Submission to the
Financial System Inquiry

August 2014

Homesafe Solutions Pty Ltd

Executive Summary

Homesafe Solutions Pty Ltd welcomes the inclusion of “access to equity in the home” in the Interim Report of the Financial System Inquiry. We also welcome this opportunity to make a second round submission to the Inquiry.

The untapped equity in Australian homes should be considered as a potential fourth pillar of the Australian retirement income system.

The “access to equity in the home” observation (page 4-25) and question (page 4-33) posed by the Interim Report relates to both reverse mortgages and home reversions. In relation to home reversions and particularly the experience of Homesafe Solutions Pty Ltd, regulation is not the only impediment and we have highlighted a number of other impediments.

In terms of regulation, the key issue is that there is no overarching regulation of home equity release products. The present regulation operates at a product level for reverse mortgages, and does not provide any framework or protection for home reversion products such as Homesafe Wealth Release.

A legislative guarantee for consumers to continue living in their own home as part of any product offer is critical for both the viability of the offer but also to protect consumers. Without a framework, there are potential risks for new, unscrupulous operators entering the market and putting the viability of this emerging sector at risk.

A potential step towards a legislative framework is the development of an ASIC advice and information campaign, a reference to an appropriate Parliamentary Committee and/or an exposure draft amendment of the National Credit Code.

The second significant policy impediment is a lack of funding for home equity release which constrains the supply of products. This is particularly the case with respect to home reversion products which are funded by a pooled residential property vehicle. Pooled residential property is regarded as a new asset class and is likely to require some form of Government assistance to attain acceptance with institutional investors.

Other impediments include the inconsistencies with State and Territory property laws, the lack of financial literacy in relation to home equity release products and the impact of the age pensions assets test.

The value of residential property in Australia reached an estimated $5 trillion at the end of 2013. At the same time, the size of our retirement savings shortfall continues to be unsustainable. Product innovation in home equity release coupled with Government action can address this.

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Policy context

The retirement incomes system is generally viewed as comprising three pillars: the age pension, compulsory superannuation and voluntary savings (including non-compulsory superannuation). (Interim Report 2-97)

The equity that senior Australians own in their homes represents a significant amount of savings, which is often overlooked from the perspective of retirement funding. Home equity represents a substantial pool of savings, and should be viewed as a potential fourth pillar of retirement incomes.

This concept of a "fourth pillar" has been explored in detail by Christine Brownfield in her paper to the Actuaries Institute in May 2014.[1]

The value of residential property in Australia was estimated to have been $5 trillion at the end of 2013. A significant share of this is owned by retirees. A meaningful proportion of this housing wealth could therefore be released to assist with retirement funding. Unfortunately there is both a lack of community acceptance and widely available safe, secure products.

This increase in the value of residential property has taken place while the nation continues to have an unsustainable Retirement Savings gap. Housing wealth has the capacity to bridge this gap.

The Rice Warner report *Retirement Savings Gap as at 30 June 2013* commissioned by the Financial Services Council estimates the gap as being $727 billion as at June 2013.

While there are a range of challenges that are apparent from the analysis, the relevant point of analysis is that there is a cohort of older Australians that have suffered from the fact they have not enjoyed Superannuation Guarantee contributions over their working lives. As a consequence, they have far less time to close their savings gap to be living at adequate levels in retirement. However they have managed to acquire significant housing wealth.

The culture of home ownership in Australia provides Australians with a home where they can live with autonomy and independence and once it is fully paid a potential source of retirement income. To encourage and validate home release products that protect consumers could be a new part of this home ownership culture.

[1] "The Fourth Pillar – The Role of Home Equity Release In Retirement Funding" http://actuaries.asn.au/Library/Events/FSF/2014/BrownfieldFourthPillarPaper140505.pdf.

Introduction to Homesafe

Australia's ageing population has the distinction of having one of the highest proportions of homeowners internationally: 84 per cent of the population aged 65 and over are homeowners.[2] This demographic is 'asset-rich but cash-poor', with most of their savings entombed in the family home. Thus seniors do not have the financial liquidity for their retirement, and particularly as they need to fund their increasing health and care requirements.

Despite recommendations to Government (e.g. Productivity Commission 2011), there has been inadequate investment in mechanisms that release home equity while protecting the home owner. The banking industry has created a limited range of debt-driven equity release products. However, these are largely unattractive, as the consumer is left vulnerable to market fluctuations, with their own longevity increasing the erosion of equity in their home as interest is capitalised to the original debt.[3]

The Homesafe product is a unique debt-free equity release mechanism that enables eligible senior home owners to sell a fixed proportion of the future sales proceeds of their home, in exchange for an up-front cash amount.

This mechanism is designed to create security and certainty for consumers, who can live in their home with complete autonomy and control until such point as they are ready to dispose of it (i.e. through public sale, transfer to heirs, etc). At this point, the investor is paid their share of the sales proceeds.

This offering is fundamentally different to debt-based equity release products, such as reverse mortgages, in that it involves a one-off sale, rather than a loan with compounding interest rates that erode the owner's equity in the home over time. The mechanism provides certainty to the senior homeowner in that they know the maximum share of the sales proceeds that the product provider will receive. There is protection for the homeowner in the event the home is sold earlier than expected, and from missing out on windfall gains should the property appreciate very strongly.

[2] ABS Survey of Household Wealth and Wealth Distribution, 2011-12
[3] ASIC Report 109 "All we have is this house" November 2007

Homesafe product background

The Homesafe Wealth Release was designed by Mr Peter Szabo, an Actuary with more than 30 years experience.

In 2005, Peter Szabo teamed up with the Bendigo and Adelaide Bank Ltd to launch Homesafe Solutions Pty Ltd. The Homesafe Wealth Release product is available only from Homesafe Solutions.

The Homesafe Trust, which funds this product, holds over $400 million in residential equity and to date has been funded wholly by Bendigo and Adelaide Bank.

The Homesafe Wealth Release is currently available in Sydney and Melbourne.

<u>Homesafe product explained</u>

Homesafe Wealth Release (Homesafe) enables senior homeowners to sell a share of the future sale proceeds of their home for an immediate cash sum. The senior homeowner has the certainty that they will always retain the unsold share of the sale proceeds. The basic approach of Homesafe can be explained as follows:

- The Homesafe Contract completely protects the rights of the senior homeowner to remain in their home for the remainder of their life. They remain the legal owner and Homesafe can only complete the Contract after the death of the senior homeowner(s). As a result the senior homeowner remains in control of their home for the remainder of their life.

- The Homesafe Contract enables the senior homeowner to sell the property at any time, buy back the sold share and to lease the property and keep the rent.

- In order to provide for an equitable outcome for senior homeowners the Homesafe Contract provides for the sold share to be reduced in the event of an early sale (the Early Sale Rebate) and if the sale proceeds exceed a specified benchmark (the Excess Proceeds Rebate).

- The Homesafe Contract is transparent and sets out the formulae which are used to calculate the Early Sale Rebate and the Excess Proceeds Rebate.

- The senior homeowner has the certainty of knowing that they will always retain the unsold share. The Homesafe share can never increase and may decrease depending upon the two rebates. As a result the senior homeowner can plan with certainty that the unsold share will always be available to fund age care or for a bequest.

Interim Report of the Financial Services Inquiry

Homesafe Solutions welcomes the key observations of the Inquiry that both

> "The retirement phase of superannuation is underdeveloped and does not meet the risk management needs of many retirees."

And that

> "There are regulatory and other policy impediments to developing income products with risk management features that could benefit retirees."
>
> (page 4-3)

The report reiterates the fact that Australia's ageing population is a "major challenge" for the financial system and significantly needs a "suitable range" of products.

While the discussion in the Report is brief, it rightfully identifies access to equity in the home as being a product to assist retirees and that the market is underdeveloped.

Consistent with the Panel's request, this submission responds to the Interim Report request of further information on page 4-33:

> ***The Inquiry seeks further information on the following area:***
> • What, if any, regulations impede the development of products to help retirees access the equity in their homes?

This report also provides additional evidence to support the specific observation on pages xxxix and repeated on page 4-25:

> ***Observation***
> *There are regulatory and other policy impediments to developing income products with risk management features that could benefit retirees.*

Interim Report – impeding regulations (4-33)

> ***The Inquiry seeks further information on the following area:***
> • What, if any, regulations impede the development of products to help retirees access the equity in their homes?
> (page 4-33)

The current regulatory regime does not adequately reflect the requirements of an innovative and developing market for products that enable retirees to access equity in their home.

The current National Consumer Credit Protection Act 2009, and specifically Part 3-2D of the Act and Schedule 1 of the act (the National Consumer Credit Code) relate to consumer protections and licensee requirements for Reverse Mortgage products.

Instead of providing a structure for a range of products, including guaranteed rights for consumers, it has only provided a very narrow regulatory structure in response to one specific form of equity release products (ie reverse mortgages).

An appropriate legislative framework would send a market signal to consumers and advisers that these are legitimate products with protections and benefits.

As demand for new forms of retirement income products grows, less scrupulous operators will look to develop products that sit outside any regulatory structure.

As a consequence, a new risk emerges that this failure to regulate will not prevent the introduction of "rogue" products. Such products would then inevitably erode confidence in high quality home equity release products.

At least on the basis of protecting consumers, Homesafe Solutions would strongly encourage commencing steps towards a legislative framework, such as the development of an ASIC advice and information campaign, a reference to an appropriate Parliamentary Committee and/or an exposure draft amendment of the National Credit Code.

Interim Report – regulatory and other policy impediments (4-25)

> ***Observation***
> *There are regulatory and other policy impediments to developing income products with risk management features that could benefit retirees.*
> *(page 4-25)*

The principal aim of regulatory and policy frameworks for home equity release products should be to ensure that the consumer/homeowner has the legal right to remain in their home for the remainder of their life. In this way the greatest reservation of homeowners considering home equity release will be removed.

Our product already provides this guarantee for retirees in accessing equity in their home.

It also provides a mechanism to deal effectively and fairly with unforeseen events following retirement, including major health events and events that may impact on their immediate family without any warning.

But having the product sitting within an appropriate regulatory and policy framework would validate and guarantee these product offerings.

In relation to the observation, there are five impediments to developing products with risk management features.

Firstly, as outlined previously, the existing legislative and regulatory framework is inadequate. The NCCP Act regulates at the product level, which is the policy equivalent of "shutting the stable door after the horse has bolted". Regulation at an individual product level will not prevent the introduction of "rogue" products that will inevitably erode confidence in home equity release.

It therefore follows that the absence of a legislative framework and regulation is a fundamental impediment to the wider acceptance of home equity release. Specifically, a legislative framework should include the legal right to reside in the home.

The second impediment is the significant shortfall in the supply of funding for the two main types of home equity release products: being home reversions and reverse mortgages. In many respects the fundamental issue facing both product types is a lack of willingness of major financial institutions to develop funding solutions.

A home reversion offering creates a diversified pool of interests in residential property, which does not fit into an established asset class. There is uncertainty over the timing of income, as it is not possible to predict exactly when the homes of retirees will be sold and a share of the proceeds received by the pool. It would take time for a secondary market to develop. The asset pool created by a home reversion offering is therefore illiquid and unusual.

A 2011 article[4] in The Australian newspaper by eminent economist Professor Ian Harper concluded:

> "The government needs to consider how best to encourage private investors, including superannuation funds, to invest in diversified claims on the future sale proceeds of people's houses. It may simply need to prime the pump, as it has done in the market for residential mortgage backed securities, to encourage the private sector to step in.
>
> An active market in debt-free equity release offers greater choice to older Australians in retirement and advanced age, as well as creating a new asset class for Australian institutional investors. The government stands to gain from a reduced call on public funds, which is why the Productivity Commission calls on it to make the first move."

Essentially the investment impediment can be described as home reversion assets being a new asset class and as such not warranting adequate consideration because there are other defined and accepted investment options. In the past other investment classes have faced similar hurdles and once accepted have thrived.

The third impediment is the need to comply with the property laws of the States and Territories.

The regulatory impediments for home reversions (a sale of a share of the future sale proceeds of the home) are significant on account of the fact that home reversions are treated as a property transaction and property law in Australia is State based.

At the State and Territory level, issues impacting on home reversions include stamp duty and differences in the structure of real estate contracts.

These issues make it extremely difficult to manufacture a cost efficient home equity release product to be offered in all States and Territories. The solution would be for all regulation in relation to home equity release products to be at the Commonwealth level. As such, an Approved Home Equity Release Product would therefore not be subject to State based taxes and State based property regulation.

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[4] See http://www.theaustralian.com.au/opinion/unlock-home-savings-to-fund-old-age/story-e6frg6zo-1225993848749

Fourthly, inadequate Financial Literacy about home equity release by both homeowners and advisers is an impediment. An information campaign by ASIC would significantly assist educating homeowners and advisers, including both legal and financial advisors.

Finally, the present means testing of the age pension can be a disincentive to home equity release because cash amounts released are included as an asset for the purposes of the assets tests. An alternative would be to exempt amounts accessed by home equity release for a set period (eg five years) in order to eliminate the disincentive.

Home Equity Release and Aged Care

The interim report raised the following issue:

> *"one issue with releasing home equity is that an individual may later have insufficient equity to fund an accommodation bond for an aged care facility".* (page 4-33)

This issue can to a large degree be alleviated (and in most cases eliminated) by appropriate product design. An individual concerned about having sufficient equity for an accommodation bond may decide that for example they must have at least 50% of the value of their home to fund the accommodation bond. This can be achieved readily through a home reversion by only selling 50% of the future sale proceeds. In the case of a reverse mortgage, some products allow a "protected share" so this could be set at 50%. This would of course be reflected in a reduced loan amount.