin 1991 relative au crédit à la consommation*.

with respect to the specific purposes and dangers of ERS. In all other countries, there are no specific rules on pre-contractual advice or information, and only rules governing the sale of real estate (Sale Model ERS) are applicable. These have little impact on the instrument's credit functions.

b) Other interested parties (family or dependency relationship)

ERS concern the family and therefore often impact on other members of the family and heirs. We did not find binding legal rules making it compulsory for either party to inform or advise these stakeholders about ERS contracts. However, many respondents, and providers and regulators in particular, have pointed to the necessity for such information to be given in practice. In some countries, providers require information given to the users of ERS to be passed on to their relatives. In the UK, providers advise customers to discuss an equity release transaction with family members in order to avoid future problems. In Ireland, providers impose contractual obligations to draft a will and involve their heirs in the process. In Spain and Finland, providers and regulators consider that heirs' involvement is advisable but not imposed by contract. In all cases, there is no legal obligation to provide information to interested parties, and this is either the subject of a clause in the contract or, more frequently, merely a recommendation.

c) Potential information requirements under EU law for Loan Model ERS

This survey could not cover the vast body of specific information rights existing under national and EU financial services regulation and applicable to Loan Model ERS[221]. The Sale Model has little or no overlap with financial services regulation. As the rules are designed for conventional loans, and ERS "reverses" their structure, it may be assumed that many of these rules would not apply to ERS. The concept of the loan is reversed since debtors are not required to repay the loan. The purpose of the loan is also reversed. It is not provided for the acquisition of equity in real estate but to release it. The relation between loan and security is similarly reversed. The security is the true debtor while the debtor has the role of a guarantor. This reversion gives rise to a need for additional duties to advise and inform as outlined above under section IV.1a. The following table sets out on a very preliminary and general basis whether existing duties to provide information in connection with credit and pension schemes are applicable at all for ERS, or whether they lose their meaning, or are even detrimental, given the reversed structure of this type of product. For the purpose of creating a framework for comparison, we have used the information requirements of Directive 2008/48/EC on Consumer Credit and Directive 2003/41/EC on occupational retirement provision as a source, although both Directives do not apply directly to ERS. As shown as an example elsewhere[222], however, these Directives reflect the general standard of information rights in financial services and distinguish between advertising, pre-contractual information and contractual information. We have integrated the first two steps in the marketing of financial products since they overlap.

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[221] For these rights see the, as of end December 2008, yet unpublished EU Study Reifner, Impact of Directive 2002/65/EC concerning the distance marketing of consumer financial services on the conclusion of cross-border financial service contracts between professionals and consumers, Project No. SANCO/2006/B4/034 Hamburg 2008 pp 26 ff, 50 ff; for another EU project on EU consumer information rules see Schulte-Noelke, H., (Ed), *EU Verbraucherrechtskompendium*, (in collaboration with Twigg-Flessner, Ch. Ebers,M.; Börger, A.; Fischer, S.; Meyer, L.; Scheuren-Brandes) 2008 (available at http://www.eu-consumer-law.org/index_en.cfm).

[222] See (fn 210).

Table 15: Typical information rights in financial services and Loan Model ERS

Item	Pre-contractual **If also required in Advertising marked with an (A)**	Contractual	Problems for ERS (Loan Model)
Consumer Credit Regulation			
Supplier	The identity of the creditor geographical address of the creditor.	The identities geographical addresses.	No problems.
Interme-diary Substitute	If applicable, the identity of the credit intermediary involved. Geographical address of the credit intermediary involved.	The identity of the credit intermediary involved. Geographical address of the credit intermediary involved.	No problems.
Supervision Register		Where applicable, the name and address of the competent supervisory authority.	No problems.
Product Characteristics	The type of credit the ***total amount of credit*** and the conditions governing the drawdown.	The type of credit ***the total amount of credit*** and the conditions governing the drawdown.	Given that the Directive allows for exemptions (when such a calculation is not possible), this is not a problem for ERS.
Price Parameter	The annual percentage rate of charge. The total amount payable by the consumer. The borrowing rate b, the conditions governing the application of the borrowing rate and, where available, any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions and procedure for changing the borrowing rate; if different borrowing rates apply in different circumstances, the above-mentioned information on all the applicable rates.	***The annual percentage rate of charge.*** ***The total amount payable by the consumer, calculated at the time the credit agreement is concluded***. The borrowing rate, the conditions governing the application of that rate and, where available, any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions and procedures for changing the borrowing rate and, if different borrowing rates apply in different circumstances, the above-mentioned information in respect of all the applicable rates.	Unclear whether fees for liquidation qualify. This amount will only be known at the end of the contractual relationship.

Item	Pre-contractual If also required in Advertising marked with an (A)	Contractual	Problems for ERS (Loan Model)
Additional Cost	Where applicable, the charges for maintaining one or several accounts recording both payment transactions and draw downs, unless the opening of an account is optional, together with the charges for using a means of payment for both payment transactions and drawdown's, any other charges deriving from the credit agreement and the conditions under which those charges may be changed. The interest rate applicable in the case of late payments. Where applicable, the existence of costs payable by the consumer to a notary on conclusion of the credit agreement. The arrangements for its adjustment. Any charges payable for default.	Where applicable, that notary's fees will be payable. Where applicable, the charges for maintaining one or several accounts recording both payment transactions and draw downs, unless the opening of an account is optional, together with the charges for using a means of payment for both payment transactions and draw downs, and any other charges deriving from the credit agreement and the conditions under which those charges may be changed. The interest rate applicable in the case of late payments as applicable at the time of the conclusion of the credit agreement any charges payable for default; the arrangements for its adjustment. Any charges payable for default.	No problem. If interest has to be debited to another account in order to avoid anatocism this could cause a problem. No problem but as late payments are mostly not possible the true regulatory problem is after cancellation for a depreciation of the mortgage.
Payment	The amount, number and frequency of payments to be made by the consumer. In the case of a credit in the form of deferred payment for a specific good or service and linked credit agreements, that good or service and its cash price.	The amount, number and frequency of payments to be made by the consumer. In case of a credit in the form of deferred payment for a specific good or service or in the case of linked credit agreements, that good or service and its cash price. The right of early repayment, the procedure for early repayment, as well as, where applicable, information concerning the creditor's right to compensation and the way in which that compensation will be determined.	There are no payments by the consumer but payments by the provider. This should be considered in any legislative effort. Unclear whether this would qualify for a linked agreement since there is a negative financing of a home whose later sale is linked to the earlier credit ("reverse"). Who carries the risk that a buyer does not pay or that the home has hidden vices?

Item	Pre-contractual If also required in Advertising marked with an (A)	Contractual	Problems for ERS (Loan Model)
Right of Withdrawal	The existence or absence of a right of withdrawal.	The existence or absence of a right of withdrawal. The period during which that right may be exercised and other conditions governing the exercise thereof, including information concerning the obligation of the consumer to pay the capital drawn down and the interest in accordance with Article 14(3)(b) and the amount of interest payable per day.	A right of withdrawal is normally not given in mortgage loans. In Sale Model ERS, it is hard to imagine.
Risks and Liability	A warning regarding the consequences of missing payments. Where applicable, the sureties required.	A warning regarding the consequences of missing payments. The sureties and insurance required, if any.	This kind of warning is superfluous but there should be a warning. No problem.
Term Changes	The duration of the credit agreement.	The duration of the credit agreement.	The duration is depends on lifetime and is not fixed. There should be alternatives for ERS.
Law Language Litigation Complaints		Whether or not there is an out-of-court complaint and redress mechanism for the consumer and, if so, the methods for having access to it.	No problem.
Pension regulation[223]			
Provider	Brief particulars of the situation of the institution/ current level of financing of their accrued individual entitlements (on Demand).		If an insurance company takes over part of the task both should be indicated.
Product Characteristics	The rights and obligations of the parties involved in the pension scheme. the target level of the retirement benefits, if applicable the level of benefits in case of cessation of employment (on Demand).		Not applicable.
Execution	The annual accounts and the annual reports statement of investment policy principles.		Not applicable.
Risks Liability	The financial, technical and other risks associated with the pension scheme.		It would be possible and necessary to provide a full risk

[223] The cited elements are supposed to be typical information duties for private pension schemes and do not suppose that they apply to ERS products in any way. It would be beyond the scope of this research to identify the whole body of typical information rights in this area and which are still regulated at national level.

Item	Pre-contractual If also required in Advertising marked with an (A)	Contractual	Problems for ERS (Loan Model)
	The nature and distribution of those risks. Where the member bears the investment risk, the range of investment options, if applicable, and the actual investment portfolio as well as information on risk exposure and costs related to the investments (on Demand).		assessment for the transaction which concerns depreciation of the real estate, variable rates and longevity.
Term Changes	Any relevant information regarding changes to the pension-scheme rules.		No problem.
Termination	The appropriate information on the benefits which are due and the corresponding payment options. The arrangements relating to the transfer of pension rights to another institution for occupational retirement provision in the event of termination of the employment relationship (on demand).		Applies to Sale Model ERS.

This overview shows that, in general, the same information as required in ordinary credit and pension schemes would indeed be applicable and necessary for ERS. However, in some instances specific requirements would be necessary to clarify duties that do not make sense in the reversed forms of credit. Specific ERS legislation could be useful in expanding duties to provide information, while liberating providers from existing rules that are inappropriate.

d) Independent Advice

There are some examples of a duty on providers to recommend that customers take independent advice (in contrast to a duty to provide for independent advice which can be an expensive burden on providers[224]).

Under the FSA's MCOB 8 (ERS advising and selling standard) in the UK, initial disclosure of the nature and scope of the service in relation to a regulated mortgage transaction is extended to advice[225]. In France, notaries have been responsible for that advisory role under the Consumer Law applicable to Loan Model ERS. In Spain, although consumer credit law is not applicable to credit mortgage in general terms, under Decree Legislative 1/2007 (Consumer Law, consolidated) notaries and registrars have a general duty to provide information and advice to consumers entering into a contract that is witnessed by them. Mortgages and sales contracts (related to both Loan Model and Sale Model ERS) must be executed in a public deed before a notary. Also, DA1, art 1.4 of La 41/2007 establishes that, in order to strengthen transparency and customer protection, companies that offer reverse mortgages regulated by that Law must offer independent advice services to customers. Independent advice must also take the client's financial

224 The duties as to advice provision play an especially important role in relation to the elderly. Elderly people constitute a potentially vulnerable group and are in need of careful advice. Lack of information is a factual - barrier for any product, particularly for complex financial and real estate-related transactions. However, giving advice exposes the provider to legal risks and compensation claims. It has to be acknowledged that this is not always easy to achieve. By way of example, during the parliamentary procedures enacting Spanish Law 41/2007, some proposals were oriented to making advice by the Banks or Credit Institutions' ombudsman compulsory. However, in the final version the prevailing draft established that independent advice must be provided in a manner still to be decided by the Ministry of Economy.

225 See http://fsahandbook.info/FSA//handbook/MCOB/8.pdf.

situation into account, together with the financial risks associated with the product. Further, it establishes that independent advice must follow the procedures, conditions, and requirements set by the Ministry of Economy.

According to the legislation in force in Belgium,[226] a public notary is obliged to provide independent advice and to point out the rights and obligations arising from an act before drawing up a deed[227]. The industry has proposed legislation aimed specifically at extending this to Loan Model ERS, although, in accordance with that proposal the borrower could waive the requirement of prior consultation with a notary.

2. Early repayment

Early repayment regimes apply to Loan Model ERS. Restrictions on early repayment may affect the profitability and risk of an ERS. A number of examples have been identified in this area. In France, there is a specific ceiling on the fees imposed in the event of early repayment[228]. In Belgium, if the agreement falls within the scope of application of either the Consumer Credit Act or the Mortgage Act (which is disputed in the national report)[229], the fees that can be charged by lenders in the event of early repayment are capped (cf. max. two / three months of the total cost of the credit, depending on the amount of the credit - art. 23 Consumer Credit Act; maximum three months' interest - art. 12 Mortgage Credit Act). Loan Model ERS fall under the Consumer Credit Act[230]. In Spain, within the "incentivised sub-type" (Law 41/2007) the mortgagor may cancel the loan without having to pay a penalty for early repayment, as detailed in the Spanish National Report[231]. In Germany, any mortgagor may cancel the contract after 10 years without any penalty, according to the law which makes fixed loan contracts for lifetime illegal and hinders prepayment charges if the consumer chooses to terminate the contract after 10 years.

In the UK, and in accordance with practice followed by providers, almost all calculate fees for early repayment based on a backwards sliding scale where the percentage of the product value decreases over time. A major provider suggested instead a method based on the market interest rate prevalent at the time of early repayment, which would better reflect the true costs of adjustment.

Early repayment raises issues in relation to ERS profitability. Even though ways of financing mortgage credit – including ERS - vary from one country to another, as a general rule, a provider obtains funds by issuing securities or bonds guaranteed by mortgages on the property sold on the primary or secondary market. The techniques and products vary considerably depending on the timescale of the loans, whether rates are fixed or variable, the payments, the techniques and the market procedures. Early repayment involves, alongside an advantage for the consumer, a burden for the provider who must buy back the financial instruments (which would lose their object). The burden

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[226] See http://staatsbladclip.zita.be/moniteur/lois/2005/11/03/loi-2005009766-print.html.

[227] See Art. 9 § 1 Act of 25 Ventôse year XI on public notaries.

[228] The maximum compensation for early repayment to the provider is fixed by decree by art. R. 314-2 of the consumer code. Also, Ordonnance no 2006-346 of 23 March 2006 relating to Sureties set that the total amount to be repaid under Loan Model ERS "prêt viager hypothécaire" is fixed at a ceiling, which is the price of the property at either death or sale of the housing asset.

[229] Please see Belgium country report: credit agreements secured by a mortgage, but not (primarily) intended for the acquisition or retention of rights in immovable property fall within the scope of application of the Consumer Credit Act. In accordance thereof, our experts consider that Consumer Law is applicable. However, there is room for partial application of Mortgage Law.

[230] Please see country report: credit agreements secured by a mortgage, but not (primarily) intended for the acquisition or retention of rights in immovable property fall within the scope of application of the Consumer Credit Act.

[231] See Part II: Country Report II.5 Spain (p.44).

to the provider varies according to the period remaining, the trend of rates and the market situation. Failure to take into account the effective burden borne by the provider as a result of early repayment is a disincentive for providers and creates barriers. Early termination rules that do not take the burden for providers into account can create barriers[232].

3. Compound interest (Anatocism)

Compound interest is interest calculated by computing the rate against the original capital plus reinvested interest each time the interest becomes due. When simple interest is calculated, only the interest on the original capital is added. The legal regime relating to compound interest impacts upon the possibility of providing Loan Model ERS.

The approach towards Anatocism varies accordingly from country to country. ERS restrict repayments to the future proceeds of sale of the property. This implies that interest on the principal is compounded. This may conflict with the Roman law principle of Anatocism, forbidding interest charges on interest. In some southern European Member States such as Italy, that law remains in force and has been revived for consumer protection purposes.[233] Others have loosened its impact.

- In **Belgium**, compound interest is restricted by the Civil Code, the Mortgage Credit Act and the Consumer Credit Act. Under Article 1154 of the Belgium Civil Code (*BurgerlijkWekboek*), it is possible for interest to attract further interest, but this possibility is subject to two conditions. The first relates to the method to be used. This form of interest may be imposed either by a Court decision, or by a specific agreement between the parties. The second condition imposes a minimum time limit of one year over which compound interest is chargeable. Art 14 Consumer Credit Act establishes that there is an obligation to determine the exact amount of credit in the credit agreement. Art. 10 Mortgage Credit Act only provides for interest calculated on the principal sum outstanding[234].

- In **Italy**, the Supreme Court[235] has declared a number of contractual clauses applicable to overdraft credit to be void on the grounds that they breached the principles of Anatocism.

- In **Portugal**, the rule[236] has been effective in dealing with escalating debt, whereby accrued interest is debited to a separate account, thus preventing the sum from being compounded on the interest-bearing capital.

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[232] Opinion of the European Economic and Social Committee on the *Green Paper: Mortgage Credit in the EU*, (COM (2005) 327 final (2006/C 65/21). This opinion was drafted in relation to general mortgage markets and we find it equally applicable to Reverse mortgages.

[233] See *Overindebtedness and Consumer Law in the European Union, 2003* Final Report EU-Contract Reference No. B5-1000/02/000353 – (Reifner,U. Niemi-Kiesilainen, J.; Huls,N.; Springeneer, H.) http://news.iff-hh.de/media.php?id=1886.

[234] See Part II: Country Reports XIII.3.a) Belgium (p.117).

[235] For a short comment to the decision issued by the Italian Corte di Cassazione on the matter of compound interests (anatocism) see: http://www.law-economics.net/public/Nota%20anatocismo%20sez.%20un..pdf. In short: in 1999, the Supreme Court officially declared interest clauses in credit contracts between banks and consumers which provided for a capitalisation of interest every three months null and void on the basis that it infringes the Italian Civil Code (sections 1283 and 1419). The original decisions were based on the fact that those interest clauses were grounded on a mere "trade usage". Moreover, the Supreme Court consistently declared that these interest clauses are not binding during the period between the termination of any agreement with the bank and the paying off of any overdraft or loan facility. Later, the Supreme Court decision no. 21095 of 4 November 2004 ruled that the right to claim compensation for monies paid under compound interest clauses should apply retrospectively.

[236] See no.1 of article 560 of the Portuguese Civil Code, and Part II: Country Reports XVI.4 Portugal.

- In **Greece**, there are comprehensive regulations restricting Anatocism.[237]

- In **Germany**, the law[238] prohibits a contractual clause allowing "in advance" interest to be added to the principal sum outstanding. However, some exceptions have been created. First of all, exemptions apply to current accounts. Another exemption has been applied to a *disagio*, a situation where interest is prepaid and thus added to the principal. As German law allows an agreement that outstanding interest should bear interest again, it is quite difficult to distinguish whether such an agreement was made in advance. Notwithstanding these exceptions, it must be emphasised that Germany has also revived the idea of limiting pyramid debts through specific legislation governing interest on consumer credit in the event of default and unpaid interest must be allocated to a separate account. All payments are first applied to reduce the principal, while interest in default is kept separate and bears interest only at the statutory rate of 4% a year. Compounding default interest is precluded, and this would affect ERS in situations where the lender cancels the contract. It is therefore questionable to what extent German Courts would allow another exemption for ERS. A possible model would be to use two accounts; German courts do not see that as avoidance of the Anatocism principle.

- In **Luxembourg**, the rule that repayments in default are first applied to reduce the principal is also in force.

- In **Spain**, Art 1109 of Spanish Civil Code establishes the possibility that unpaid interest can accrue further interest. The *dies ad quem* for this to occur is the time when a claim for the unpaid interest is brought to the Courts. However, there are some specific provisions under mortgage law. Although mortgages are intended under Spanish Law as a means to guarantee a loan (not to guarantee interest on the loan), under certain circumstances, such as in cases of mortgages agreed on the basis of an overall amount to be paid back (i.e. capital + total interests agreed on completion of the agreement), it is permissible that the mortgage be used to guarantee up to five years' interest (Art 220 Regulation of Mortgages Law). In addition, there is scope for an agreement that the mortgage should guarantee interest for two years plus the current annuity (Art 114 Mortgage Law) within the 5 year limit. In order to cover unpaid accrued interest, mortgagees are allowed to apply for an extension of the mortgage over the same real estate (Art 115 Mortgage Law), for instance by way of conversion of the interest due into capital. When the creditor cannot recover unpaid accrued interests "under mortgage court procedures", recovery takes the form of a "personal credit action" against the mortgagor. However, Law 41/2007, Art 114 of the Mortgage Law is not applicable in schemes that benefit from the "incentives" created by. Instead, should the heirs decide not to repay the loan plus interest, the credit provider can claim up to the amount of the deceased's state (Additional Disposition 1st of Ley 41/2007). This implies that interest over interest can be charged providing the total amount does not exceed the deceased's state

Anatocism thus creates barriers to ERS Loan Models. However, as we have explained, jurisdictions have introduced various ways to avoid this impediment. The position is very diverse and depends on levels of credit use and consumer protection in individual Member States. Anatocism is either abolished or reduced in its scope if new financial products are marketed which necessarily involve compounding interest, especially in current accounts, overdraft, revolving credit and credit-card credit. Much depends on whether national legislators view these rules as outdated and historic, belonging to a

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[237] See (fn 233), Reifner p.86.

[238] See German Civil Code §§ 248, 289 BGB, and Part II: Country Reports IX.5.a) Germany (p.100).

time when interest payment itself was seen as an evil, or as a consumer protection concept.[239]

4. Amortisation

This item refers to Loan Model ERS, although amortisation does not occur. Equity Release is the logical opposite of equity increase through amortisation.

In many countries, "normal" mortgages are characterised by a model in which the borrower eventually acquires his or her home by making regular payments against the principal. Amortisation remains prevalent in most countries, where the idea of a mortgage is still dominated by the idea of one's home free of debt in the future. For instance, in France, this approach was imposed by law and prevented lenders from offering ERS, a difficulty which was overcome recently by specific approval by the legislature of ERS.

Loan Model ERS creates a legal duty to reimburse the provider for the amounts advanced to the mortgagor. Unless the contract is only for a fixed period, like in Finland, which does not qualify for our criteria of "life long" payments, the contract is terminated completed when the consumer has deceased. The amortisation is therefore not fixed by time. Also, the final amount due to the provider together with accrued interest is unknown at the time when the parties complete the contract[240].

In countries such as France, Spain[241] or Greece, "normal" mortgages are related to regular payments against capital and interest. Adaptations are needed to provide for a mortgage, which is repaid only after the death of the owner and the sale of the house.

In countries such as Finland, where an equivalent to Loan Model ERS products with fixed periods is sold, providers such as Nordea have reported that, if clients decide not to renovate and not to pay back the full amount, they are prepared to negotiate an amortisation plan.

VI. Soft law: self-regulation, codes of conduct and recommendations

Given the lack of a homogeneous definition of equity release products, and the division of both forms of ERS between different legal forms, a number of sector-specific laws and Codes impact upon the development of ERS. This provides opportunities for self-regulation and codes of conduct. The European Economic and Social Committee (in relation to the European mortgage market), has asked for voluntary codes to be drawn up by the trade associations of European financial institutions in consultation with consumer associations, which should include sanctions and compliance mechanisms checked by national ombudsmen and registered with the courts or the chambers of commerce. The Committee has also recommended that affiliation to a given voluntary Code of Conduct should be included in the information packages and documentation

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[239] For this discussion see Reifner, U. *Das Zinseszinsverbot im Verbraucherkredit*, in Neue Juristische Wochenschrift (1992), pp.227-243.

[240] As an example, in Spain, Law 41/2007 expressly that the limit of 5 years to charge interest (Art 114 Mortgage Law) is not to be applied. What is more, it says that heirs answer to the debt all the goods in the deceased estate which sums up to acknowledging that the value of the home may not be enough to guarantee the loan. This lack of determination is an exception to general mortgage law.

[241] Mortgage Law imposes upon the credit provider that the mortgagor has a right of early redemption (amortisation). When the mortgage has been created over a home by a natural person, the bank cannot charge any commission or penalty for early amortisation in accordance with Art 7 of Law 41/2007. In other situations (Law 2/1981) those commissions for early repayment cannot exceed: i) 0.5% of the early repaid capital when the early repayment is done within the first five years of the life of the credit or loan, or ii) 0.25% of the early repaid capital when the early repayment is done at a time after that indicated in the previous point.

issued by ERS providers.[242] The "European Code of Conduct on pre-contractual information to be given to consumers by lenders offering home loans"[243] has suggested a formula for duties to provide information for home mortgage loans in general. The French and the Spanish National Mortgage Federations hesitated to subscribe to it since they considered that these duties overlapped with existing national law. The relationship between such codes and the law is still unclear, and this hinders their effectiveness. In this respect, the Directive on Unfair Commercial Practices (Directive 25/2002/EC) could serve as a model. It creates a liability for statements that a company has made in public, which makes a given Code of Conduct indirectly binding.

It should, however, be kept in mind that self-regulation, regulatory codes and voluntary codes, as well as Codes of Conduct incorporated in banking law, are applicable only to the parties to the agreement.

In the UK, some of these recommendations are detailed prescriptive rules as to the form, content and timing of information disclosure prior to conclusion of a financial services contract (this has been a central element of the FSA's regulatory technique in the UK since the agency's inception). For a variety of reasons, including the complexity of the detailed rules and costs of maintaining its rulebook, the UK FSA has sought to turn away from detailed prescriptive rules and to rely more heavily on "high-level" principles as its preferred regulatory technique in situations where there is a choice, (e.g. in situations where there are no binding EC directive provisions). The eleven "high-level" principles are set out in the FSA's Principles for Business Handbook.[244]

Over and above formal "Codes", in recent years, the UK FSA has invested heavily in its "Treating Customers Fairly" initiative, a supervision / educational project for finance companies, the goal of which is that firms take responsibility for translating the general norms of the principles for business into concrete operational policies and practices that produce fair outcomes in consumer financial markets. Principles 6, "Customers' Interests" and 7, "Communications with Clients" are most relevant to the FSA's expectations in relation to pre-contractual disclosure and Principle 9 to the FSA's advice standards.

Also in the UK, other practices and recommendations derive from stakeholders such as the Association of British Insurers (ABI).[245] Finally, a number of recommended practices have been approved by the industry (particularly by the UK standards setting body, Safe Homes Income Plan - SHIP). The latter relates to both types of ERS: both Home Reversion Plans and Lifetime Mortgages are governed by the Code of Conduct published by SHIP when they are provided by a SHIP member.

In other countries, such as Italy, some providers of Loan Model ERS operate in accordance with their own internal codes of conduct, which are made public. According to the Italian national report, a Code of Conduct between Consumers Associations and the Association of Italian banks could be a fair way to ensure uniform standards by credit providers active in the Italian market.

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[242] Opinion of the European Economic and Social Committee on the *Green Paper: Mortgage Credit in the EU* (COM (2005) 327 final (2006/C 65/21).

[243] See Commission Recommendation of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (Text with EEA relevance) (notified under document number C(2001) 477) and also its evaluation by iff. See above (fn 143).

[244] Available at: http://fsahandbook.info/FSA/html/handbook/PRIN).

[245] By way of example, in the UK, firms advise customers to discuss an equity release transaction with family members (ABI interviews Sept 2008) but there is no legal requirement to inform or include anyone other than the firm's customer(s). These recommendations have been the subject of claims and decisions. See Ombudsman News Issue 72 Sept/Oct2008 for several case studies drawn from complaint files about conflicts that arise when family members and legatees are unaware of the equity release transaction, see: http://www.financial-ombudsman.org.uk/publications/ombudsman-news/72/72-mortgages.html.

Codes of Conduct are voluntary, therefore not all lenders subscribe to it. When taking into account that the Unfair Commercial Practices Directive has introduced sanctions for not fulfilling Code guidelines when a company states that it is following them, Codes of Conduct without such sanctioning could be insufficient to protect the interests of the elderly.

VII. Surety law

1. Lack of data for risk evaluation

Lack of reliable data, mainly on long-term property valuation, and uncertainty in the area of longevity are risks, which affect upon both Loan and Sale Model ERS. Uncertainties increase placement fees and affect the proposed loan/sale to value ratio.

In Loan Model ERS, four main variables must be indexed in order to assess risks undertaken by providers and clients:

a) Value of the property

- Predictions of the value of properties far into the future are necessary. A potential barrier is the lack of indicators to help providers identify and accurately forecast their risk when they offer ERS. The recent drop in real estate prices in the UK and Spain[246] has made this important problem evident.

- Such predictions may also suffer from the customer's bad behaviour. A proposal submitted by industry to the Belgium's government, in order to introduce the right of providers to monitor whether the value of the asset is preserved or increased is considered crucial by the credit industry. The proposal therefore provides that the creditor should have a right of access to inspect whether it is well preserved. France has a similar regime derived from Consumer Protection Law and from (with a different scope) French Civil Code[247].

- The valuation process itself may also create misunderstanding and moral hazard. In the proposal we refer to above, submitted by the industry to Government in Belgium, it is intended that an independent expert be appointed (before completion) by both parties to value the property. Further specifications would be necessary as to the qualifications of the expert.

b) Creditworthiness of the customer

- While recent legislation, notably Directive 2008/48/EC, now requires, where necessary, consultation of a database on the creditworthiness of borrowers in the consumer credit context, excluding mortgage loans, national legislation does not usually provide for a duty to inform in relation to the "creditworthiness" of real estate. Risks in this situation include the risk that, where a sale realises insufficient funds, the borrower or his heirs may be left with the burden of paying the balance.[248]

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[246] See Section D.III.2.a) above (on p.75).

[247] See Part II: Country Reports IV. France (p.58).

[248] Martín, Z. *La nueva normativa reguladora de la hipoteca inversa*, in Revista Crítica de Derecho Inmobiliario, (2008), pp.1275-1317.

c) Interest rates variations.

- This risk of interest rate variations falls mainly to the providers in countries such as UK where interest rates are fixed for life in all products. In countries like the Netherlands and Finland, where consumers have to pay interest according to a variable rate, the risk lies with the borrower.

d) Longevity and disappearance of the borrower.

- While the above three risks also apply to conventional mortgages, this is an additional risk factor. Experts have pointed to other risks beyond longevity. For instance, the possibility that the mortgagor just disappears. This is a situation which is increasingly common among elderly people[249].

2. Transfer of title

Loan Model ERS does not imply the upfront transfer of title. Ownership is transferred upon termination and usually upon the death of the beneficiary or beneficiaries. In all cases, and particularly when a very significant amount of debt has accrued, it is unlikely that the heirs will wish to cancel the mortgage by paying to recover the real estate. This leaves the financial institution with the task of maintaining or selling the asset.

Sale Model ERS, imply early transfer of the title. In case of non-fulfilment of the life annuity obligations as a result of the buyer/provider's insolvency, the vendor bears the risk of being left without a home and without a pension. This is illustrated by the regulation in Art 1805 of Spanish Civil Code. It provides that non-payment of life annuities does not entitle the vendor to recover capital or immovable assets which had been transferred upon the completion of the contract in consideration for the lifetime income.

3. Transfer of sureties

A further problem may arise in connection with the transfer of sureties in Loan Model schemes. In reverse mortgages, the borrower transfers the security to the lender. The lender may acquire the ability to deal in that security, for example by selling it to third parties in countries where there is no direct link between the mortgage and the loan. A mortgage may thus be taken out at the time the loan is made for the expected maximum amount of the loan and be traded at that value before the borrower has drawn down the full amount. In Germany, where this problem has arisen, legislation has recently been introduced to prevent these unwanted sales of the surety alone.[250]

Member States in which the surety can be transferred to a new lender include Belgium, Germany, Greece (only by assignment of the claim, whereby as a result of "accessoriness", the mortgage is transferred *ipso jure* to the assignee), Spain, France (possible but generally a new mortgage is taken out), Hungary, Italy, the Netherlands (possible but a new mortgage is nearly always created), Austria, Portugal, Finland and Sweden. Of these, both Germany and Sweden make the mortgage subject to the agreement of the parties concerned, whereas Belgium, Greece, Spain, France and Italy do not. In Denmark, Ireland, Poland and the United Kingdom, the surety cannot be transferred to the new lender and the borrower must take out a new mortgage. In Hungary, with its *önálló zálogjog* (i.e. the independent/non-accessory mortgage lien), the

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[249] See Silvestre, JA Miquel *Hipoteca inversa, algunas hipótesis de conflicto*, Diario la ley n. 6924, 14 April 2008, ref D-116.

[250] See Risikobegrenzungsgesetz (Law to Limit Risks in Capital Markets) Printed Matter of the German Bundestag (BT-Drucks) 16/7438.

system is the same as in Germany before the new legislation was introduced. In Poland, the bill on the *dug gruntowy* aims at establishing mortgage collateral, which would allow for flexibility similar to the German and Hungarian systems.

4. Mortgages for future debt

In ordinary mortgage loans, the debt is biggest at the beginning of the contract. In ERS, this is reversed. Thus, a mortgage that will cover future debts must be created. If this possibility is restricted by national law, this may create an obstacle to Loan Model ERS.

According to the European Mortgage Federation, in approximately half of EU Member States (15), a mortgage may be granted in respect of "existing and future debts" or "for all debts". Conditions are often attached, as is now the case in France, where the future debt must be specified.

As specified in the national reports sections on the legal situation, some countries have rules stipulating that all debts be held by one single lender, including Belgium, Germany, Greece (Greece allows mortgages in respect of future debts but a mortgage can only guarantee a specific debt, existing or future), Spain (the future debt must be determined "maximum amount of credit, term, etc." in the mortgage contract[251]), Hungary, Ireland, Italy, France, the Netherlands, Austria, Poland, Finland and the United Kingdom.

VIII. Bankruptcy law

1. Safety of assets in case of bank bankruptcy

In Loan Model schemes, upon bankruptcy of the lender, the borrower may lose entitlement to future payments and with it his or her pension while the security remains part of the assets of the bank in bankruptcy.

In most countries, such as France, Greece, Bulgaria, Portugal or Spain, the mortgage is linked to the value of the loan. This does not pose a significant problem, since it restricts the title the creditors of the bank can use for liquidation to the effective value of the consumer's debt. In these cases, the main concern associated with bankruptcy is that the expected payments under the ERS will not be made.

These concerns have been voiced by consumer organisations[252] because it threatens the security of the payments in old age. In countries where the credit provision is not a bank monopoly, the guarantee of future payments may become a problem.

Compared with other private pensions where, for example, special funds guarantee the total amount of the sum invested in a pension and, of course, compared with public pension schemes, a Loan Model ERS may thus provide less security and homeowners may fear to lose both home and pension.

In Sale Model schemes, bankruptcy poses a higher risk for the consumer. The title has been released and consumer will be left with no priority claim and bank guarantee schemes do not apply[253].

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[251] Art 153 Bis Mortgage Law introduced by Law 41/2007.

[252] See, for instance Finland Country Report Part II: Country Reports VII.6.a) Finland (p.98).

[253] This is further illustrated in the section related to legal barriers (on p.95) as well as in country reports such as Spain or Malta.

2. Debt recovery in case of depreciation of home and consumer bankruptcy

Fluctuations in real estate prices and longevity, together with the existence of either Loan Model or Sale Model ERS, contracted on a lifelong basis, bring along the possibility that providers may have to deal with negative equity. These problems are increased by consumer protection clauses inserted in some legislation. As explained above, in France, if the value of the property on eventual sale is less than the total sum of the outstanding debt, this difference will not be transferred to the beneficiaries of the inheritance and if the value of the debt exceeds the value of the property, the bank will not be able to require additional funds.[254] This may affect profitability, and thus create a barrier. A similar rule exists in Spain, although there the limit (only in ERS, a subtype of the Mortgage Model as regulated by law 41/2007) is the deceased's estate[255] If there is negative equity, in all Loan Model schemes there remains the personal liability of the owner or his or her heirs. It may even give rise to early cancellation of the contract by the bank if house prices fall below LTV limits and the consumer is not creditworthy enough to continue.

The idea that ERS guarantees a lifelong payment may thus be jeopardised by market developments for which the law cannot compensate.

IX. Summary

1. The use property in the form of real estate to help meet the financial needs of elderly citizens and to increase the funds available to them has been provided by concepts such as "life rent", which are found in nineteenth century Civil Law Codes, or as provision for the lifetime of a beneficiary under Common Law. These concepts have largely fallen into disuse in the modern welfare state. Since private pension schemes have become more significant, and more and more people have become homeowners by means of credit secured through mortgages, the idea of equity release has also entered legal systems where amortisation of the loan, personal liability of the borrower and time limits for the duration of the loan remain central to some regulatory schemes.

2. Several different developments have occurred in law. In the UK and Ireland, whose legal systems are based on common law, ERS have already spread and gained a significant market. These countries have developed their own regulatory body, in which mortgage as well as pension legislation has been adapted to the special features, risks and needs of products which "reverse" expectations of what an ordinary mortgage loan is, especially in contract and consumer law. Their involvement concerns consumer protection issues, and duties to provide information in particular.

France and Spain have instead developed an active interest in facilitating such schemes within their legal framework which, as is the case in many civil law countries, has been somewhat hostile to loans which "eat up" the value of a home instead of building it up. This legislation does not merely liberalise credit law. It incentivises the use of ERS, for example by providing tax benefits and subsidies if certain criteria are met with an obvious intention to protect consumers. Such indirect rules affect the market by privileging certain ERS products, which are therefore used more often.

All other countries deal with ERS within their general civil and administrative law.

3. Tax law is seen as the most problematic area of ERS regulation. Stamp duties and notary fees are sometimes so significant that they make such schemes too costly for

[254] The maximum compensation for early redemption to the provider is fixed by decree by art. R. 314-2 of the consumer code.

[255] Spanish Law 41/2007.

consumers and providers. Another problem is the release of equity which may be subject to income tax. This applies especially to the Sale Model ERS. A number of countries support homeownership by exempting mortgage payments from income tax in the same way as payments into private pension schemes. ERS usually does not qualify for either of these tax exemptions, since these loans do not give access to homeownership, instead but offering an exit from it. The pension taken from the equity of a home does not consist of designated savings from income. Although they amount to part of a payment from a loan, these pensions may even be taxed if the equity had been built up within a state supported pension scheme.

4. As Sale Model ERS fall within the law governing sales and leasing, sometimes combined with insurance law, it does not pose specific problems and does not tend to be very diverse in nature. The sale of property is not subject to substantive restrictions and there is no concept of sellers needing specific legal protection from purchasers. There is also no idea that such sellers may be in need of special supervisory arrangements comparable to Financial Services Supervision, although in this respect a country like Spain, which has created special legislation, views such schemes as financial services. In general terms, however, there are no significant legal barriers. There are indirect problems with tax law, since the Sale Model, unlike the Loan Model, forces the homeowner into the early sale of a home in which the increasing equity would otherwise have remained dormant for taxation purposes until death. Some countries may tax such an increase on liquidation.

5. On the other hand, the more widespread and modern form of ERS, the Loan Models, share the wide diversity that still characterises the law governing mortgages and home loans.

a) Banking supervision law, which has not yet been harmonised as it relates to the extension of credit, has developed different regimes. In some countries, a banking licence is required, with the result that all Loan Model ERS are subject to the full supervisory regime, and they are subject to into banking law (Austria, France, Germany, Greece, Portugal, Slovakia, with a special permission for credit unions in Poland). Most Member States require a formal notification, registration or authorisation for non-banks, combined with special supervision. Only Cyprus, the Czech Republic, Denmark, Estonia, Finland and Latvia allow mortgage lending without such arrangements, but even non-banks have not been identified in this area. This may be due to the restrictions on accessing refinancing where the market is much more regulated and supervised.

Some countries require an additional insurance licence for ERS, since annuities are seen as payments under uncertainty, which is often complied with through the split of ERS into two products, the loan and the annuity, and the ERS product is then sold in collaboration with an insurance company.

b) In civil law, only Belgium has regulated the traditional form of mortgages in such a way as to impede ERS in principle. On the other hand, the Netherlands for example has defined the mortgage loans for which it provides special consumer protection by the purpose of the home loan. This makes such rules not applicable to ERS.

Most regulations concerning ERS mainly protect consumers through duties to disclose information in the marketing, and through additional advice at the pre-contractual and contractual stage. While some Member States apply the Consumer Credit Directive to ERS, others have laws with similar contents but outside its framework. The European Code of Conduct on Home Loans overlaps with many of these rules. A special body of self-regulation and decrees exists in the UK, where the FSA is the most significant regulator.

c) While in general the reversion of the mortgage does not significantly change the form and contents of the requisite information in order to enable adequate choice, some duties would require adaptation, especially where the legislator forbids excessive lending and requires restrictions on the amount of credit available. Responsible lending must be seen differently where the loan is not required to be repaid from of the borrower's regular income. At the same time, the target group for the information may be too narrow if the specific problems of ERS as they affect the family and heirs are taken into account.

d) A special barrier to ERS lies in the principle of Anatocism where it applies, since compounding interest is one of the core features of ERS and conflicts with the interdiction against charging interest on interest. Another core feature of Loan Model ERS is their link to the lifetime of the borrower which, on the other hand, implies a restriction on early termination. Since all countries have rules facilitating early termination and limiting fees and indemnities, the use of that freedom could significantly affect the calculation of its return.

6. As far as the legal regime for sureties is concerned, Loan Model ERS share the problems of diversity with all mortgage loans. This has particular significance for ERS where, as is the case in Germany and Austria, a mortgage provides for an independent second claim not linked to the size of the outstanding debt of the loan and separately tradable. Although these problems can be limited through contractual links, abuse is not excluded and may require special trust which, again, may act as a barrier where non-banks are allowed to make the loans.

Some countries also have general restrictions on securing future debt. In this case, the reverse character of Loan Model ERS, where the loan is built up instead of being repaid, may make additional securitisation necessary.

7. A last set of problems arises from insolvency and bankruptcy law. The insolvency of the provider will directly affect the intended pension. In addition, detached mortgage systems may even auction the home without giving the consumer the full amount of the loan secured. In Member States where non-banks are active and are not part of any collective insolvency protection scheme, the risk for the retirement pension is visible and may discourage consumers from entrusting their home to a bank.