

## GUIDELINES FOR EQUITY RELEASE SCHEMES

**The Conveyancing Committee of the Law Society of Ireland has developed these guidelines in order to assist practitioners when asked to advise on Equity Release Schemes.**

*“Equity release schemes”* is a generic name given to a range of financial products now being offered by lenders.

The schemes available allow a homeowner to release equity from their home, allowing them to obtain a lump sum. The schemes are marketed to older people who are homeowners, and who may find themselves living on a tight budget. It is a condition of equity release schemes that the borrower meet a minimum age criteria, and therefore the borrowers can be a potentially vulnerable class of persons.

### **1. PRODUCT TYPES**

The schemes currently available on the market can be broadly divided into two groups and, while both schemes allow the borrower to release equity in their home, the terms and conditions applicable vary greatly:

**1.1 Lifetime Mortgage Schemes** allow the borrower to **mortgage** an interest in their home without any liability to repay the mortgage during their lifetime, and the borrower continues to own their home. If there is more than one borrower, then they must own the property jointly.

The mortgage is paid back upon the happening of any of the following events: the property being sold; the borrower moving out permanently; or after their death. An important point to note here is that some of the lenders may insist upon the mortgage being paid off in circumstances where the borrower moves out, for any reason, for more than six months, and this is discussed later on.

The amount of money that can be borrowed depends upon the age of the borrower and the value of their home. Depending on the product provider, the type of mortgages available to the borrower are either a fixed rate lifetime mortgage, where the interest is either fixed at a set rate for a number of years or for the lifetime of the mortgage or, alternatively, a variable rate lifetime mortgage, where the interest rate will fluctuate with interest rates generally. Again, depending on the product provider, the borrower can borrow a lump sum, instalments or both.

The borrower is charged interest on the money borrowed, which is added to the sum borrowed. Therefore, each month the borrower is charged interest on what they have borrowed, plus the interest added from previous months. An important consideration here is that the borrower could be left with ‘negative equity’, in circumstances where

the amount they owe is more than the value of their home. Therefore, it is vital that the borrower receives a 'no negative equity' guarantee from the product provider.

The borrower can redeem the mortgage at any time. However, if they have a fixed rate mortgage, they may be charged an early repayment fee.

More recently, a product has been launched into the market, which is an 'interest only' mortgage. This means that the borrower pays off the interest on a monthly basis leaving the principal to be repaid when the property is sold. This type of mortgage can be taken out, not only on the borrower's family home, but also on a holiday home or an investment property.

**1.2 Home Reversion Schemes** enable the borrower to **sell** an interest in their home whilst retaining the right to live there during their lifetime. A feature common to all reversion schemes is that the purchaser will not pay the market rate for the interest purchased but pays the market rate, less the value of the life interest of the occupant(s) who will occupy the property for their respective lifetimes.

The percentage of the property which the reversion company buys depends upon the homeowner's age and also the value of the property. The borrower takes the money as a lump sum and it is not possible for them to take instalments.

The borrower may either have a fixed-share contract, which means that the percentage of the borrower's home which is acquired by the reversion company, is fixed from the start and does not change regardless of how long the borrower lives or how much their property is worth in the future. Alternatively, they may have a variable-share contract, which means that the longer they live the less of the property they own. In this scenario, although the borrower receives a bigger lump sum at the time they first sell the interest to the reversion company, the percentage owned by the reversion company increases each year, but the borrower does not get any further payments.

Upon the death of the borrower, the property is sold and the reversion company will receive their percentage from the sale proceeds.

## **2. LIABILITY/ RISKS FOR SOLICITORS**

It is important to remember that the type of clients becoming involved with this unfamiliar product will be elderly. Accordingly, they will be relying on their solicitor to point out any potential for disaster either in the short or long term, and to reassure them whether, in fact, they are doing the right thing.

Therefore, what is the role and obligation of the solicitor presented with documents for execution and charged with the task of advising the client? Although the answer will depend on the circumstances of each case, it is suggested that the solicitor's role would include consideration of the following:

## **2.1 CAPACITY**

This is something which normally arises in the context of making a Will, and the same test would apply to Equity Release Schemes. Do you know your client well enough to assess their ability to manage their own affairs? Are they aware of their assets and liabilities and the names of their next of kin and potential beneficiaries?

In the event of there being any doubt about the capacity of the client, a letter should be obtained from the client's doctor confirming such capacity. A client may resent being asked for such a letter and it may be necessary to explain that this is for the protection of the solicitor as much as for the benefit of the client.

## **2.2 THE PURPOSE OF THE FINANCE BEING RAISED**

The solicitor should enquire as to the purpose for which the loan advance is being sought, and consider whether there are any other options available to the client. The solicitor should also discuss in general terms the fact that an equity release scheme, while providing cash now, may limit the options available to the client later in life when it may really be needed, i.e. has the client thought about whether they will have enough money left to fund their care in a nursing home?

The question of duress must also be considered. Is there a possibility that the client is under pressure from a child or any other person to raise money for an ill-advised purpose? The standards for solicitors dealing with cases of a possible presumption of undue influence were set out in *Carroll v. Carroll* (1999) 4 IR 241, which emphasised the necessity for the solicitor to ascertain all relevant facts including details of family members and the client's relationship with them. Factors which may alert the solicitor's attention to the possibility of undue influence would be:

- When the client is borrowing money for the benefit of a third party, or to gift to a third party, and there are objective indications of pressure or influence from others (e.g. family members);
- When the client is physically or mentally infirm;
- When the client is dependent upon family members to look after their financial affairs;
- When there is family division, typically between the client's adult children; and
- When the client is in an inexplicable rush to complete the transaction.

## **2.3 THE TERMS OF THE PROPOSED SCHEME**

It is vital that the acting solicitor understands the transaction and recognises what is involved, and it is necessary to read and review the documents presented to the client, as the product terms are continually changing. Therefore, regardless of the product name, it is important to identify the type of product at hand.

The solicitor should discuss with the client the different types of schemes available to ascertain whether the terms of a different scheme would suit the client's circumstances better.

It is necessary for the solicitor to explain the terms of the loan, the nature of the mortgage securing the loan, the legal effect of entering into such a transaction, the circumstances in which the loan and the mortgage must be repaid and the obligations on the client to ensure that they do not trigger any event of default.

The client will need to know if there is anything that might interfere with their right to possession of the house during their lifetime. Any such possibility will be set out in the terms of the relevant scheme.

## **2.4 VALUATIONS**

It would be advisable for the solicitor to recommend that the client arrange to have an independent valuation of the property carried out. This assures greater protection for the solicitor as the independent valuer can confirm the valuation of the lender's valuer.

However, a client might well reject the advice to obtain a second valuation, having already paid for the lender's valuation, but the client should, at least, be informed by letter that such advice is given. An accurate note should also be kept of any attendance at which such advice is given.

The potential loss may be even greater if the scheme is a Home Reversion Scheme. In this case, any loss would fall on the client's estate after their death rather than on the client during their lifetime. In such circumstances, the solicitor should clearly advise having the valuations checked and having the valuation of the life interest checked. If the client rejects the advice, it will be important that the advice be recorded in correspondence and in any attendances on the file.

## **2.5 INTEREST RATES**

In the case of the Lifetime Mortgage Schemes, consideration will clearly have to be given to all aspects relevant to the interest rate: the current interest rate; whether it is fixed or variable; is a redemption fee payable in the case of early redemption? if the rate is variable when can it be varied and by how much? is there a minimum length of time which must expire before it is varied? is there a maximum rate beyond which it will not be increased? if open-ended what criteria will apply to the interest variation? etc. Some of these matters may have different significance depending on whether your client is aged 60 or 80 for example.

## **2.6 THE IMPORTANCE OF GIVING INDEPENDENT AND PROPER ADVICE**

It was pointed out in the case of *Carroll v. Carroll* that it is not enough for a solicitor merely to follow their client's instructions. The solicitor must give advice which takes into account all the relevant circumstances and in circumstances where there can be no conflict of interest.

### **2.6.1 Independent advice**

An important question is whether the solicitor's advice to the client is independent.

The solicitor should be careful not to advise the client on the terms of documentation in circumstances where the solicitor's firm has a relationship with the lender, the promoter, or an intermediary who has an interest in ensuring the sale of the product to the client, such that the solicitor's advice may later be viewed by others as not having been entirely independent, or was given without full disclosure of the nature of any relationship having been made.

The safest rule is for the solicitor to maintain absolute independence.

### **2.6.2 Social welfare**

Advices given to the client will also include advice on what effect the equity release scheme might have on the client's social welfare benefits. If they are means-related, will the proceeds from the scheme have an effect on the entitlement to receive the benefit? Therefore, solicitors consulted should ensure that their client makes the relevant enquiries with their Social Welfare Office.

In these circumstances, a prudent solicitor would not only advise the client to seek the necessary advice but would defer execution of the documentation until such time as the client advises that they have done so, and of the outcome of such advice.

### **2.6.3 Tax advice**

The solicitor should recommend that clients seek their own taxation advice, unless they have expertise in this area.

### **2.6.4 Financial advice**

The solicitor should give consideration to the client obtaining independent financial advice, to include such matters as the comparing of interest rates available e.g. fixed rates with variable rates.

### **2.6.5 Keeping records of advice**

It is essential that proper attendances of all advices are kept and are supported by follow-up correspondence, which should confirm the advice given, and demonstrate that it was given in full knowledge of all the relevant circumstances. Written advice is

preferable because an elderly client might well need time to absorb complex advice and be given an opportunity for reflection.

In cases arising from equity release schemes for the elderly, the person to whom the advice was given will also be deceased at the time a claim is brought and the attendances and correspondence will be of prime importance.

### **3. EQUITY RELEASE SCHEME ISSUES**

Practitioners should pay particular attention to the following non-exhaustive list of issues which arise in relation to equity release schemes:

#### **3.1 Lifetime Mortgage Schemes**

##### **3.1.1 Borrower obliged to make a Will:**

Some lenders require the borrower to make a Will, and the Executor is obliged to sign a Form of Undertaking to co-operate with the lender. Further, the borrowers are obliged to disclose to the lender the names of their beneficiaries.

##### **3.1.2 Right to call for Repayment of the loan or to Sell the House:**

Some lenders reserve the right to call for repayment of the loan or to sell the house during the borrower's lifetime if another lender forecloses on another of the borrower's properties that is in no way connected with the mortgage.

##### **3.1.3 Right to sell the property:**

In some schemes if the homeowner ceases to reside in the house for 6 months or 6 out of any 9-month period without the consent of the company, then the company has the right to sell the house. At the time of this document going to print, one of the product providers has recently varied that period to 12 months out of any period of 18 months.

#### **3.2 Home Reversion Schemes**

##### **3.2.1 The Windfall Factor:**

As already mentioned, under a home reversion scheme the purchaser does not pay the market rate for the interest purchased, but pays the market rate less the value of the life interest of the occupant(s). The windfall factor arises because the market value paid for the interest sold is reduced by the value of the life interest of the homeowner to take account of the fact that they would remain in possession for the rest of their life. However, an exorbitant profit may fall to the product provider if the homeowner sells an interest in their home to the product provider and dies shortly afterwards.

However, some of the product providers have introduced schemes to offset this windfall factor and the terms of same should be carefully reviewed.

### **3.2.2 Maintenance Obligations under Co-Ownership Agreement:**

Common to this type of scheme is that the borrower is required to enter into a Management Agreement and a Co-Ownership Agreement to ensure that the property is well looked after, and includes provisions re. insurance and the right to inspect etc. The Co-Ownership Agreement contains a Pre-Emption Clause, which provides that, should the borrower wish to sell the outstanding interest in the property, the product provider would have first option and, upon exercising this option, it can buy the property at the 'market price', which would be defined in the scheme.

## **4. FAMILY AND THE LOSS SUSTAINED BY THE BORROWER'S ESTATE**

A borrower may be encouraged by a lender to discuss the equity release scheme with family members, thus ensuring that any problems are resolved before money changes hands. However, if a client does not wish to involve family members, a cautious solicitor should again ensure that they have proper attendances of all advices on their file.

A further consideration for the solicitor to bear in mind is the impact that a scheme could have on a borrower's estate, in that monies available for distribution under the estate will be reduced, which means there is potential for family members and beneficiaries to complain later. If a claim is brought against the solicitor for the deceased houseowner by the houseowner's estate will the claim be successful? It would clearly be dangerous to assume that it would not.

At one time it was thought that a solicitor who was negligent in drawing up a Will could have no liability to beneficiaries who suffered consequent loss. This was changed by the English case of *Ross v. Caunters* (1979) 2 AER 580 in which it was stated that:

“A solicitor who is instructed by his client to carry out a transaction that will confer a benefit on an identified third party owes a duty of care towards that third party in carrying out that transaction, in that the third party is a person within his direct contemplation as someone who is likely to be so closely and directly affected by his acts or omissions that he can reasonably foresee that the third party is likely to be injured by those acts of omissions.”

This was followed in the Irish High Court in the case of *Wall v. Hegarty* (1980) ILRM 124 which related to a claim by a beneficiary who lost a benefit due to a Will having been wrongly executed.

Of course it might not be possible to identify a beneficiary at the time the house is mortgaged or an interest in it is sold. A number of Wills can be made at different times and different beneficiaries named in each one. This point arose in *Ross v. Caunters* in which it was stated that:

“I accept, of course, that a testator may at any time change his Will and that while he lives no beneficiary under his current Will can have more than a spes. But his death

changes all that. In this case, but for the negligence of the defendants, the plaintiff would have received a share of the residue of an ascertainable amount; and that amount is no mere spes.”

## **5. REGULATION OF HOME REVERSION FIRMS**

Finally, since 1<sup>st</sup> February 2008, the Financial Regulator is now the body responsible for the authorisation and supervision of home reversion firms. Accordingly, home reversion firms were required to apply to the Financial Regulator by 30<sup>th</sup> April 2008 for authorisation. Further information can be obtained from the Financial Regulator’s website at [www.financialregulator.ie](http://www.financialregulator.ie).

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