Institute of Actuaries of Australia

Super Policy Forum

Reverse Mortgages –
The only alternative retirement product?

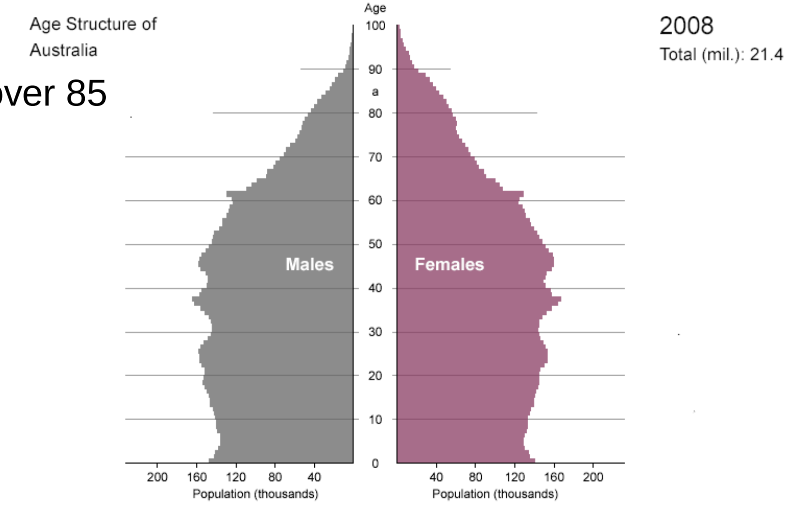
Martin Lynch - RBS

Reverse Mortgages Brief Introduction

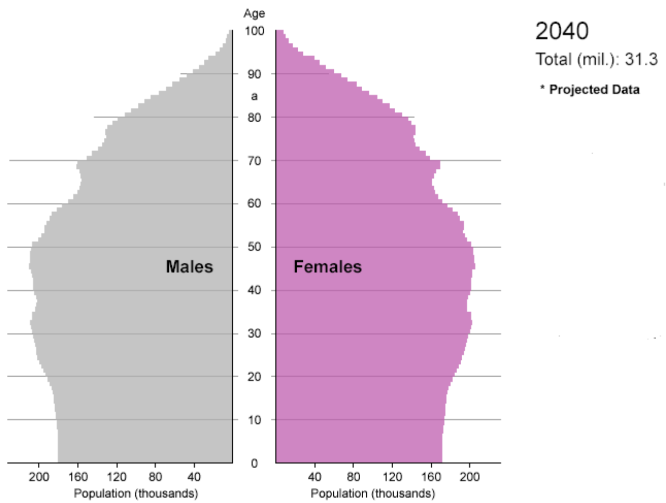
- How it works
  - Home owners aged over 60 borrow against the equity in their property
  - No repayments required until property sold
  - Borrowing limits depend upon age of customer – e.g. 60 =1 10%. 95 = 50%
  - Guarantee of lifetime tenancy and no negative equity
  - Options of combination of lump sum, monthly income and/or line of credit
- History of the product
  - Started in early 1990’s in Australia with Advance bank, becoming St.George
  - Reputation tarnished by problems for borrowers in the UK in early 1990’s
  - Rapid growth since 2002
  - SEQUAL established with Code of Conduct for lenders
  - Reverse mortgage the predominant product versus Reversionary product
- Current position
  - Fewer lenders following global funding tightening
  - Growth steadier with lower advertising
  - RBS now the largest provider of the product in Australia
  - Greater appreciation of the role the product can play in
  - Growth in aged care funding

Retirement Funding
What is the problem?

- Ageing population
  - Population aged over 65 set to grow by 200% and over 85 by 400% by 2047
  - Non-core due to retail nature of business
  - NIM of A$5.6m & NPBT of A$3.9m in 9m of 2009
  - Increased life expectancy
  - Increasing healthcare costs



- Retirement funding
  - 70% of retirees live on basic pension (Source: NATSEM)
  - Westpac/AFSA suggests a modest budget is $19,533 pa against pension of $16,500
  - Rising proportion of population is aged over 60, so little scope for increased government spending

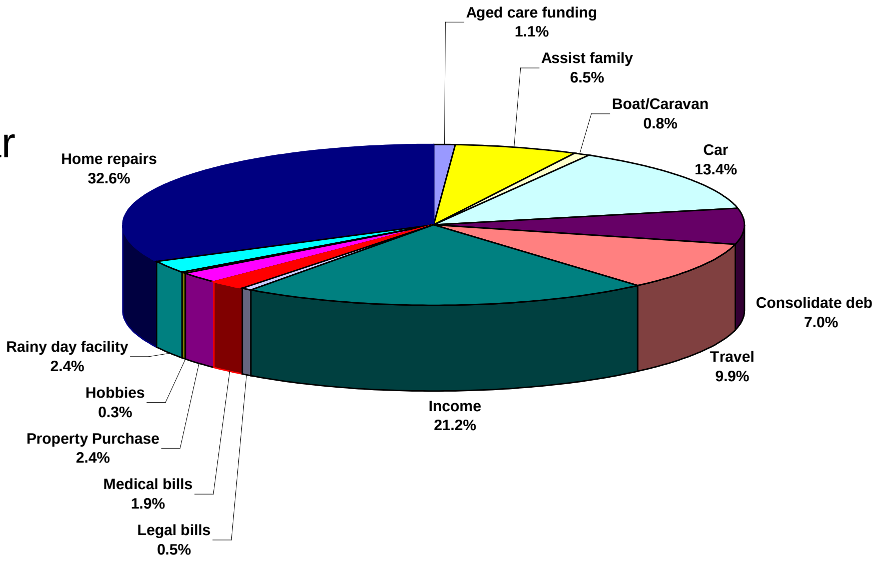


Retirement Funding
What solutions are there?

- Government
  - The demographic shift makes it impossible for the government to make up the 15% shortfall
  - Longer term more self-funded retirees will come through, but may take 20 years and require a delay in retirement to 70, plus an increase in compulsory contributions to 15%
  - Pension Loan Scheme
- Family
  - Clearly a good option if possible
  - Families support their parents in decision to take out reverse mortgages
- Downsize
  - High costs of moving
  - Centrelink impact
  - Emotional factors
- Work longer
  - Problem of age discrimination
- Reverse Mortgage/Equity Release
  - $600bn in equity held by retirees

Retiree perspective – What they use it for and what they think of it

- Primary Uses
  - Average loan c.$70k
  - Top 3 uses: Income, Home Repairs & Car
  - Very small amount of SKI
  - Aged care funding is increasing
- Attitude to the product
  - 98.5% would recommend the product
  - Stress relief – “Rainy day facility”; Peace of mind
  - Can improve value of home – win/win



Beverley Aulton, 69, of Highgate, took out a reverse mortgage in May last year and has used the money for home repairs, garden expenses and even veterinary bills for her maltese terrier Indiahna.
"It has been a lifesaver for me," she said. ``I couldn't survive on the pension and keep my house.
"The reverse mortgage loan has allowed me to stay in the home I love and has taken away everyday worries like whether or not I can afford to put petrol in the car."

Summary & What Next? The Actuarial Challenge

- Summary
  - A lot of time is spent on retirement strategies for people with money/investments
  - Reverse Mortgages are about the only product that can help cash poor retirees – the majority
  - Demand will continue to grow as understanding and awareness grows; demographics are overwhelming
  - A good solution when structured effectively; new regulations will improve sales process further (hopefully!)
  - Australian products are the most flexible and customer friendly available

- What next? The Actuarial Challenge
  - Product risk for the lender is the No Negative Equity Guarantee – how should this be priced/hedged
  - Longevity/House Prices/Interest Rates
  - Repayment rates are higher than modelled; LVRs are low
  - Expected correlation between interest rates, inflation and house prices….should protect lender
  - If this can be proved then interest rates can fall c.0.5%