HM TREASURY

Post-legislative assessment of the Financial Services (Land Transactions) Act 2005:

Memorandum to the Treasury Committee

Cm 8156

September 2011

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the Economic Secretary to the Treasury
by Command of Her Majesty

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1 Memorandum to the Treasury Committee

Introduction

1.1 This memorandum has been prepared by the Treasury for submission to the Treasury Committee and will be published as part of the post-legislative scrutiny process set out in Command Paper 7320: Post-legislative scrutiny – the Government's approach.

1.2 The Financial Services (Land Transactions) Act 2005 ("the Act") received Royal Assent on 19 December 2005 and came into effect two months after being passed.

1.3 The Act extends to England and Wales, Scotland and Northern Ireland.

Summary of the objectives of the Act

1.4 The purpose of the Act is to enable activities relating to financial arrangements involving the acquisition or disposal of land to be specified as "regulated activities" under section 22 of the Financial Services and Markets Act 2000 ("FSMA"), and hence to be brought under Financial Services Authority (FSA) regulation.

1.5 More specifically, it brought home reversion plans[1] and home purchase plans[2] into the scope of FSA regulation.

1.6 Concerns had been raised about home reversion plans because the products are complicated and their consequences extend for many years into the future, and most of them are sold to elderly people, often those in financial need. Further to this, the profits made by the providers of these products had seemed disproportionate.

1.7 Home purchase plans were brought under FSA regulation in order to address anomalies in the levels of consumer protection between standard mortgages and equivalent Sharia-compliant products, which have the same purpose and outcome.

Implementation and secondary legislation

1.8 The Act has been implemented by the FSA, through a regulatory regime that began on 6 April 2007.

1.9 There have been no post-legislative reviews or assessments of the Act. However, the FSA will carry out a post-implementation review of their regulation in due course, once any changes made as a result of the current Mortgage Market Review have been in force long enough to clearly inform such a study.

[1] A typical home reversion plan is an arrangement whereby a homeowner sells all or part of his house in return for a lump sum and/or income, and continues to live in the house for life with little or no rent to pay.

[2] Home purchase plans are a type of Sharia compliant product. Often referred to as Ijara or diminishing Musharakah products, the contract is an arrangement whereby the scheme provider buys a property and rents it to the customer over a term. The customer also pays the original purchase price over the same term and acquires ownership at the end of that term.

Preliminary assessment of the Act

1.10 The costs of the extension of the FSA's regulatory powers to include home reversion plans were initially estimated as a one-off compliance cost of approximately £11million and ongoing annual costs to the industry of approximately £5million. The cost to the FSA was estimated to be negligible.[3]

1.11 Following further market analysis, in their April 2006 Consultation Paper[4] the FSA estimated the costs to be a one-off compliance cost to the industry of approximately £1,490,000 and ongoing annual costs to the industry to be approximately £400,000.

1.12 Responses to the FSA's consultation supported these figures, so the Treasury's final Regulatory Impact Assessment in September 2006[5] used the FSA's lower figures, as set out in Table 1.A below.

Table 1.A:

Summary of revised costs (£)	HRPs	HPPs	HRP + HPP
One off costs	1,492,000	340,000	1,832,000
Recurring costs	401,000	10,000	411,000
Total first year costs	1,893,000	350,000	2,243,000

1.13 Eighteen providers of home reversion plans were active when regulation began. This number has gradually dropped and by the end of 2010 only seven providers were active. One new entrant has been authorised in 2011, which means that there are now eight active providers. Most offer two reversion products: a 100 per cent reversion lump sum only, or a more flexible alternative.

1.14 Six providers of home purchase plans were active when regulation came into force. One withdrew at the end of 2009 and the remaining five providers have remained in the market. Four have only one home purchase plan product available, while one also provides a 'rent only' product (designed as the Sharia alternative to a buy to let mortgage).

1.15 This decrease in the number of providers of both products has been in line with the decrease in activity in the mortgage market since 2007. It means that the costs to industry of FSA regulation have probably been smaller than anticipated. The FSA has not taken any enforcement action involving either product since regulation began.

1.16 The benefits of FSA regulation have been as foreseen in the 2004 consultation document:

- reduced confusion for customers wanting to make a fair comparison between products offering broadly similar benefits;
- providers ensuring an accurate, independent property valuation;

[3] The November 2003 HM Treasury consultation document 'Regulating Home Reversion Plans' and accompanying Regulatory Impact Assessment is available at: http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/con_reg_home_rev.htm

[4] The April 2006 FSA consultation and cost benefit analysis 'Regulation of Home Reversion and Home Purchase Plans' is available at http://www.fsa.gov.uk/pubs/cp/cp06_08.pdf

[5] The September 2006 HM Treasury paper 'Secondary legislation for the regulation of Home Reversion and Home Purchase Plans: A final regulatory impact assessment' is available at http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/ria_homereversion_130906.pdf

- consumers having access to the Financial Ombudsman and Financial Services Compensation Schemes; and
- the avoidance of regulatory arbitrage.

1.17 Additional benefits for the home reversion market have been:

- the provision of advice during the sales process in relation to an individual's tax and benefit position;
- reduced information asymmetry between the reversion provider and the consumer through greater information and disclosure requirements; and
- all equity release products being subject to the same regulatory regime, creating a level regulatory playing field for firms.

Conclusion

1.18 The benefits of FSA regulation of home reversion plans and home purchase plans are hard to quantify, as they centre on increased levels of consumer protection and information; recourse to the Financial Ombudsman Service when things go wrong; reduced opportunities for regulatory arbitrage; and maintaining a level playing field between alternative and conventional financial products.

1.19 Both products are long term, therefore complaints and evidence of consumer detriment may be slow to emerge. However to date no serious issues have come to light. Regulation generates increased consumer confidence, which is often seen as a benefit. Industry and consumer groups welcomed FSA regulation of these products.

1.20 The costs of regulation are small, particularly given the small number of providers active in these two areas.

1.21 The Government therefore considers that the reforms made by the Act have been effective without imposing significant costs.

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