Equity Release Council response to the Balance of Competences review: *Single Market – Financial Services and the Free Movement of Capital*

Introduction

- The Equity Release Council is the industry body for the equity release sector. Born from an expansion of the remit of SHIP (formerly Safe Home Income Plans), the Equity Release Council represents the providers, qualified financial advisors, lawyers, intermediaries and surveyors who work in the equity release sector. The Council has just under 300 members, representing some 90% of the market. Through its independent Standards Board, The Council requires its members to adopt its Rules and Guidance for the protection of consumers.

- The Equity Release Council is grateful for the opportunity to respond to HM Treasury's consultation in the field of financial services as part of the Review of the Balance of Competences.

- This response first discusses the role of equity release in enabling older people to support themselves in retirement, briefly outlines the relationship between the provider members of the equity release sector and domestic regulators, before discussing particular concerns with the Solvency II Directive, highlighting several issues relating to the competency of the EU in this area and the influence of the UK.

- The Council's response particularly addresses questions relating to how EU rules have affected the equity release sector; the principle of subsidiarity; the detail of EU rule-making; the shift towards regulation and supervision at the EU level; the level of influence of the UK; and the effectiveness and accountability of the EU policy-making process.

Background

1. The challenge of the elderly being able to "support themselves" in retirement is becoming an ever increasing concern. In the UK, many have saved, contributed to pensions or been members of pension schemes. However, there is a considerable number where the main (only) asset has been the purchase of their property. This property does provide, in retirement, a "rent free" home, security and peace of mind. The challenges for the elderly are the "pension gap"; that they are living longer; that they may retire with some debt and they individually are funding long term care. A means of "safe" access to drawing an income based on their property so they can continue to work part time, pay for home improvements or supplement a pension shortfall is becoming a more "normalised" consideration for elderly home owners. It is not right for everyone, but for a proportion of the population it makes a significant enhancement to their life and independence.

2. In the UK, the majority of "safe" equity release is provided by firms who are Equity Release Council members (see the Towers Watson report for further detail[1]). At the same time, many of these firms are relatively small, innovative insurance firms, compared to the European insurance giants. In order to address a key consumer demand, safeguards and consumer protection standards have been put in place that exceed regulatory requirements. It is worth pointing out that the consumer feedback enjoys the "highest net promoter" scores of any financial services product.

3. The challenge this industry / market has faced has been that its funding is through the prudent risk management processes of insurance firms who have found in providing the funds for equity release for these consumers they can "match" the assets against long-term insurance liabilities, thus providing an economic risk management benefit to providing annuities to pensioners and equity release to another group of pensioners. This has all worked very well and has been totally acceptable to UK regulators. However, in the development of the Solvency II Directive, some challenges have emerged from an EU perspective, which appears disproportionate, anti-innovation, damaging to competition and unhelpful for UK (and EU) in the development of solutions to the EU ageing population challenge.

4. The House of Lords Select Committee on Public Service and Demographic Change, in its report *Ready for Ageing?*[2] (Appendix 2) said, "an effective equity release market to unlock housing assets held by older people is important."[3] The Committee went on to recommend that "the Government elected in 2015 should, within six months, establish two commissions based on cross-party consultations: one to work with employers and financial services providers to examine how to improve pensions, savings and equity release, and one to analyse how the health and social care system and its funding should be changed to serve the needs of our ageing population."[4] It said that "the Government should work with the financial services industry to encourage the growth of a safe and easy-to-understand equity release market."[5] These recommendations can only be realised if the challenges posed by Solvency II to the UK's equity release market can be successfully overcome.

The Council's concerns in relation to the Solvency II Directive

How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

1. The insurance sector in the UK has expended considerable effort in looking to develop a workable Directive. Some have estimated the cost to industry has been over £2bn in getting ready, with more over the next two years.

[1] *Equity release: Accessing housing wealth in retirement*. Towers Watson, 2013. http://www.towerswatson.com/en-BE/Insights/IC-Types/Ad-hoc-Point-of-View/2013/06/Equity-release-Accessing-housing-wealth-in-retirement
[2] *Ready for Ageing?*, House of Lords Select Committee on Public Service and Demographic Change, March2013. http://www.publications.parliament.uk/pa/ld201213/ldselect/ldpublic/140/140.pdf
[3] Op cit, page 15, paragraph 41
[4] Op cit, page 17, paragraph 56
[5] Op cit., page 45, paragraph 143

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2. Insurance firms who fund equity release have had to make considerable efforts to seek to explain the consequences of any 'poor' interpretation of the draft Directive. Suggestions were put forward to amend the draft article wording about "fixed" cash flows to wording such as "demonstrably predictable to match the cash-flows of the portfolio of obligations", but these were rejected at the trilogue stage. The potentially poor interpretation of the text could materially undermine the economic value of providing these products to the elderly, increase risk to insurance firms by not having available greater asset diversification, push up costs to annuitants and reduce competition and choice.

3. The overall aim of Solvency II, i.e. effective risk and capital management, is duly supported, but there appears to be a disproportionate application which does not recognise the value of approaches / assets which may not be used in other EU countries. It appears not to respect the concept of subsidiarity or the fact that what may be relevant in one territory does not necessarily need to apply in all.

How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?

4. It is clear from work via the European Pension and Property Asset Release Group (EPPARG) that many firms across the EU have been exploring or looking to develop products which allow the elderly to stay in their homes and draw an income from this asset. Working with some parts of the European Commission, there has been a constructive dialogue on how this kind of product could be developed to enable the home owning elderly to draw an income from their home.

5. From a commercial perspective, UK firms had been in a position to play a leadership role in developing new markets, products and providing funding to developing firms across the EU. However, the uncertainty and potentially unhelpful interpretation of ER assets as an admissible asset for the Matching Adjustment has resulted in these opportunities being re-evaluated.

6. There seems to be a case for the EU to limit its treatment to very material risks to the market, rather than over legislate to the point that new or different ideas are stifled.

7. With regard to equity release, the UK would benefit from an ability for prudential rules to be adaptable to local markets. As we have said above, UK regulators have for many years accepted equity release mortgage as a suitable asset for matching the long-term cash flows of pension annuity products. The intervention of the EU through the Solvency II initiative, places that situation, and the equity release market itself, at risk. Many major European countries are unfamiliar with equity release mortgages. However, that lack of familiarity should not mean that they will be any less suitable as matching assets in the UK, so we would look for a more flexible approach from the EU as the negotiations on the Level 2 text proceed, although such flexibility is by no means assured.

How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?

8. In many respects, EU rules on financial services regulation have followed the UK, rather than led the agenda. The UK has for some years had a risk-sensitive approach to the capital requirements of insurers. The EU's Solvency II initiative has sought to bring consistency across Europe by extending that risk-sensitive approach. However, the potentially disproportionately narrow range of admissible assets for the matching of long-term insurance liabilities, as described above, will make the provision of equity release mortgages by insurance companies much less viable than it has been.

9. From the point of view of consumer protection, as mentioned above, equity release is the financial product with the highest rate of post-sale satisfaction. The current draft of the Solvency II Directive risks removing this much needed and much appreciated product from the range of financial solutions available to consumers, working against, rather than in the interests of consumer protection.

Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?

10. The EU rule-making in financial services does not appear to be set at the right level and seems to ignore many national, economic and social differences in an approach to get a "one size fits all" into the current environment. This tends to reduce innovation, favour super-large and influential firms and reduce the opportunity of improved local consumer solutions and competition. Most, if not all, innovation in equity release has come from smaller firms and new entrants who are most able to adapt to the needs of local markets, but who also are most at risk from the EU's "one size fits all" approach.

How has the EU's approach to Third Country access affected the ability of UK firms and markets to trade internationally?

11. The EU's approach to third country access may have been modified in the short-term, but the uncertainty remains and therefore it is always going to pose a threat and inhibit long-term investment. For some firms, the prospect of working outside the EU orbit may seem increasingly attractive.

Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers?

12. The issue for consumers is not necessarily the quantity of EU regulation but its quality and the extent to which it allows for appropriate flexibility for national markets. The difficulties of defining a "third pillar" retirement product[6] in the EU demonstrate the

[6] *Consumer Protection in Third Pillar Retirement Products*, European Commission, April 2013.
http://ec.europa.eu/dgs/health_consumer/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf

problems for developing EU-wide rules in relation to retail financial services products. This difficulty also feeds through to the difficulties in regulating those products in an appropriate manner. The issue for equity release providers is that the potential for consumer benefits may be stifled by inappropriate regulation or an inappropriate application of otherwise worthwhile regulation.

13. In some areas it is possible that a segment of consumers would benefit from cross EU level retail financial regulation and if some of these regulations were "comply or explain" it may be possible for the evolution of some products and services to be safely developed, based on sharing good practice. However, it is unclear at UK level why adding another layer of retail regulation on top of leading-edge regulatory supervision via PRA and FCA would be beneficial or even cost effective.

14. In the UK, the FSA and now the FCA have worked effectively with SHIP (Safe Home Income Plans), the predecessor to the Equity Release Council, to help rebuild confidence in equity release as a useful and trusted financial solution. The increasing influence of the EU makes that local cooperation more difficult because the UK's regulatory agenda is driven by EU-wide issues, which are not necessarily those of the greatest relevance here. The EU's focus should be those high-level factors that impact on the single market, rather than the granular, local matters best resolved at the national level.

What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different?

15. The impact of the shift towards Europe has been to increase the regulatory overhead. For example, it has become necessary to form a European organisation, the European Pension and Property Asset Release Group, to operate at the European level, alongside the UK Equity Release Council's work in its home country, in order to ensure that the potential benefits of equity release are more widely understood and its place within a range of retirement income solutions is not overlooked. As a leader in innovation in financial services, there is a risk that the UK's market may be held back by increasing European influence over the regulatory agenda. The creation of the European Supervisory Authorities (ESAs) may therefore not be beneficial for the UK in one sense. On the other hand, if EIOPA is able to ensure a consistent approach to insurance regulation across Europe, it removes the risk that less well regulated companies are able to achieve a competitive advantage in the UK simply through regulatory arbitrage.

16. The drivers for a shift towards regulation and supervision at an EU level need to be understood. In some areas where there is a homogenous market or pan-European material risk there would appear to be a case for a proportionate level of regulation and oversight, but what is key is that we do not lose sight of the 'purpose' for consumers of a healthy financial services market and generally the best way for a proportionate approach risk to be addressed which does not over-regulate or damage growth could be for regulatory priority.

17. There is a potential risk of "super" regulators and supervision of supervision and that is the potential for regulatory creep and markets being held back by regulatory risk appetite.

Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?

18. Solvency II has shown that the UK can have influence on EU financial services legislation. MEPs Sharon Bowles and Peter Skinner have both been open to and supportive of the UK's position during the difficult and protracted discussions on the Omnibus II text. The PRA and FCA are both well represented on appropriate committees and other regulatory bodies. If rules were set only at the UK level they would clearly be more immediately tailored to our local market. If, however, the EU is willing to take proper account of the diversity of markets within it regulatory sphere, there should be no reason why rules coming from Europe should adversely affect either business or consumer interests here.

19. Another issue is the operation of the trilogue system in the wake of the Lisbon Treaty. We believe that in the case of complex legislation like Solvency II the trilogue system does not work optimally. As mentioned above, we have been fortunate that a handful of MEPs have been willing to become expert in the subject. But for the vast majority this remains a closed book, resulting in a democratic deficit. On a wider basis, we believe HMG should revisit the trilogue procedure with other member states, to see whether it can be improved or replaced.

20. Of course the influence of Europe is not confined to legislation. The Test-Achats case on the use of gender as an underwriting criterion for insurance arose not from financial services legislation, but from the application of equality legislation to existing financial services regulation. The UK's influence must therefore extend across the range of legislation, not only financial services legislation, to ensure that all market participants in financial services, whether consumer, provider or intermediary, are well served.

21. Considering that the UK has been regarded globally as a leading financial services centre and in the insurance sector highly respected for its risk management capabilities it feels that it should have a greater level of influence.

How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that democratic due process is properly respected?

22. The effectiveness of impact assessments is hard to judge. What has been extraordinary has been the use of an "impact assessment" as a solution to a "political impasse" in the trilogue process, i.e. to keep the file moving. Some may have suggested this should have been conducted at the outset and maybe the period from assessment used to better develop the Directive text and appropriate application. It is also unclear how EIOPA's own risk appetite and remit works in the context of providing input to the process.

23. One issue with the Long Term Guarantee Assessment exercise conducted by EIOPA during the spring and early summer of 2013 was that it was too detailed and too prescriptive. In a sense, it did not allow firms the opportunity to put forward their ideas or their true opinions. They were faced with complex technical specifications of multiple scenarios

which were labour-intensive but, in the end, only answered the questions on EIOPAs agenda. The assessment was intended to resolve the question of how to deal with products offering long-term guarantees, but its results were not universally accepted. Real agreement took face-to-face negotiation over several more months. In the end, the European Parliament will decide, perhaps evidence that due democratic process is respected.

24. Having said that, the perhaps unintended consequences for equity release, of the Solvency II matching adjustment proposals, should not be lost in the general relief of agreement on the Level 1 text. It remains important that the Level 2 and Level 3 texts are equally determined through appropriately democratic means that are based on an understanding of all the consequences.

Conclusion

25. In summary, we believe that the equity release sector in the UK – growing in its importance for older people – has not been able to make its concerns heard. This is a function of the size of our market (roughly £1 billion per annum) compared for example to the annuities market. But it is also a function of equity release not (yet) being applied in some other EU member states.

26. These concerns raise legitimate questions about current approaches to pan-European legislation if a well-regulated and socially and economically useful business model can suffer "collateral damage" in this way.

27. The Council would be happy to discuss these issues in more detail with officials if it were to be helpful.