New product could end 'defective' reverse mortgage market

by Ben Abbott15 Apr 2023

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  Pre-retirement property owners among the beneficiaries, says company

A new, highly innovative mortgage product could spell the effective end of reverse mortgages and similar products globally within the next two years, says Futureproof CEO John Innes.

The new mortgage, trademarked the Equity Preservation Mortgage®, has been designed by a team of banking, insurance and technical product specialists at Futureproof, to put an end to what its team sees as the "inherently defective" design of existing reverse mortgage products.

Futureproof said the resulting product would enable retirees – as well those with equity at any age – to use the equity they have built within their properties to generate an income stream for a variety of purposes or to fund embedded financial, banking and insurance products. They could do so without depleting their equity, in a revolution Innes (pictured above) said "changes everything" for the market.

"It's the old story with existing products out there, particularly in retirement funding – you have providers trying to tweak around the edges of existing products and it's not going to work when the products are inherently defective in design – you have to solve the design defect," Innes said.

The new mortgage product was designed to pay interest rather than accrue and compound it and was also fully insured. Innes said this would "completely revolutionise retirement funding", while brokers would benefit from a market opening in pre-retirement, given there were no age restrictions.

Tackling multiple retirement incomes problems

Futureproof recently announced a tie up with Hong Kong and London-based venture capital firm IMS Digital Ventures, which will see IMS become a major shareholder and player in helping scale the new mortgage product globally, with a view to launching it in mortgage markets in mid-2024.

Founder and CEO of IMS, Anastasios Papadopoulos, who will sit on Futureproof's board, said the deal aligned with its strategy to back world-class entrepreneurs with deep market expertise who were looking to solve large-scale global problems – in this case the 'global retirement funding gap'.

Innes said in western countries such as Australia, the US and UK, many retirees were asset rich but cash poor, leaving them underfunded for retirement. He said in our Australian test market about 70% of retirees were home owners, and the average house price for these seniors on average was about $1.1 million.

But these customers faced a retirement funding shortfall, with average retirements lasting 20 years, while being funded only for 10. "That also ignores when dear old dad has a stroke, or mum has dementia, and they need to go into high or low care with an aged care accommodation bond," he said.

With accommodation bonds in major cities reaching above $1 million in some cases – a fee often required twice as two parents were unlikely to go into the same room at the same time – Innes said they people could be in "real trouble" if they were underfunded or had depleted their equity due to a reverse mortgage.

"These customers are not poor, but no bank or insurance carrier has a product for them – it is ridiculous. How are they looking after these ageing customers? These are old-school people, loyal, but they are not being helped with even a modest income product – it doesn't make any sense."

Innes said there was the parallel problem of inter-generational unfairness, where younger generations couldn't get into the property market, and unless there was complete home wealth transfer between generations, they were unable fund their own retirement, causing a downward spiral or funding deficit.

Problems in the reverse mortgage product universe

Reverse mortgages have been questioned for their in-built capacity to deplete borrower equity, and Innes said with compounding interest every month, "your debt doubles every 10 years give or take, depending on interest rates and you are in negative equity around 20 years give or take, depending on house prices".

An ASIC review of the market conducted in 2018 found while in many cases they do allow older Australians to achieve their immediate financial goals, longer term challenges do exist, with all 30 borrowers examined paying "little to no attention to the longer-term implications of their loan".

"Reverse mortgages were invented 35 years ago in the UK and they have never changed" Innes said. "They are not fit for purpose and are inherently defective, and that is also true of shared appreciation mortgages – indeed, all products in the equity release category."

"As a banking product, reverse mortgages are problematic because they are 100% risk weighted – they are Tier 1 capital intensive to write, which is why most lenders don't want to do them."

He said major banks Westpac and the Commonwealth Bank had pulled out of the market they inherited from their St George Bank and Bankwest mergers respectively because they "never wanted to be in it", and currently no major banks are offering reverse mortgage products.

"Shared appreciation mortgages, like reverse mortgages, are not fit for purpose for lenders. Traditional equity release mortgage products can't be securitised easily. So, they are struck with them on their balance sheet and that is a big problem for a lender," Innes said.

The Equity Preservation Mortgage® is 50% risk weighted, making it twice as capital-efficient for lenders to write, and meets the primary need of the borrower for income whilst not depleting their home equity. Innes said this is a disrupter of the $20bn a year global reverse mortgage market.

“The reason it will be disrupted is because it is advice-driven, and the UK and Australia have strong advice regulation and there are state-by state consumer duties in the US. If a financial adviser puts someone into a reverse mortgage instead of the Equity Preservation Mortgage®, they will get sued for loss of inheritance or lost equity.

“All you need is one class action from 30 or 40 disgruntled borrowers or their affected families. No financial adviser will be willing to stick their neck out and keep pumping their clients into a reverse mortgage within one to two years – they are facing their ‘Kodak moment’ and they just don’t know it yet,” Innes said.

“This will be a great outcome for borrowers and a great outcome for lenders. It is a unique fintech innovation and will spell the end of what I think is a dreadful industry - the reverse mortgage industry.”

Preserving equity while providing retirement income

Innes said the Equity Preservation Mortgage® was a mortgage-based financial instrument that aimed to overcome the defects of existing equity release mortgages, including reverse mortgages, shared appreciation mortgages, shared equity mortgages and retirement interest-only mortgages.

To be licensed only to regulated financial institutions and delivered via a SaaS product platform to the industry, he said it monetised home equity into a tax-free annuity income or used to fund embedded financial and insurance products, with no depletion of home equity over terms from 15 to 30 years.

Innes said the loan structure meant banks or issuers were deploying a portion of a property’s equity on a regulated platform of assets in a similar way to annuity products, with the earnings of those assets paying down the cost of a loan taken out on another portion, as well as insuring it against risk.

Because the loan was fully insured, credit risk was removed for the lender through mortgage insurance and the borrower had no exposure to investment risk, interest rate risk, capital risk or equity depletion risk. Innes said on a $1m house, an asset-rich cash-poor borrower could generate a $36,000 tax free annual annuity that they could not access anywhere else.

While he said the product was likely to be advice led, and therefore distributed through financial planners, there could be significant potential for those in the pre-retiree market of people in their 40s or 50s. These are borrowers who could also benefit at any age from taking out the Equity Preservation Mortgage® for additional tax-free income, wealth generation, superannuation top-up, purchase a deferred annuity or other new products.

The IMS deal gives Futureproof access to top-tier software engineers in Silicon Valley, Hong Kong and Singapore who will be fast-tracking the product launch over the next year, with a planned release in mid-2024 in the USA and then in Asia, United Kingdom and Australia.

More information on Futureproof may be found on the Company's website at www.futureprooffinancial.co .