

Non-banks and Demographics

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Bank of England

Fourth ESRB annual conference

Session 2: The role of non-banks in the economy and the financial system

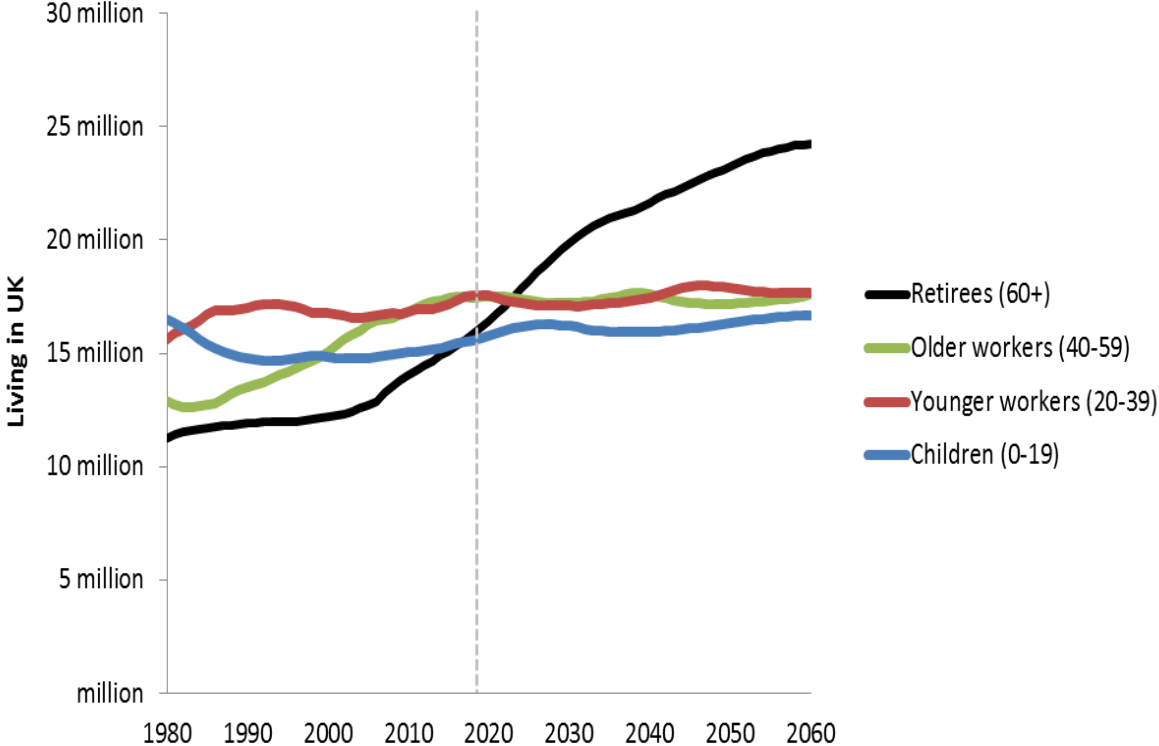
Frankfurt, 27 September 2019

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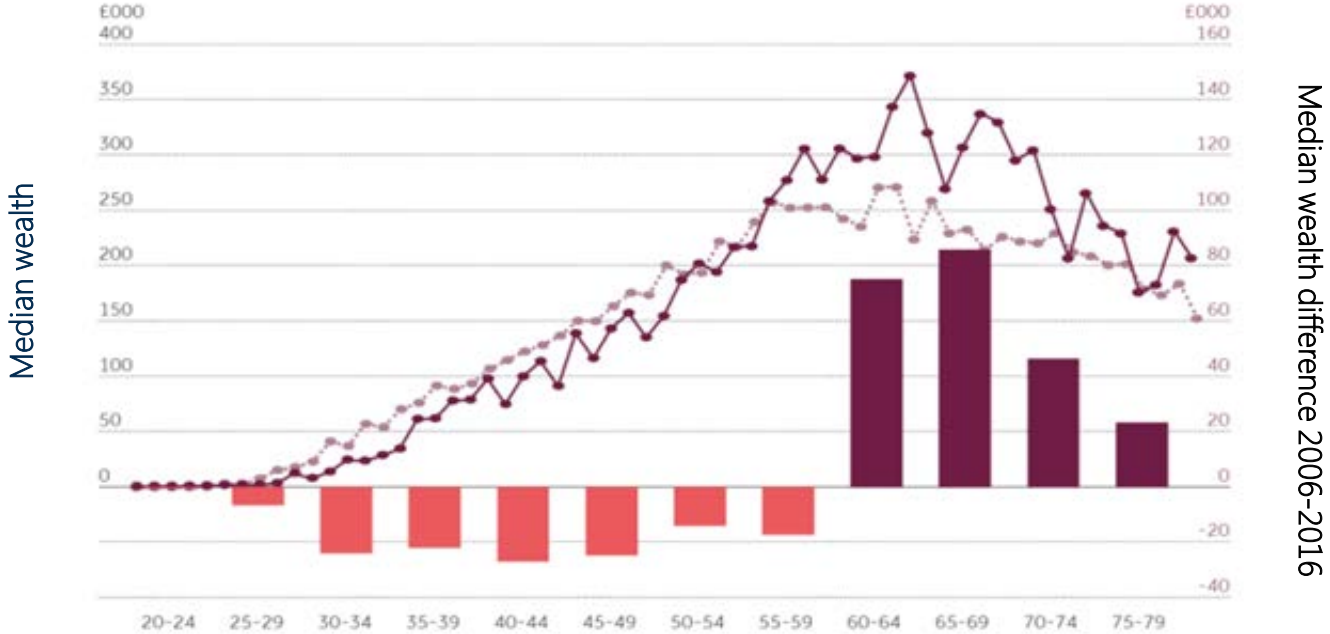
UK is an ageing society



Source: ONS population estimates and projections



Older cohorts see wealth grow

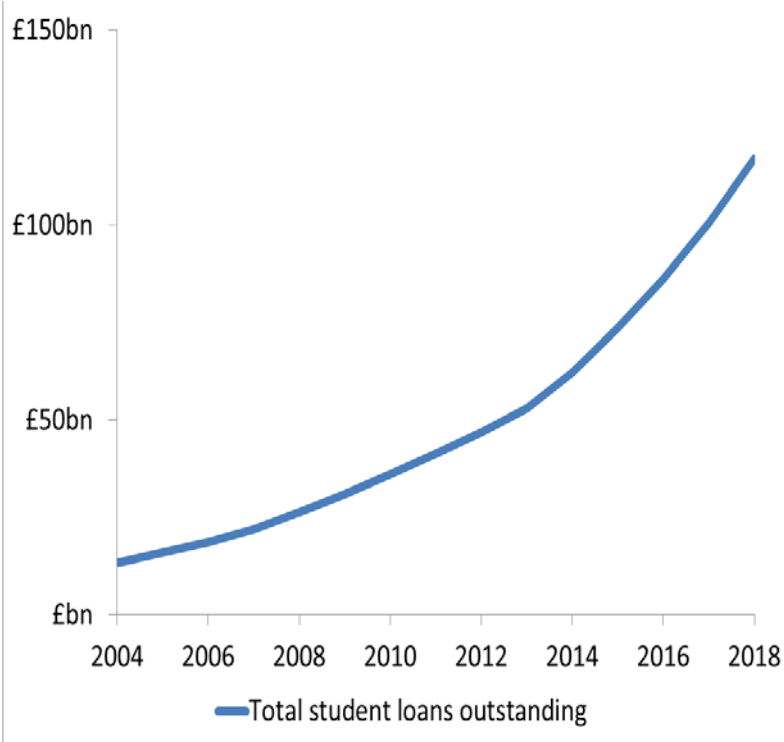


Pale line wealth in 2006 and dark line is wealth in 2016
Source: FCA analysis of ONS Wealth and Asset Survey data. December 2018 prices.

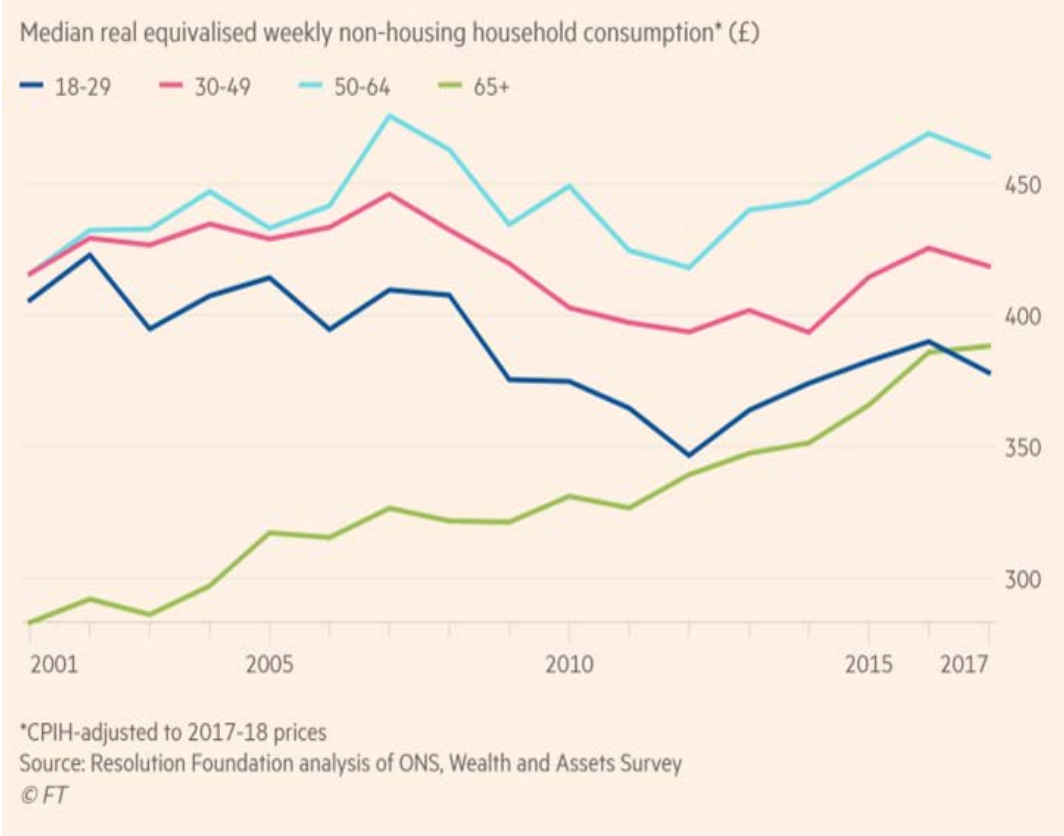
Median wealth difference 2006-2016



While younger cohorts see disposable income drop



Source: Student Loan Company

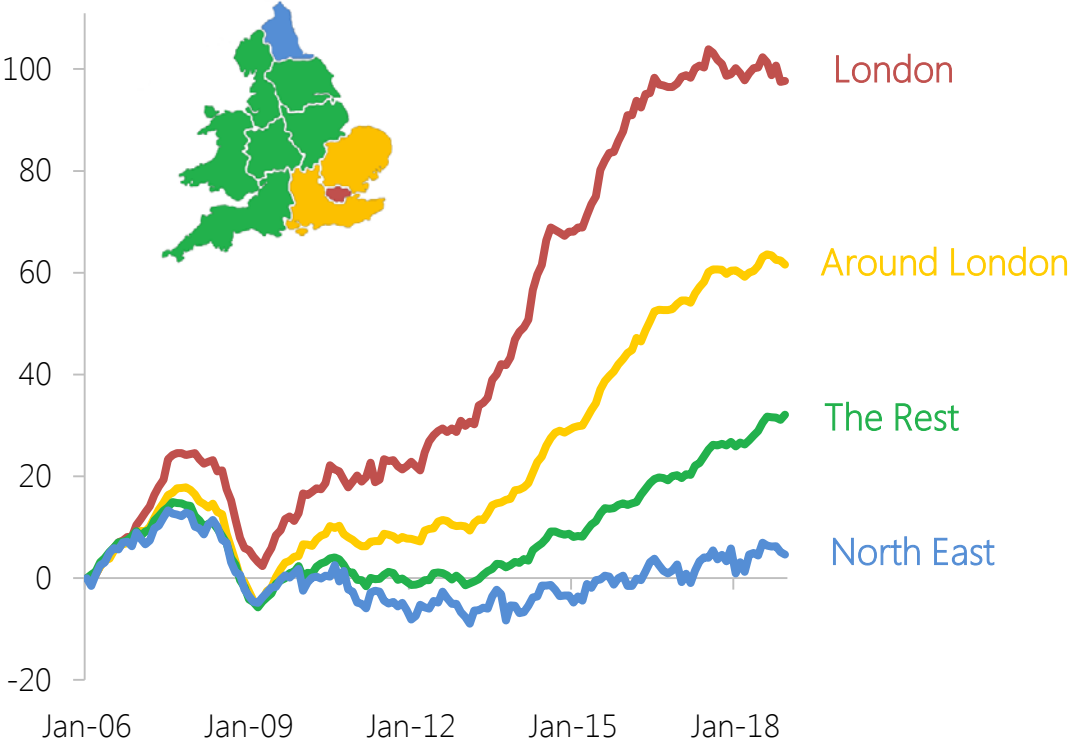


*CPIH-adjusted to 2017-18 prices
Source: Resolution Foundation analysis of ONS, Wealth and Assets Survey
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Student loans have grown, under 30's spending falling in real terms



Combined with sharp increase in housing prices

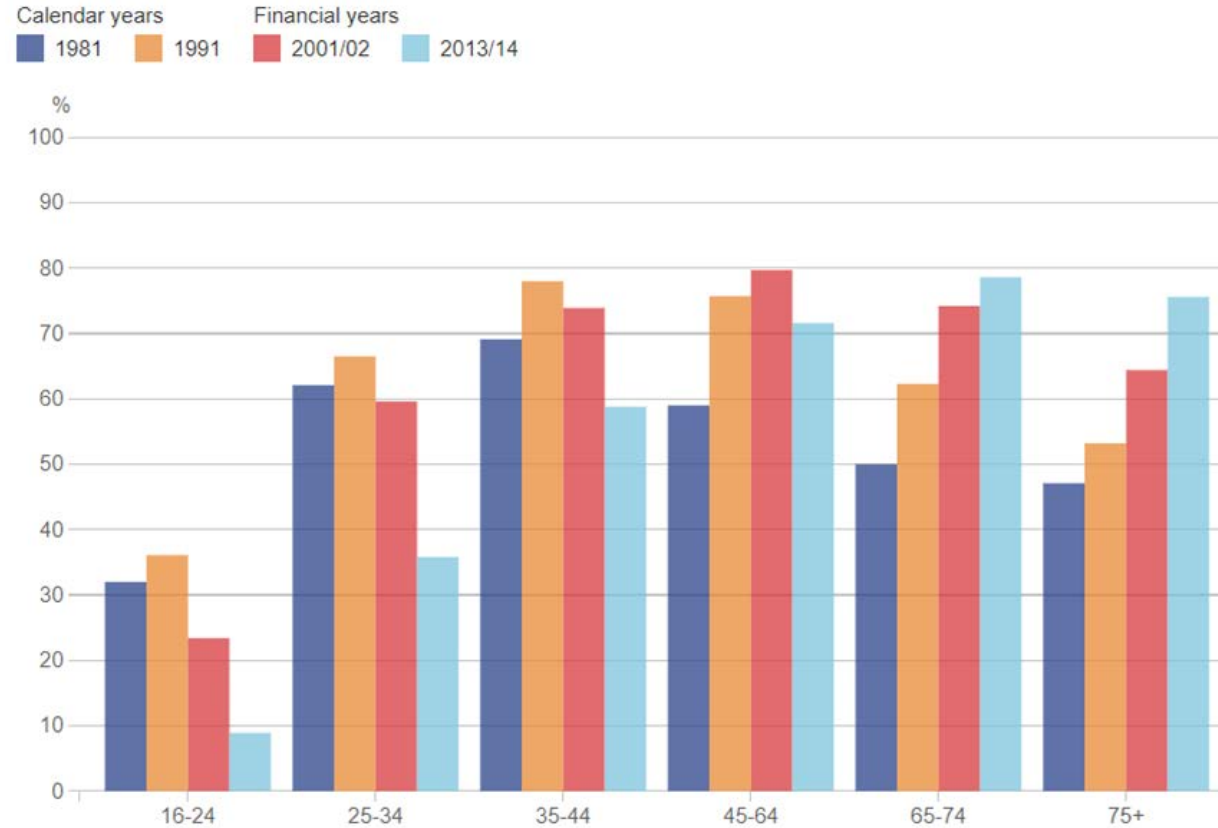


Source: ONS



Big changes in home ownership since the 80s

Percentage of each age group that are home owners, England, 1981 to 2014



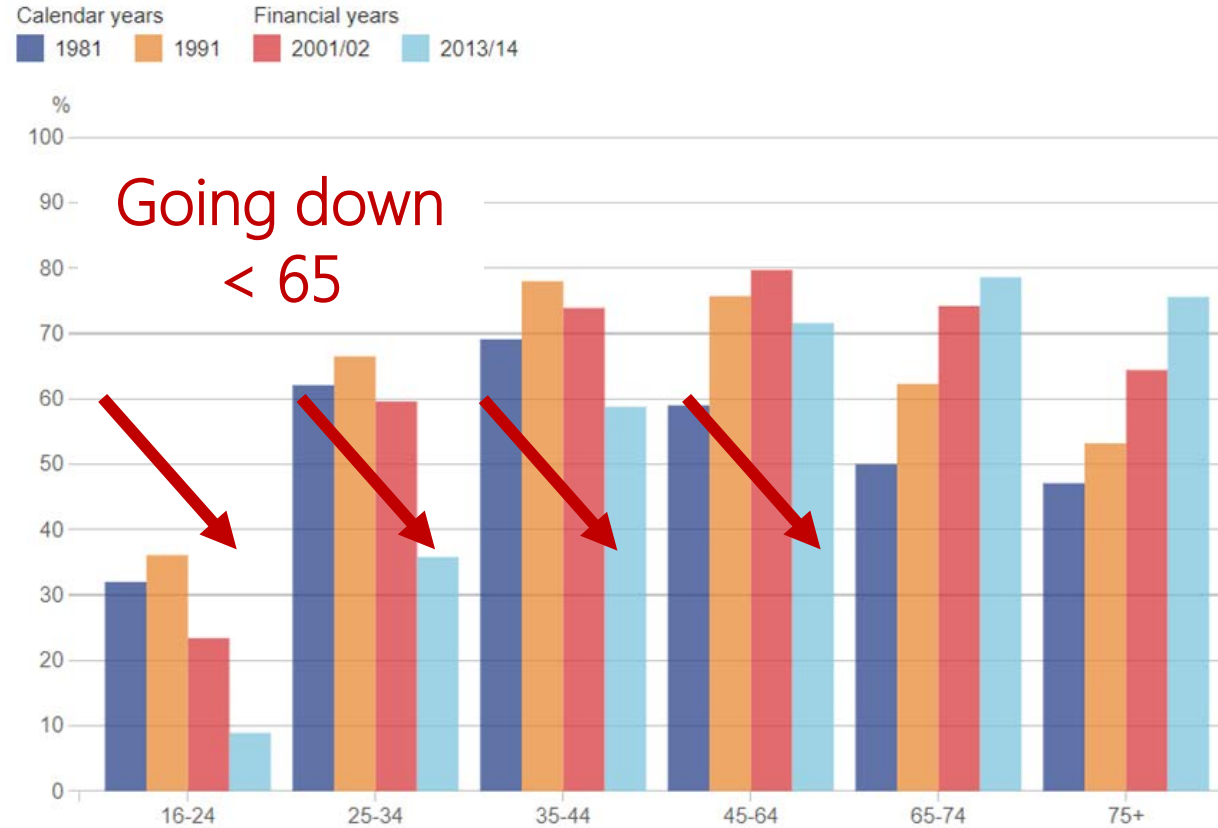
Source: ONS based on English Housing Survey



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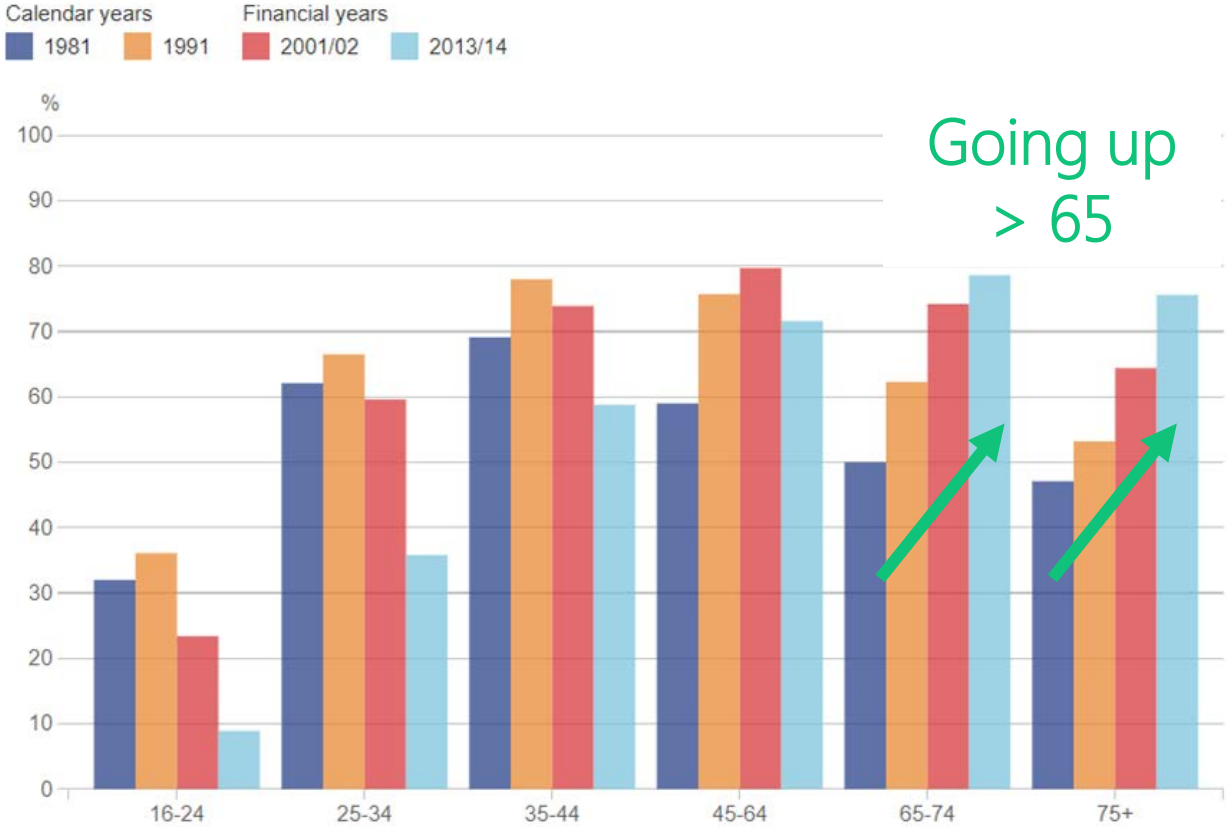


Source: ONS based on English Housing Survey



Big changes in home ownership since the 80s

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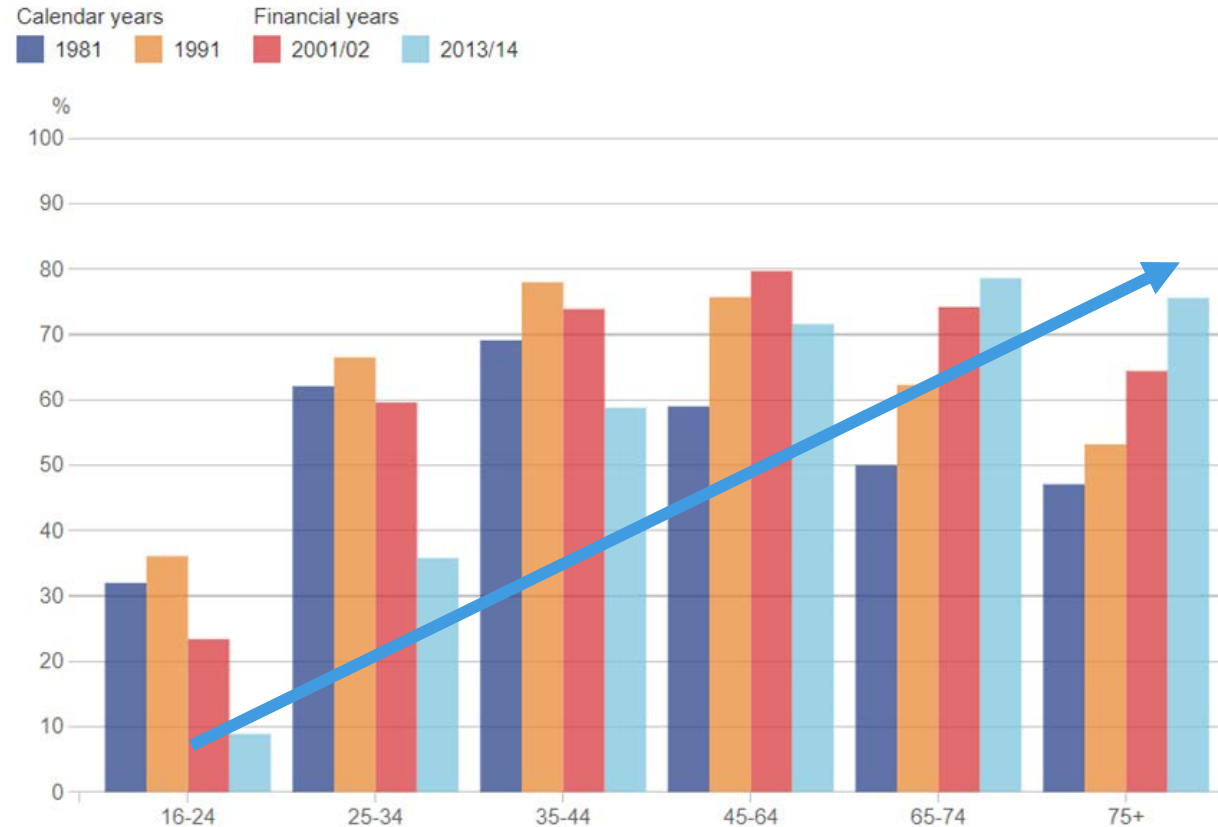
Going up
> 65

Source: ONS based on English Housing Survey



Big changes in home ownership since the 80s

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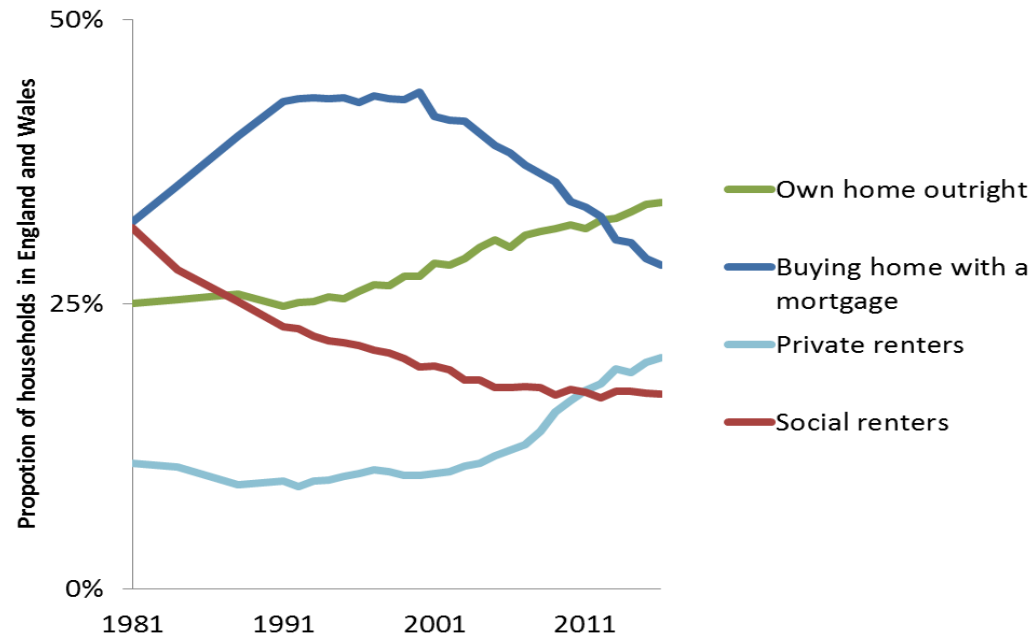
Older cohorts
much more likely
to own a house

Source: ONS based on English Housing Survey



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Changing demand in mortgage market

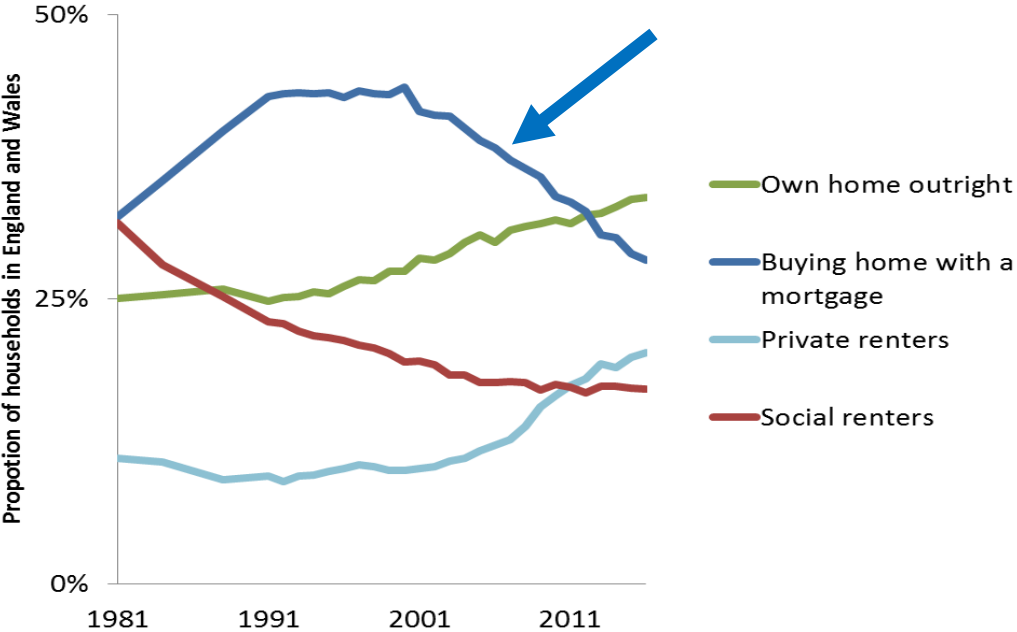


Source: English Housing Survey



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Changing demand in mortgage market

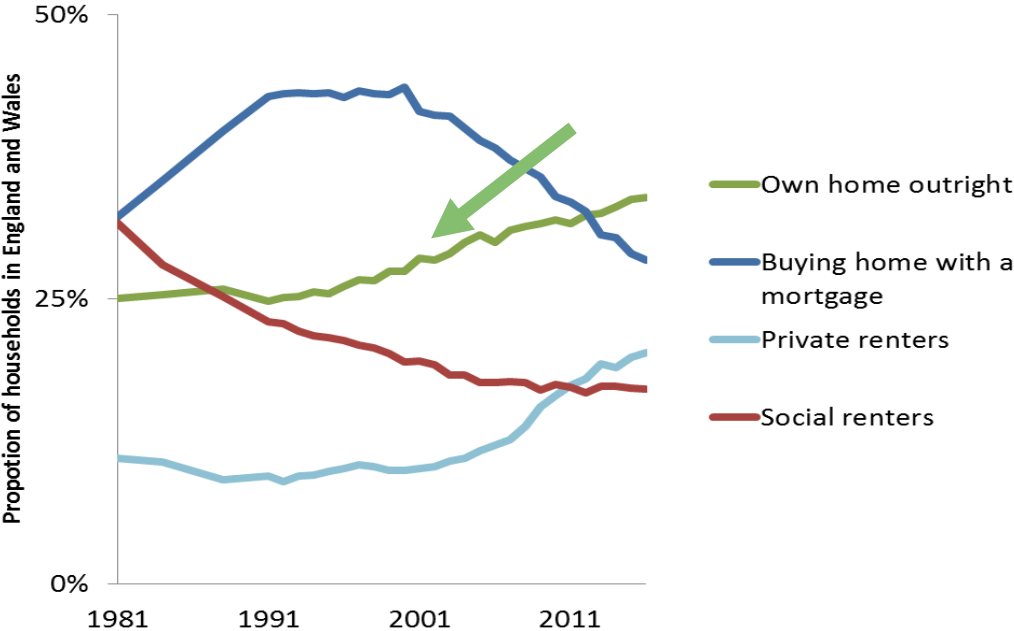


Source: English Housing Survey

Share households buying with mortgage in long term decline



Changing demand in mortgage market

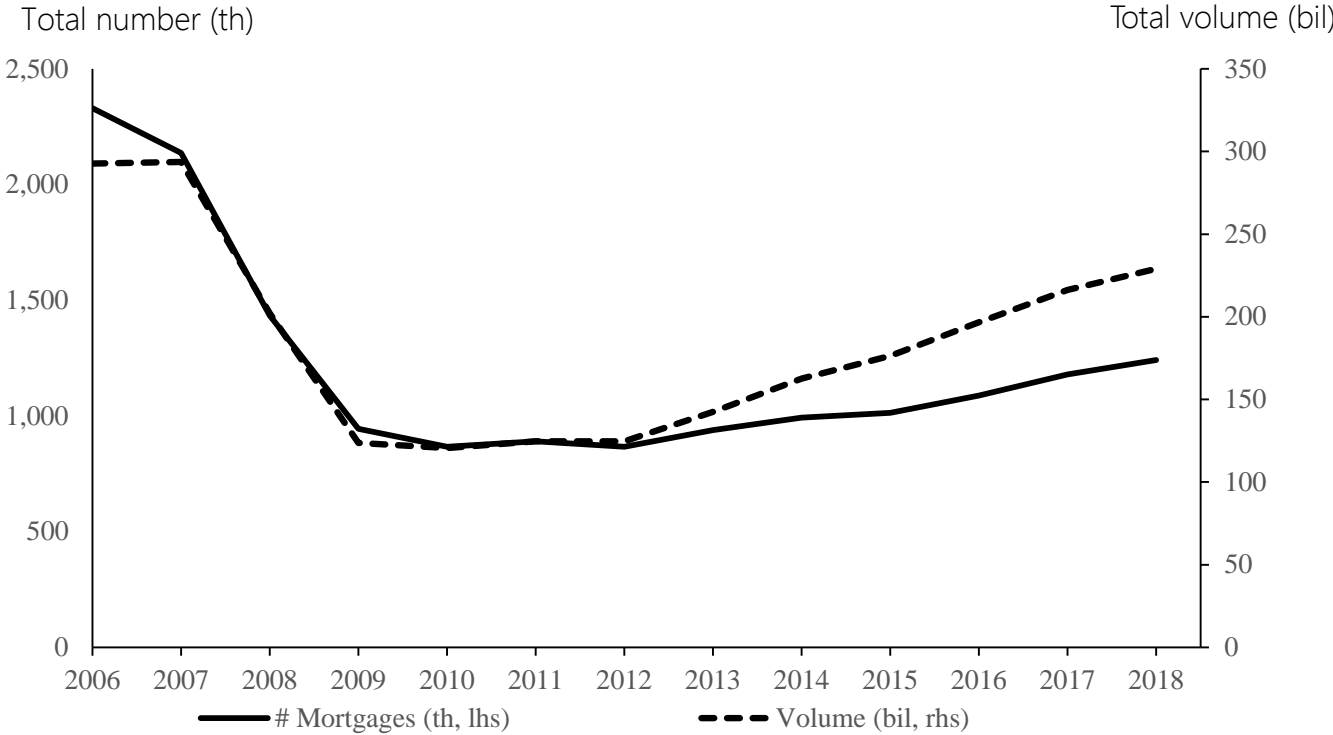


Source: English Housing Survey

Share households
owning property
outright increasing

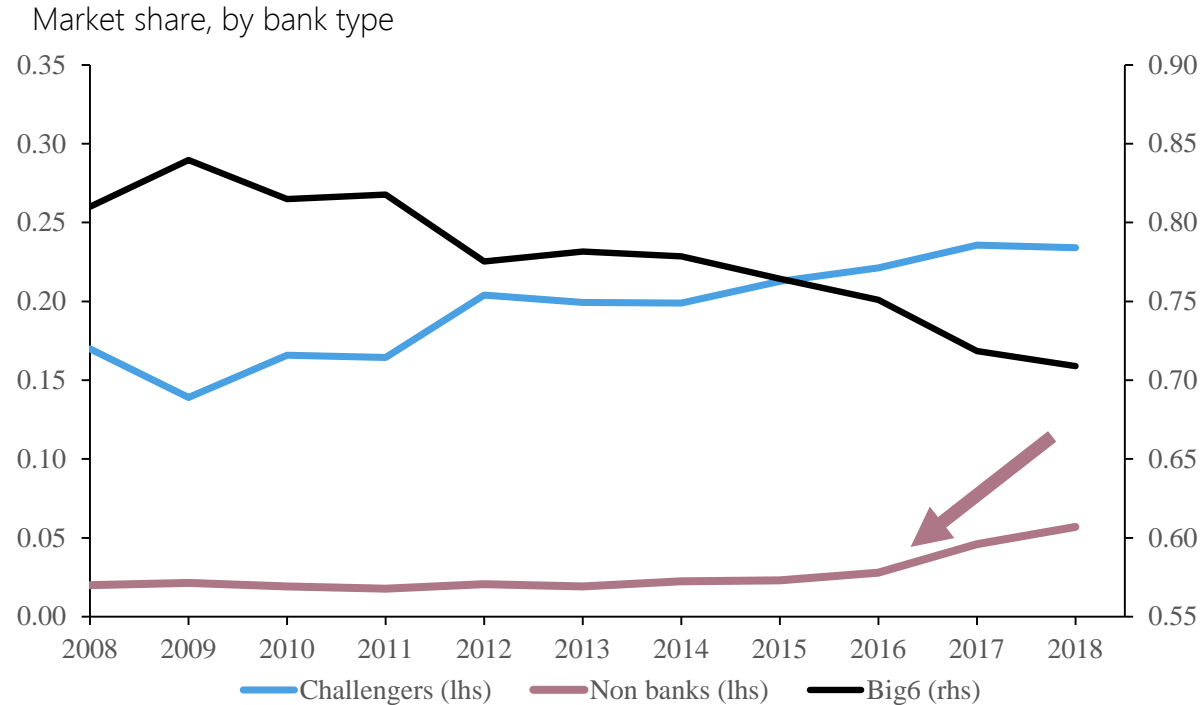


Fewer mortgages originated



Source: FCA - PSD and Bank of England calculations

And growing role of non-banks



Source: FCA - PSD and Bank of England calculations

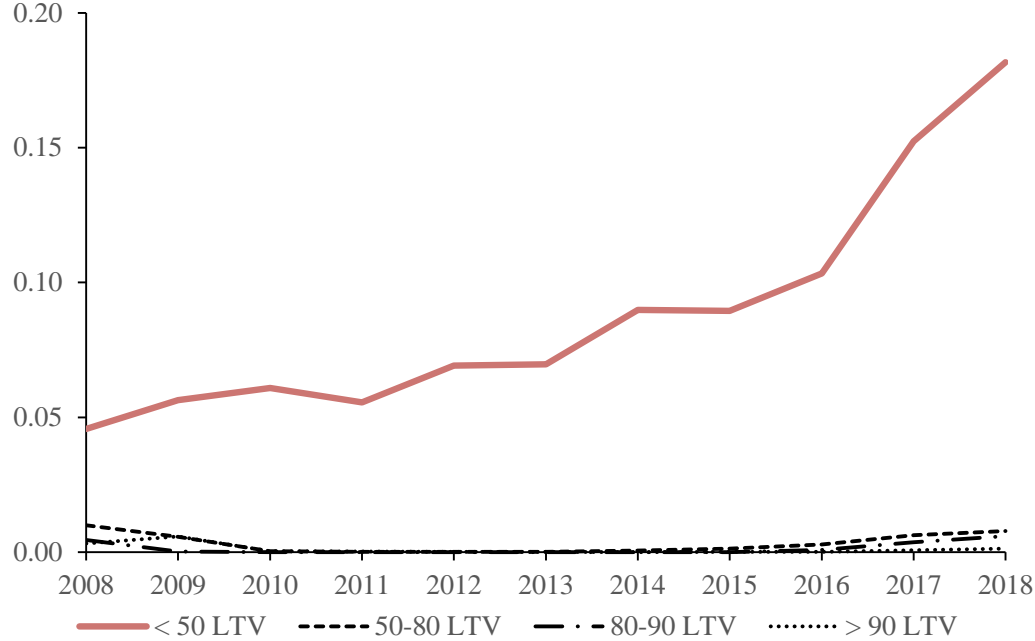
Low base but fast growth, especially since 2016



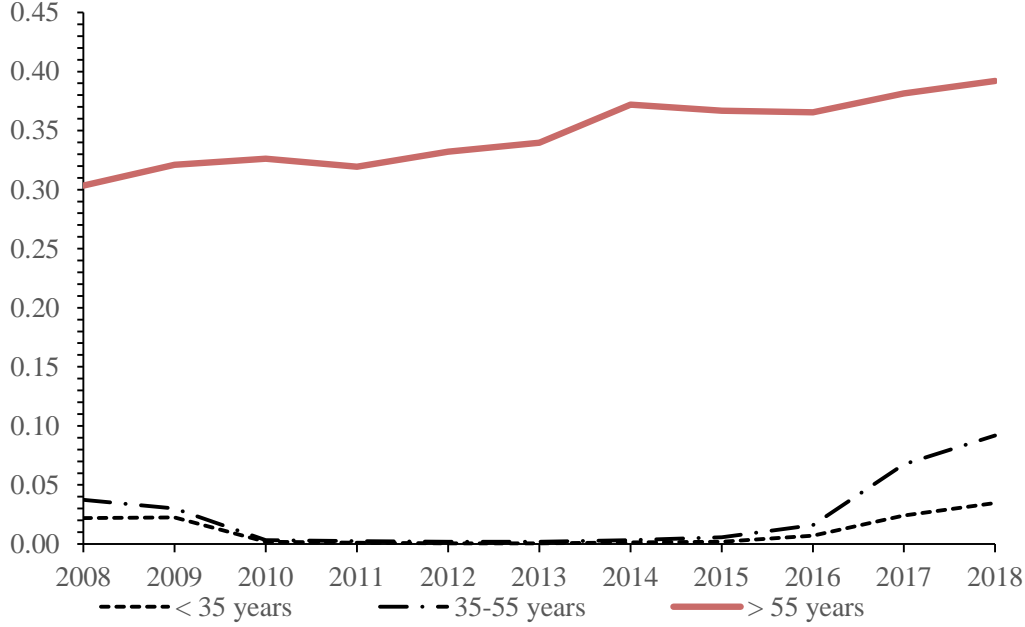
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Mainly in low LTV mortgages for 55+ households

Market share non-banks, by LTV



Market share non-banks, by age cohort



Source: FCA - PSD and Bank of England calculations

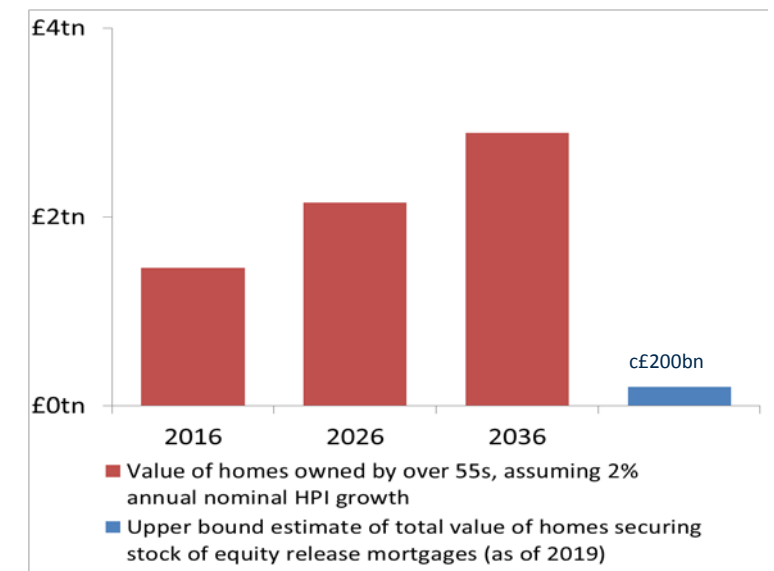
Equity release mortgage

- A loan paid to a borrower
- Secured against their home
- Loan repaid when house sold
 - Upon death, entry into long-term care
 - Earlier voluntary prepayment
- Allows wealth to be turned into cash



Niche market, but demand growing

- Large proportion retirees is asset rich but cash poor
 - Way to release cash
- Increasingly harder for young people to get on property ladder
 - Possibility for intergenerational transfer outside bequest
- Over-55s' untapped property wealth is growing



Source: Equity Release Council and Bank of England calculations



Niche market, but demand growing

- In UK growing with 7 percent each quarter since 2016
 - 2018: nearly 4 bn in equity release lending
- Growth depends on lot of factors
 - Need: demographic pressure, retirees' consumption and care cost
 - Future funding social care cost
 - Consumer preferences intergenerational wealth transfer
 - Feasibility: home ownership, mortgage debt, residence turnover rate
 - Lenders willing to sell these products
 - Price: loan interest rates have fallen significantly in UK since 2016



Equity release mortgage

- Key loan characteristics
 - Long maturity (duration ~15-20 years)
 - Fixed interest rates apply until maturity (“rolled up”)
 - Interest rates relatively high, but decreasing
 - No Negative Equity Guarantee (NNEG)
 - loan repaid is capped at house value
- Key risks to lender
 - House price risk
 - Longevity risk
 - Interest rate risk (for banks)



Barriers for banks providing ERMes

- Standard mortgages fit better with bank balance sheet
 - ERMes are a poor match for short-dated, floating rate liabilities (deposits)
- Expertise needed in assessing longevity risks
- But banks can act as underwriter/originator
 - Brand and customer base
 - Generate fee income



Attractive to insurers

- Search for yield in low interest rate environment
- Option to diversify exposure
- Good match for long-dated, fixed rate liabilities (annuities)
 - Avoid maturity transformation and interest rate risk
- Have expertise in assessing longevity risk
- Cash-flows vary with borrower longevity



Benefits ERM provided by insurers

- Diversification of funding sources for the real economy
- Unlocking cash → increased consumption
- Can help fund deposits of first-time buyers
 - Way to help younger cohorts on the property ladder
 - Only benefits children with wealthy parents
 - Distributional consequences

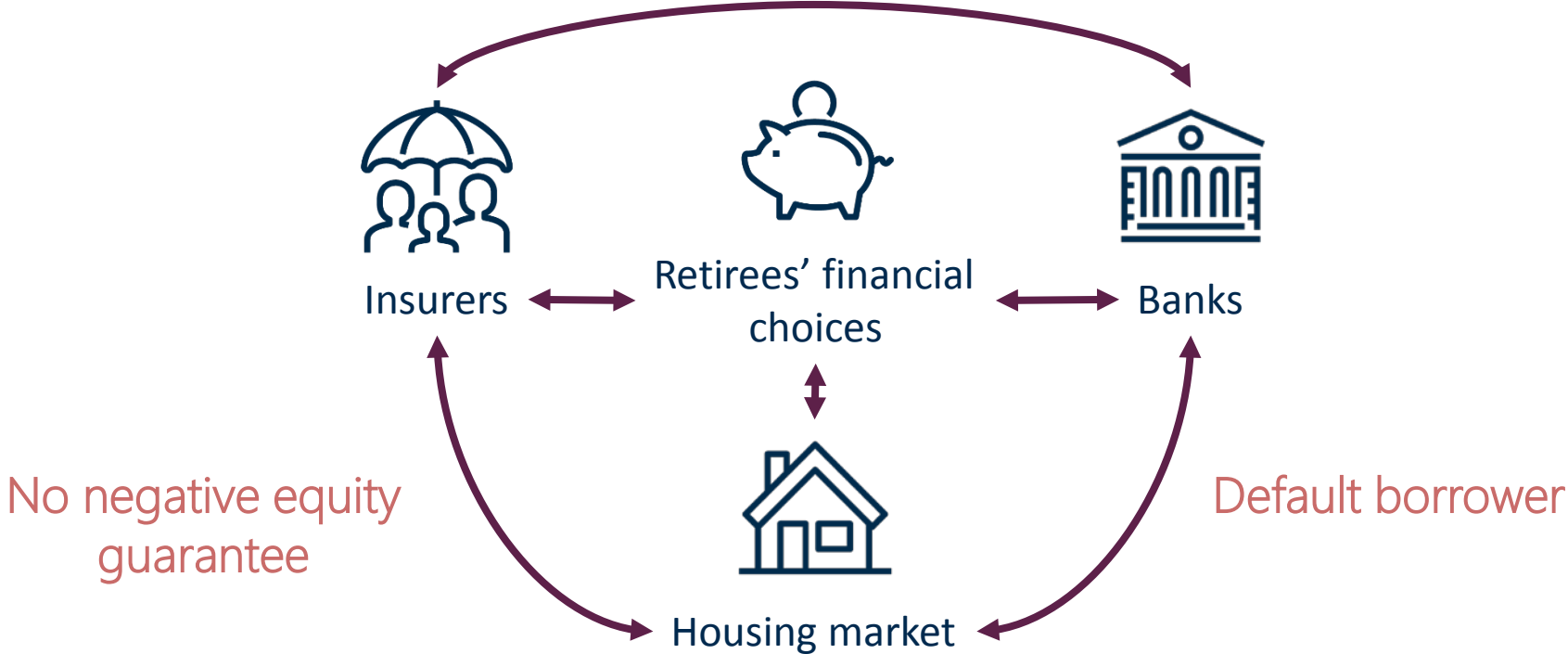


Micro-prudential risks insurers

- Solvency risk
 - Inherent risk of products (e.g. NNEG)
 - Sector concentrations
 - Limited experience assessing risk mortgage market
 - Mitigants: Solvency II regulation and capital requirements
- Conduct risk
 - Uncertainty in enforceability of some product terms
 - Potential redress cost associated with new products
 - Mitigants: Pillar 2A capital requirements, FCA engagement



Risks to financial stability



Increased interconnectedness: both banks and insurers exposed to housing market



Final remarks

- Economy is always changing and financial system constantly evolving
- Demographic changes are a key driver
- Clear benefits of a well-functioning, diversified financial sector
- Non-banks might be better suited to provide certain financial products
- Important to monitor these changes, especially interconnectedness
- Over time the focus of regulation may need to shift



THANK YOU



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