CHAPTER- VI

PERCEPTION OF INSTITUTIONAL RESPONDENTS AS TO REVERSE MORTGAGE SCHEME

6.1 Introduction

This section analyses the responses to questions asked by researcher during interviews with officials of commercial banks, insurance companies and National Housing Bank. These questions were about their general perceptions about the reverse mortgage scheme, the risks associated with it and options for managing them, why the demand for the scheme has not picked up in a significant way and what needs to be done to make it popular. This section reports main themes that emerge from the responses given by these respondents.

The present chapter has been divided into three sections. Section I is about introduction and organisation of the chapter. Section II reports the perceptions of senior officials of the institutions that are closely associated with implementation of reverse mortgage scheme. Section III provides a summary of the chapter.

6.2 Perceptions of Institutional Respondents

This section reports on the perceptions of institutional respondents from NHB, Commercial banks and Life Insurance Companies regarding reverse mortgage scheme. These institutions are closely associated with implementation of reverse mortgage scheme. This information was collected while interviewing some senior officials of these institutions. Their perceptions were captured on the issues like:

I. Their experiences with this loan scheme.

II. The risks and problems faced by them in its implementation.

III. Why there are very few takers of this product.

IV. What are its future prospects and

V. What needs to be done to improve the demand for this loan facility
The common themes that emerged from their responses on these issues are hereby reported.

6.2.1 Perceptions of Bank’s Executives

Most bank officials that researcher spoke with confirmed that the product has failed to find takers during the last five years of its existence in India. Despite its potential economic appeal, using reverse mortgage to finance consumption after retirement has been the exception rather than the rule among elderly homeowners. The response to reverse mortgage scheme has not meet with the expectations of banks. For a large number of banks, one can count the number of reverse mortgages done on finger tips. According to bank official there are some very basic reasons that have worked against this product which has done well in international markets. Some of the reasons given by them are:

a) Socio-Cultural Factors

i. As per the perception of bank officials, the psychological aspect of the loan for consumers is the most critical barrier to its acceptance. The psyche of Indians does not make them comfortable with the idea of selling their home. In India there is an age-old family tradition of passing down one’s property over generations. It is the passing down of the family property, which provides a key link in the establishment of the family social unit. In India, people spend whole life into building a dream home for themselves. So, they have a strong emotional attachment with that property. It will take some time for banks to break this psychology. Senior citizens have strong bequest motive. Sentiments overrule the requirements, when it comes to mortgaging one's own dwelling.

ii. Indian culture places importance on providing for one’s parents. This reduces the available audience for the product. Reverse mortgage is psychologically resented by children as it sends the message that they do not take care of their elders. So, there is an element of psychological tension associated with this product.
iii. Most elders in India do not like to go into debt in old age. There is a social stigma attached to borrowing, especially for old age people. It becomes difficult for banks to promote this product in Indian market.

b) Problems and Risks faced by Banks

Banks are not pushing reverse mortgage products with great enthusiasm. They see a number of problems with the present product:

i. Reverse Mortgages are significantly different from traditional “forward” mortgages. Lenders with little experience in the reverse mortgage market often are confronted with unfamiliar documentation requirements. Moreover they have to deal with senior citizens, most of who do not understand this complex product and have a large number of queries, many of which are difficult to answer. Despite spending a good deal of time with them, they are not ready to take up the product. In India, the housing finance market is booming and, therefore, banks do not show interest in this innovative product.

ii. The banks feel that that this is a long term product involving a number of risks like longevity, property title, interest rate, property price fluctuations and property valuation. The banks due to short term nature of their operations are not too keen to assume all these risks. The risk to the lender also arises from “non-recourse” clause in reverse mortgage loan. This prevents either borrower or his estate from owing more than the value of the home when the loan is repaid. There are no reliable long term data on property price fluctuations that could help the lender in appropriately pricing the product. There could be legal risks also if the lender is not able to bring the underlying property to sale, due to litigations. The lender responds to such perceived problems by either decreasing the loan amount or charging higher interest rate. This makes the loan unattractive.

iii. Bank officials have expressed that one of the reasons for their not taking interest in pushing this new product is related to accounting for accrued interest on loan
amount. Although the interest on reverse mortgage loan leads to income for banks, they don’t actually get the income on yearly basis. Since they account for it on accrual basis, they have to pay tax on it. This creates a problem of timing of cash flows. There is a cash outflow on tax, but there is no cash inflow until the tenure of the loan. This prevents the bank from aggressively pushing this product.

iv. One of the main obstacles to greater participation by lenders in the reverse mortgage market is a lack of demand for these loans. Without greater demand, bank officials say they are unable to achieve adequate diversification in their reverse mortgage portfolio to make it a profitable proposition. Specifically, tenure risk, or risk that certain borrowers would live in their homes and receive payments for longer than the lender assumed in its pricing model, can be reduced only through a large portfolio, so that long-lived loans are balanced by short-lived ones. The risk of adverse regional shocks in the real estate market could also be mitigated through geographic diversification. However, such diversification can be difficult to achieve with a limited geographical presence and with a low volume of loan origination.

v. The banks fear the bursting of property price bubble. This scenario could pose a significant risk for the lenders in reverse mortgage market. As these are very long term products, it is possible that by the time most loan agreements have run a good period and started redeeming themselves either due to end of term or death of property owner, a major downward correction in property prices, could cause a major loss to lender.

vi. The bank officials point out that in the long run this product could create reputational risk for banks as witnessed in the US recently. Recently in US, three major financial institutions offering this product withdrew it due to this risk. They point out that in this loan, while borrowers are not required to make monthly mortgage payments, they can end up with a loan in default if they fail to pay their property taxes and keep their property insured. The banks in US in
the last two years witnessed a growing number of such technical defaults. Due to this they were forced to foreclose the loan on seniors. This step started adversely affecting bank goodwill. Banks felt that when a product creates more reputation risk than values, it is better to get out of it. They don’t want to give a message by foreclosing the loan on seniors that they do not take care of them.

vii. There is shortage of long term risk free government securities where bank can lock their funds for long term to provide an assured annuity to the senior citizen. This could provide a hedge against long term interest rate fluctuations to loan provider.

viii. Bank officials feel that the scheme is loaded against the borrower. The guidelines are such that the borrower gets a very low annuity amount. Instead of mortgaging the property, the better option for senior citizen would be to sell the property, invest the proceeds in a bank and live in a rented house. The interest earned from the sums deposited should be sufficient to take care of his monthly requirements.

ix. Initially the product could not take off due to lack of clarity on income tax treatment of money received. But this aspect was subsequently clarified that any money received on account of reverse mortgage loan shall not be subject to income tax. However under the new version of the product, known as reverse mortgage loan enabled annuity, created in collaboration with insurance sector the regular annuity is still taxable.

x. Widespread undervaluation of real estate properties involving unaccounted money and large number of benami holdings are also major obstacles in the scheme to take off.

c) Bank officials perceptions on future prospects of Reverse Mortgage

Most bank officials feel that despite the problems being faced reverse mortgages should be encouraged in the country. The main reason is that social security is inadequate in the country. Significant demographic changes are taking place in India. The elderly population is slated to double in the next decade. One needs to look at the
financial implications of longevity. It is in this context that seniors should seriously examine reverse mortgage. This has the potential to be best pension plan.

They have also expressed that changes in the social fabric will alter the perception towards this product in the near future. Gradual collapse of joint family, rapid urbanization, greater desire for financial independence and greater willingness to assume debt in old age could motivate future retirees in Indian society to give greater acceptance to it. It can lend dignity and peace of mind to elders by opening a financial lifeline for them.

d) What needs to be done to improve the demand

i. The Bankers feel that government should take initiative in building a database on mortgaged properties, quality of houses, their residual life, value of transactions etc. to reduce the risk exposure of banks. Such database should contain information on properties against which owners have availed loans, summaries of those loans and comprehensive information on those properties. It will help lenders share and access mortgage information, exercise stronger due diligence and reduce fraudulent transaction.

ii. Regulatory framework should be strengthened to ensure that most properties have clear ownership title. The bank officials have experienced that legality of title ownership is affecting the target market as large number of residential properties in India do not have clear ownership title.

iii. In US the product is popular as the banks hardly face any risk. In the US there is guarantee from the government organisation to the lenders that if the loan amount exceeds the property value than their liability of the lender is only restricted to the property value. Guarantee of this kind, if provided in our country may motivate lenders to aggressively promote this product as it protects them from longevity risk.

iv. There is a need for reliable long term data on property price fluctuations that could help the lender in appropriately pricing the product.
v. As it is an unconventional product, there is need to create a better awareness about it. A large number of senior citizens do not even know of the product existence and those who are aware of it do not know about its detail features. There is a need for enhancing consumer confidence through improved consumer information. Special educational programs will need to be developed to target different segments of the older homeowner population, including less financially sophisticated elders.

vi. There is a need to set aside funds for property taxes and insurance in cases where borrowers have demonstrated consistent delinquency in making these payments.

6.2.2 Perceptions of insurance Company Executives

This section reports on the perceptions of life insurance company’s officials. This is important as a new version of the product has been developed and offered in our country in which life insurance sector is also involved. This version provides a life time annuity to the borrower in place of term annuity in the earlier version. Internationally also in many countries this product is offered by life insurance companies. Therefore their views are very important in making assessment about this product. There is growing realisation that reverse mortgages are less like forward mortgages than they are like life insurance. As reverse mortgages promise a lifetime income, this becomes an area where the life insurance industry is very well suited. The common themes that emerged from the responses given by insurance company officials are reported below:

i. They feel that by its very nature, the product should have been promoted by insurance companies. It is basically a long term product involving many risks of long term nature like longevity risk, property price fluctuation over long term and long term interest rate movements. Having a product of this kind in the bank’s portfolio could lead to asset liability mismatch. Banks have traditionally been providers of short term finance. They are not likely to be comfortable with the
demands being made on them regarding the risk assessment and proper pricing of the product. Banks are hardly promoting this product or taking some proactive measures regarding generating business in this area. Recently some initiatives have been taken to involve insurance companies in this business by launching a new version of the product in the form of reverse mortgage loan enabled annuity which provides a life time annuity to the client. Even in this model client will mainly have an interaction with bank. Instead of one intermediary there will now be two. The product should now generate income for two intermediaries. This kind of revenue model makes the product costly for the consumer.

ii. Insurance companies by very nature of their business are into managing longevity risk and long term interest rate movement risks. Their actuarial staff can do a better work in assessing these long term risks and appropriately price the product.

iii. The insurance companies have many products in their portfolio. This could help them in cross matching the risk profiles of different products. This aspect was clarified by them in this form. In the reverse mortgage, the main risk is that the client may live unduly long (longevity risk) which could lead to loan amount becoming more than the property value. Life insurance companies have a large number of pure term plans and endowment plans in their portfolio. These products carry maximum risk in case of early death of the insured. In reverse mortgage the maximum risk is from longevity or late death and in case of term and endowment plans maximum risk arises from the early deaths. This scenario provides the opportunity for cross matching if you have both products in your portfolio. It creates a hedging opportunity.

6.2.3 Perceptions of NHB Officials

i. NHB officials feel that there is a need to create better awareness about the product. Although their organization is doing it’s utmost to spread the awareness about reverse mortgage by frequently holding senior citizens workshops and seminars all over the country in most big cities. Despite that most of the eligible senior citizens do not even know that such a product exists. The level of
financial literacy is low even among the well educated people in our country. There is a need for greater propaganda by all associations of senior citizens, magazines, newspapers and government departments at the centre and state level dealing with matters pertaining to senior citizens to explain the reverse mortgage scheme and its benefits to senior citizens. The role of the government in terms of promoting the financial literacy levels in general and seniors in particular is very important.

ii. Lack of reliable data on property appreciation makes the task of pricing the reverse mortgage product difficult for lender. Now the National Housing Bank has started providing information on property price appreciation in major cities through its ‘Residex Index’.

iii. To make the product attractive for the retirees, lenders will have to think in terms of providing new products such as inflation adjusted annuity or growing or variable annuity. The NHB has already taken an initiative in the form of launching a new version of the product. This version is called reverse mortgage loan enabled annuity (RMLEA). This involves both banks and a private Life Insurance Company. This version provides a life time annuity to borrower as compared to term annuity in the earlier version.

iv. The elderly too need to understand that reverse mortgage is not social service but a market-based commercial solution. As the borrowers in case of reverse mortgage are property holder, they should not expect any subsidy from the government in the form of lower interest rates.

v. The growth of this sector will largely depend on establishing and maintaining consumer confidence, which in turn means ensuring that negative consumer experiences are avoided. The role of building this consumer confidence and ensuring appropriate consumer education not only falls on those within the mortgage industry but also the government, independent bodies and other regulators.
vi. The banks, because of their regular interaction with senior citizens could have played the lead role in promoting and creating wide spread awareness about this product. They should have trained their staff, so that they have good knowledge of this new product and patience to deal with senior citizens. But the banks sell what is easy to sell and makes them money and not what is in the best interests of their customers. Most banks offering this product have not done their job. They are not showing much interest in promoting this product. They see many risks with this product, which doesn’t fit in their risk appetite. Reverse mortgage therefore does not even find a mention in the product portfolio of many banks. Only two or three banks have done most of whatever little business in reverse mortgage has been done till date. Most of the promotional work in this field is being done by NHB. This has limited impact because it has no direct and regular interaction with senior citizens like banks.

vii. NHB executives feel that reverse mortgage is an unconventional and a complex product for most senior citizens. The concept of reverse mortgage greatly appeals to them. Their initial response to the product is mostly positive. But as the use of this loan facility involves a decision about their most important asset, various apprehensions dissuade them from actually using it. Most of their apprehensions are due to lack of clarity about the product features. To create better understanding we need more interaction with user group. There is a need to present consumers with complete, impartial and clear information. The role of good counselling assumes special significance in this regard. Mandatory counselling for every customer on the lines of one provided in United States could improve the situation. The NHB is thinking on the lines of preparing a list of approved reverse mortgage counsellors. It should be made mandatory for anyone seeking reverse mortgage loan to undergo counselling session with one of these approved counsellors.

viii. Government should be pressurised for tax-exemption of life time annuity under the new version (RMLeA) by all the stake holders connected with welfare of senior citizens. Making life time annuity income tax exempt may enhance the
appeal of the new version for the seniors. Taxation issue is also important for lenders. They would also find the product viable for them, if regulations permit them to deduct interest payments accumulated on their reverse mortgage loans but not receivable by them until the sale of the house. The government should address these tax related concerns to improve the reverse mortgage market.

ix. As the volumes are already high in normal home loan market, banks at present are not focussing their attention on a new and unconventional product like reverse mortgage. But there are billions of rupees invested by seniors in the house property waiting to be tapped through this new and innovative product. Once the volumes dry up in regular or forward mortgages, banks will be forced to shift their attention towards reverse mortgage market.

x. People should be made to realize that government due to fiscal constraints and high income inequalities cannot provide for the old age income and social security for all citizens. Government may not have financial resources considering the current numbers and growth projections of elderly population. In the absence of state and family support, middle class senior citizens should look to their house property to generate much needed cash in times of need.

xi. Greater participation of the life insurance sector in this market could help in risk sharing and making available lifelong annuity stream to a large number of borrowers. The process has already started in the form of new version of the scheme but it should accelerate in times to come.

6.4 Summary

This chapter presents the results of data analyses in terms of institutional respondents perception as to reverse mortgage scheme. This analysis is based on the responses to semi-structured interviews given by officials of the institutions connected with reverse mortgage.

Researcher interactions with institutional respondents reveal that most of them have a favourable impression of this loan scheme. Most institutional respondent’s feel that
reverse mortgage should be encouraged in the country. But all expressed serious concerns regarding actual implementation and social acceptability of such a concept at present in India.

There is a general feeling that changes in the social fabric in the form of gradual collapse of joint family, rapid urbanization, greater desire for financial independence and greater willingness to assume debt in old age could motivate future retirees in Indian society to give greater acceptance to it.