April 2006

Financial Services Authority

FSA Factsheet

Will your investment or savings plan pay off your mortgage?

This factsheet is for you if:

- you are using an investment or savings plan such as an endowment policy, Individual Savings Account (ISA), Personal Equity Plan (PEP) or personal pension to pay off your mortgage.

It sets out:

- why you need to review your investment or savings plan regularly;
- what to do if you think your investment or savings plan won't pay out the target amount; and
- what you can do later if you can't take action now.

The Financial Services Authority – the UK's financial watchdog

If you have an interest-only mortgage, you may have taken out an endowment policy, Individual Savings Account (ISA), Personal Equity Plan (PEP) or personal pension to pay off the loan at the end of the mortgage period. This factsheet explains what you can do if your investment or savings plan may not be on target to pay off your mortgage.

Interest-only mortgages

Unlike a repayment mortgage where your monthly payments gradually pay off the amount you borrowed (the capital) as well as the interest, with an interest only mortgage your monthly payments only cover the interest on the loan. They do not pay off any of the money you have borrowed. Money left owing at the end of the mortgage period (the term) is known as a **shortfall**.

You may have arranged to pay off the capital at the end of the term, by paying money into an investment or savings plan such as an endowment policy, Individual Savings Account (ISA), Personal Equity Plan (PEP), or you may have linked it to a personal pension. **It is important to check your investment or savings plan regularly to see if it is on track to pay out its target amount.**

If you haven't made any arrangements to pay off the capital at the end of the term, you should think carefully about how you can do this and talk to your lender as soon as possible.

Do I need to take action?

If you think you may have a shortfall, you should consider taking action as soon as possible to make sure you can repay your mortgage – see page 3. If you don't think you can avoid a shortfall, there are options available to you – see page 5.

How can I check?

If you have an endowment policy, you should have received regular letters over the last few years telling you whether your policy is on track to repay your mortgage. These are called 're-projection letters' and are marked 'red' if there is a high risk that the policy is not on track, 'amber' if there is a significant risk that the policy is not on track or 'green' if the policy is on track.

Endowment policies are linked to investments such as bonds and shares, which can vary in value. So make sure that you check each re-projection letter, even if the policy has so far been on track to repay the mortgage.

If you have an ISA or PEP you probably won't get regular re-projection letters, but you can ask your product provider to give you an up-to-date projection of the value of your plan.

If you have a personal pension, your yearly statement won't necessarily show you what your pension fund may grow to by the time you retire, so ask your product provider for an up-to-date projection of the fund. Remember that only part of a personal pension fund can be taken in cash to help pay off any loan.

Contact the provider if you are not sure where you stand on any of your investment or savings plans. You will need to continue to check the value right up to the time you repay your mortgage.

Never just cash in an investment or savings plan or stop paying in without taking professional advice – you could lose out financially.

Remember:

- **review your investment or savings plan regularly to see if it's on track to repay your mortgage;**
- **don't delay – consider taking action now to make sure you will be able to pay off your mortgage – talk to your lender; and**
- **if you can't avoid a shortfall, there are options available to you – talk to your lender.**

Mortgage endowment policies

If you think you have grounds for complaint about the sale of your endowment policy, but have not yet made a complaint, do it now – time may be running out. Our factsheet **'Endowment mortgage complaints'**

has more information. But remember – having a potential shortfall doesn't necessarily mean you were missold your endowment policy.

If you get compensation from making a complaint about the sale of your endowment policy, you should consider using it to reduce the amount you owe on your mortgage.

What can I do now to make up a shortfall?

There are various ways to make up the gap. Some offer more certainty than others. The options available to you are to make changes to your mortgage, start an additional investment or savings plan, or to make changes to your existing investment or savings plan. These are explained below. You may find that one of the options already matches your existing repayment arrangements. If so, consider the pros and cons of continuing or switching to an option that is better for you. **Always take advice if you are not sure which option is right for you.**

Use the following symbols to help you weigh up the options below:

✓ A plus point for this option

? Check this out before making a decision

✗ Take care – there is a drawback to this option

The figures in the examples that follow are for illustration only.

1. Make changes to your mortgage

Ask your lender to switch part of your mortgage – the amount of your projected shortfall – to a repayment method.

✓ Your current projected shortfall should be paid off by the end of the mortgage term.

✓ Should be fairly simple to arrange at low cost.

✓ Could be a flexible option – if the projected shortfall grows, you can switch more of your loan to a repayment method.

Example

Helen is 48 and has an interest-only mortgage of £50,000 linked to an investment. The mortgage has seven years left to run and the interest rate is 4.8%. She asked her product provider to give her an up-to-date projection and this told her there is likely to be a shortfall of about £10,000.

Helen wanted to change £10,000 of her mortgage to a repayment method, but her payments would have increased from £200 a month to £302.97 a month and she didn't think she could afford the increase. Helen talked to her lender, who told her that she could extend her mortgage term by five years as it will still be repaid by the time she retires, though extending the term does mean that she will pay more in total. Her monthly payments will now be £252.96. When the investment pays out in seven years and she pays off most of the mortgage, her payments will reduce.

Talk to your lender if you want to make a change to your mortgage – they may be able to help you.

Ask your lender to convert your whole mortgage to a repayment method so that you repay all the capital by the end of the term.

✓ Your mortgage will be paid off at the end of the term if you keep up the payments.

✓ The longer your mortgage has to run, the smaller the increase in your monthly repayments will be.

? If you can afford it, you could continue with your investment or savings plan just for saving. And some investment products include useful insurance cover such as life cover, or another type of cover such as critical illness insurance.

✗ If you were to cash in your investment you could lose out financially, and you may need to arrange other insurance cover. **So consider getting advice first if you are at all unsure.**

If you want to convert your whole mortgage to a repayment method but are worried that you might not be able to afford higher payments talk to your lender. The increase in payments may not be as much as you think and your lender may be able to come up with a plan that can help you. For example, a repayment mortgage of £50,000 and an interest rate of 4.75% with 15 years to run will cost you £388.41 a month. But in some cases you may be able to extend the term of your mortgage – a mortgage of £50,000 with 20 years to run and an interest rate of 4.75% would be £322.74 a month. This would limit the increase in the monthly payments, though it does mean that you would pay back more in total over the mortgage term. Think very carefully about extending the term if it would end after your retirement age.

Repay part of your mortgage early by paying off a lump sum, or by overpaying each month.

✓ This will reduce the amount you owe, and the amount you need your investment or savings plan to cover.

✓ It may be better value than saving up separately to pay off the shortfall in future.

? You should check whether your lender will make an early repayment charge if you overpay.

? You should also check when your lender will give you the benefit from extra payments – some do so only once a year.

Making changes to your mortgage is probably the lowest-risk option to make up a shortfall. Ask your lender if there will be any charges for making changes to your mortgage, and how much these will be.

2. Start an additional investment or savings plan

Use a cash savings account.

✓ The amount you get back does not depend on the performance of the stockmarket.

✓ May be a good option for the short term – for example, if you have to delay paying off a lump sum from your mortgage because of early repayment charges, or your mortgage is near the end of its term.

✓ Taxpayers can avoid paying tax on their interest by saving in a cash ISA. (But remember there are limits on how much you can pay into an ISA each year.)

In the long term, other options (such as overpaying on your mortgage payments) are likely to prove better value for money.

Use a stocks and shares ISA.

✓ Potentially a good way of saving over the **longer term**. Historically, stocks and shares have grown more than cash savings accounts which have interest added. (But remember there are limits on how much you can pay into an ISA each year).

? Currently a tax-efficient way of saving.

✗ This type of product is linked to the stockmarket, and the value of your investment could fall as well as rise. So there's no guarantee that your investment will grow enough to make up a projected shortfall.

✗ Stocks and shares ISAs are meant for investing in the long term, and generally may not be suitable if you only have a short time to build up a lump sum.

If you decide to start an investment or savings plan to make up a shortfall, it would be a good idea to take financial advice.

3. Make changes to your existing investment or savings plan

If you want to make changes to your investment or savings plan, you should talk to your product provider or a financial adviser. They should be able to tell you if the changes below are possible on your particular investment.

Extend the term.

? You could check whether it is possible to rearrange the investment or savings plan over a longer term, and if you are able to do so, ask your lender to extend the mortgage term to match.

✓ Gives you more time to pay off the loan by making more payments into your policy if you can't afford to increase your payments.

? You may face extra charges, and a tax liability, if you vary an endowment policy. So it may be a good idea to take advice first.

✗ The growth of your investment or savings plan is still linked to the stockmarket, so there's still no guarantee it will reach its target amount.

✗ Not a good idea if it means taking your mortgage into retirement, unless you are sure you'll be able to afford it.

✗ The longer the term of the loan, the more interest you'll end up paying in total.

Top up your investment or savings plan by paying in more each month.

? You should ask your product provider if it is possible to do this and, if so, whether there are any charges. If there were high charges, it may make this option poor value for money.

? You may also face tax liabilities, so you may want to take advice.

✗ Your investment or savings plan is still linked to the stockmarket.

- ✗ You could be worse off than if you used the same monthly payments to reduce your mortgage.
- ✗ Under a personal pension only part of any increased savings can be taken in cash. And nothing can be taken before age 50 (rising to 55 by 2010).

What can I do if I can't avoid a shortfall?

Firstly, when your investment pays out at the end of the mortgage term, you should pay all the money into your mortgage to find out exactly how much you still owe the lender. You then need to look at how best to pay off the shortfall.

Talk to your lender as soon as possible. You may have a number of options available to you, some of which we list below.

- Pay the shortfall from savings you have elsewhere.
- Discuss a new repayment period with your lender to pay the shortfall. The quickest way may be to carry on with your previous monthly payment, although you may be able to agree a lower payment over a longer term. You should avoid extending the term beyond your retirement, unless you're sure you can afford it.

In general, provided you keep up the new agreed monthly mortgage payments, you should not lose your home as a result of the shortfall.

Example

Joe has come to the end of his mortgage term and the endowment company has paid him £35,000, but this is not enough to pay off his mortgage and he is left owing the mortgage lender £8,000.

The interest rate on his mortgage is 4.4%. Joe could carry on with the monthly payment he has been making, which is £157.67. This would repay the remaining capital and interest in 4 years and 9 months, costing £8,987 in total, but the monthly amount is more than Joe wants to pay.

Joe will retire in seven years. So he has agreed with his lender that he will repay the £8,000 over seven years and his monthly payment will be £110.66, which will cost him £9,295 in total.

- You could sell your property to repay the mortgage, and buy a cheaper property so that you don't need a mortgage.
- If you have retired, or are about to retire, you could consider a lifetime mortgage. This is repaid from the proceeds of the sale of your home when you die or if you move out of it (perhaps into a care home) when the scheme will usually end. **But you should think very carefully about this as there are risks as well as benefits. The FSA factsheet *Raising money from your home* will tell you more about these and other options, but you should think about taking professional advice on this option.**

Useful FSA publications

- Endowment mortgage complaints
- FSA guide to making a complaint about financial services
- FSA guide to financial advice
- Raising money from your home
- Choosing a mortgage – taking the right steps

All of the above are available from our Leafletline (see below)

Useful contacts

Call rates may vary

FSA Consumer Helpline
Tel: 0845 606 1234
Minicom/Textphone: 08457 300 104
Leafletline: 0845 456 1555
Website: www.fsa.gov.uk/consumer

To find a financial adviser

IFA Promotion
Tel: 0800 085 3250
Website: www.unbiased.co.uk
(for a list of four independent financial advisers local to your area)

The FSA's consumer publications aim to give you general information to help you make financial decisions. The information does not constitute financial or other professional advice: for advice about your own circumstances, you should consult a professional adviser.

The Financial Services Authority (FSA) is the independent watchdog set up by government to regulate financial services and protect your rights.

We produce a range of user-friendly factsheets and booklets which are available from our website and helpline.

If, after reading this factsheet, you have any general queries, our helpline will try to clarify things for you.

We can tell you if a firm is authorised and help you if you have a complaint and don't know who to contact. But as the regulator, we can't recommend firms or advisers, or tell you whether a particular product or investment is right for you.

If you would like this factsheet in Braille, large print or audio format, please call our Consumer Helpline on 0845 606 1234 or Minicom 08457 300 104 (call rates may vary).

To help us maintain and improve our service, we may record or monitor calls.

Our website, www.fsa.gov.uk/consumer, aims to help you understand financial services and get a fair deal.

Use the site to:

- shop around with our comparative tables – including mortgages, pensions and ISAs;
- check a firm is authorised by the FSA, or is the agent of an authorised firm. If they are not authorised you will not have access to complaints procedures and compensation schemes if things go wrong;
- order any of our wide range of consumer publications;
- report any misleading financial advertising;
- see explanations of financial products in plain English;
- read recent alerts that we have issued.

© The Financial Services Authority, April 2006. FSA ref: CRED0105aM.