



THE SEARCH FOR INCOME

The relationship between financial planners and debt has always been troublesome, and in the realm of equity release products the story is no different. But as the financial downturn has reduced retirees' savings and people continue to live longer, these products might have to be considered more seriously.

Wouter Klijn reports.

"The family home should be under advice," Senior Australians Equity Release Association of Lenders (SEQUAL) chief executive Kevin Conlon says in a tone that reveals both passion and frustration.

Conlon has been speaking for over an hour at a dazzling pace and has now reached the crux of his argument.

"For too long in this country, planners have ignored the family home," he says.

"They are not even considering the family home as existing exposure to property. They go to construct a balanced portfolio of investments, but have no regards for the fact that 70 per cent of [clients'] wealth is already tied to the property market."

Financial planners' hesitance to include the primary residence of clients in developing investment strategies has been a long tradition, he says. "There is a legacy of advice where [financial planners] encouraged their clients to own their own home and they have been part of the process of what has resulted in their customers being overweighted in property. It is difficult to unwind that approach," he says.

But the global financial crisis and the subsequent tumbling share prices have caused a reduction in the superannuation savings of Australians who are either close to retirement or have just retired. For a number of retirees this has meant returning to work or scaling down their lifestyle expenditure. Those close to retirement will probably have to work for longer than they expected.

For a small group of people it meant they had to sell their home in order to free up money to live

KEVIN CONLON



on. But for this last group, equity release products, such as reverse mortgages, could help them in putting off the dramatic move to leave their home and allow them to use some of the value of their home to supplement their income.

NOT MY CUP OF TEA

Conlon's remarks reflect the low participation rate of financial planners in the reverse mortgages industry. But their lack of interest in equity release products is complex and has as much to do with the product as with planners' expertise.

Reverses mortgages have been around for almost half a century. The first of these loans was written in 1961 by Nelson Haynes of Deering Saving and Loan Association in the United States city of Portland, Maine. Haynes wanted to help Nellie Young, the financially troubled widow of his high school football coach, and drew up a contract that allowed her to borrow money against the value of her house, but did not require her to pay interest until after her death.

The product remained fairly obscure in the years after the contract was drawn up, largely due to the substantial risks for providers. After all, they would not know how long the loan would run for and the market for these products consisted of mainly cash-poor people without jobs. This made funding of the products difficult.

In the 1980s, the industry received a boost when the US Congress created a government-backed insurance program for reverse mortgages, which took away most of the risk for providers. As reverse mortgages became more commonly used in the US, other countries gradually adopted similar practices, most notably the United Kingdom.

But from the start the reverse mortgage industry struggled with image problems due

to malpractices by providers. In the 1980s, a number of pensioners were faced with losing their homes as the size of the debt had overtaken the value of their property, which served as collateral for the loan.

In the UK the reverse mortgage market grew rapidly around the start of this millennium, but also quickly gained a negative image there. Consumer groups warned of aggressive sales tactics in which reverse mortgages were portrayed as an easy way to fund travelling or other lifestyle choices, and which targeted vulnerable consumers.

Critics also castigated the high costs associated with these loans, and warned a loan of about 25 per cent of the value of a house would amount to almost the full value of the property over the course of a 25-year term. However, the precise rate at which the equity in a home diminishes depends on a number of factors, including the age of the borrower, the size of the loan, changes in house prices and interest rates.

These issues have contributed to a negative image of the product, but there are also more practical reasons why financial planners in particular have not been keen to advise on these products. Debt is not a field of expertise for most planners. The only time when they deal with this is when money is borrowed to invest, for example, through margin loans or limited recourse loans of structured products.

"Planners by natural instinct are cautious about debt in any form, especially debt that does not contribute to asset growth or tax deductibility," FPA deputy chief executive and head of professionalism Deen Sanders says.

Advice on reverse mortgages is also not highly lucrative. With an average reverse mortgage loan size of \$65,000 in Australia, the revenue that can be generated from these products is relatively low, especially because planners often need to have multiple meetings with clients to explain the workings of these complex products and the impact they will have on their finances. Although planners are not solely led by the level of fees, this does little to make reverse mortgages more attractive to them.

INTEREST INCREASES

It is safe to say the relationship between financial advisers and the reverse mortgages industry has been problematic.

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Planners were, therefore, rather surprised when clients started to raise the topic themselves at the beginning of the millennium.

Deloitte Actuaries & Consultants partner James Hickey – who has been researching the industry for SEQUAL and former reverse mortgage provider Bluestone for several years – says around mid-2000 financial planners saw more interest in the product than they expected. “Clients were hearing about these products through various media outlets and dealer groups were more or less forced to have a look at reverse mortgages,” Hickey says.

Since 2006, most large dealer groups have been conducting their own research into the industry and this has led them to believe there is value in these loans for their clients. “We did a lot of work through to 2007 to establish whether it was a product that we wanted to give advice on and to go through all the different products in the marketplace to work out the product we thought was the best for consumers,” Suncorp Wealth Management executive general manager of advice solutions David Carter says.

“In our advice businesses of Guardian Financial Planning and Cameron Walshe, we authorise financial advisers who do meet certain criteria to give advice on reverse mortgages and we’ve got one product as an approved product.”

Lonsdale was also among the dealer groups that initiated their own research. “Reverse mortgages is something that we started discussing four or five years ago, thinking there would be a general market for it,” Lonsdale chief executive Mario Modica says.

Deloitte's research shows the size of the Australian market has grown to \$2.5 billion by the end of December 2008. The second half of 2006 showed an especially high rate of money drawn down through reverse mortgages, at more than \$300 million, but drawdowns have decreased since then.

Most people who have taken up a reverse mortgage use the loan for home improvements or to provide them with an income stream. But often the purpose of the loan is not recorded and data on the use of the loans is patchy at best, acknowledges Hickey.

He says reverse mortgage are a sensible

strategy for temporary cash problems. In the current environment, retirees could for example consider using a reverse mortgage to supplement their income rather than eating further into their super savings. “You don’t have to sell your property, you don’t have to pull money out of your super and crystallise your losses,” he says.

“You can pull equity out of your home at a time where the interest rates are the lowest they have been for a long time.”

The select few planners who have been using reverse mortgages since they started to look into the product also agree they are a suitable strategy for when people are moving into aged care or enter into assisted living arrangements, and are likely to sell their home anyway. This gives them more control over the timing of the sale of the house and often smoothes the transition to permanent aged care, both financially and emotionally.

The FPA recognises the potential of an equity release strategy in financial advice.

“When we talk to members about equity release strategies, they do assure us that they see real opportunity in these products for their clients,” Sanders says.

“We are confident that planners will recognise that for the right client these strategies may in fact be quite beneficial to them. Our interest is to make sure that it’s in the full context of client need and care.”

But he says the association’s support applies more to the strategy of equity release rather than to the products currently available in the market. “Members tell us reverse mortgage strategies work really well, but there is some caution about equity release products. I think there is some caution around any form of debt,” he says.

SLOWING DEMAND

Just as the market for reverse mortgages started to take off, the financial crisis turned the world upside down. Although the depressed economic conditions have made equity release products more topical than ever – after all, many retirees will need to supplement their reduced super savings with some form of income – this crisis has also proved to be disastrous for the equity release industry as the lack of credit has wiped out all but a few product providers.

The equity release industry consisted

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of many so-called non-banks – financial institutions that are not considered full-scale banks because they do not offer depositing services in addition to their lending activities. As the banks stopped lending and the securitisation market collapsed, these non-banks were forced to close their doors to new customers.

Mariner Financial stopped selling its reverse mortgage product, Mariner Equity Access, in October 2008, and although it continues to service its existing clients, the company has no plans to re-enter the market. “Not at this stage,” a spokesperson says.

Bluestone Group stopped writing new loans, including its equity release product, Equitytap, in mid-2008. It also continues to service its clients, who represent \$300 million in outstanding loans. Bluestone Equity Release chief executive Peter McGuinness expects to get back into the market once the economy picks up again, but says it is likely it will be in a different form.

“What we are very good at is product design, risk management and back-office systems,” McGuinness says.

“What we are less strong at is retail brand. I suspect there will be opportunities in the future for us to provide everything but the retail brand; to partner up with an institution that wants to offer the product, has a retail brand, but doesn’t want to invest in the systems, the product and the IP.

“It’s like the Intel chip within a laptop: we do all the work, but we are not the front, retail-facing brand.”

McGuinness considers a major bank or a life insurance company as the most likely candidates for such a partnership.

A reinvigoration of the market would certainly be helped by the big banks adopting a more active approach in the industry. “It only takes one or two institutions to offer the product more seriously to see the demand increase quite significantly from where it currently is,” McGuinness says.

“Many of the banks that do offer it have it as a product that sits on the shelf. None of them market it specifically or approach it as a business line on its own.

“There is no competition in the market really. There are only three or four products in the market that customers can look for and many of those are only made available



JAMES HICKEY

through bank branches.”

He believes banks will direct more efforts to the product once the market matures. “In the meantime it is going to remain a relative niche product,” he says.

Carter says reports from mortgage broker channels confirm client demand has diminished after a number of reverse mortgage providers had to retreat from the market. “When reverse mortgages first came on the market they came on with quite a bang; there were a lot of [providers]. As it happened, very few people actually found they have a need for reverse mortgages,” he says.

This has also been reflected in the interest from financial planners for obtaining accreditation from Suncorp to advise on equity release products. “In most of our businesses we require advisers who want to advise on reverse mortgages to have additional accreditations. We are not getting demand from additional advisers to be authorised at the moment,” Carter says.

Carter also still has reservations about the nature of the product and says for financial planners it could pose serious problems when a loan is closed down after the death of the borrower. “You likely want to engage the beneficiaries of the eventual estates, so that as an adviser you are not faced with the prospect of an estate claiming against you for the advice given to a person who is deceased and can’t tell the beneficiaries why they wanted to do this,” he says.

He believes there are good alternatives to taking out a reverse mortgage. “There is always social security and pension. [Retirees] can set up their affairs so there is a component of social security as part of drawdowns on their capital base,” he says.

Retirees should also consider cutting back on their lifestyle when possible. “The people that do have reasonable balances in retirement tend to find that their minimum drawdown of the pension is actually more than they need to live on, and so they



actually can reinvest the excess potentially in an investment outside of the pension environment. This will build up a fund for when the pension starts to run down,” Carter says.

For some people it would also make sense to downsize their property, he says. “The property market was going quite well for a while, and I think what you saw is that people downsized their property for a while and generated cash rather than borrow against the property,” he says.

There are multiple ways to address the risk of running out of money in retirement, and Carter still sees a reverse mortgage as a last resort. “I wouldn’t have thought that people who are just retiring need a reverse mortgage. It is probably more for people who expected to have lived up to a point in time or who expected to reduce their lifestyle but haven’t. Now their savings have started to run out, and they are looking to supplement their income.”

RE-ENGAGEMENT

Yet, with Australia’s population ageing and people living for longer, any tools that can be deployed to help retirees supplement their income will be useful. This means reverse mortgages are likely to be back on the agenda for planners. Even the critics agree. It is, therefore, imperative to address the current concerns about the products. The most effective way to do this is through education of consumers and financial planners.

Many consumers do not understand the full implications of a reverse mortgage. Even consumers who have already taken up a reverse mortgage have not always understood the extent of the impact it will have on their finances. A 2007 ASIC report, “All we have is this home”, showed the majority of borrowers did not know how much the loan was likely to cost them over

time or what would happen if they breached a loan condition. A small group was even unaware of how compound interest worked.

The problem in most cases was that borrowers had not planned for the long term nor looked at how their circumstances were likely to change in the next 10 or 15 years. Much more could be done to educate consumers on these products, the regulator said. And for most part, these consumers would have benefited from good financial advice.

Advisers, on the other hand, should seek additional training to advise on reverse mortgages as these products do lie outside their usual field of expertise.

“If financial planners really want to understand the various viable alternatives for their retiree base of customers, they should understand what reverse mortgages are,” Hickey says.

“That is not to say that they should all be advocating reverse mortgages by any means, but to have at least a working knowledge of what reverse mortgages are.”

SEQUAL launched a training course last year that gives planners the opportunity to acquire accreditation as an equity release specialist. The course is endorsed by the FPA. “We really do see this as a vital discussion to have with a particular client group,” Sanders says.

“We want to make sure that every financial planner that deals with a client in this strategy is fully aware of what the issues are and are completely competent in providing that sort of advice. That’s why we established a partnership with SEQUAL and helped develop the programs.”

The creation of an official accreditation course is an important step in the development of the industry and it would help in getting planners more involved, McGuinness says. “Traditionally, [dealer groups] have relied on product providers to provide these trainings. I hope they will use the FPA structure to provide that education,” he says.

Most dealer groups are supportive of the course, but say it is up to members to decide whether or not to take the course. “I have spoken with SEQUAL three or four months ago and we were talking about the position of reverse mortgages in our network,” Modica says.

“We would be looking to encourage people to consider that course within their

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Thus far the course uptake has been low. “We probably would acknowledge that. Planners continue to be a little cautious about reverse mortgage programs,” Sanders says.

But Conlon has high hopes for the course. He believes 10 per cent of the 14,000 FPA membership base could potentially seek accreditation.

As understanding about the equity release strategy increases, the reputation among customers and financial planners should also improve. After all, the Australian industry is relatively young and many of the malpractices have never been practised here.

“This issue has not always been well understood. The Australian market has been free of those issues. It is really a historical reference to other markets, particularly the UK some time ago. Those lessons were well learned before the emergence of an Australian market,” Conlon says.

SEQUAL can be credited for creating many of the best practice standards for the industry in Australia. One of its most important requirements for members is to have a no negative equity guarantee on products, which ensures customers would never owe more than the value of their home under a reverse mortgage contract.

Education and industry standards can do much to help the development of a mature reverse mortgage industry. But the real driver is likely to come from the need to supplement income during retirement.

The government’s decision to push back the eligible age for the pension to 67 by 2023 indicates how seriously it takes the challenges of an ageing population and longevity. As Australians will increasingly have to provide for their own retirement, and investment returns will be tempered by less bullish economic circumstances in the short term, more retirees will look for alternative ways to supplement their income.

This could see the family home become a more acceptable tool in devising financial strategies. “[The family home] should be considered as part of the overall context of providing advice,” Modica says.

“Do [planners] give advice around that? Generally not, but maybe that is a thing that we need to consider in the future.” «