

Chapter 3

Reverse mortgages

3.1 Schedule 2 of the Enhancements Bill would introduce significant changes to the requirements for reverse mortgages under the NCCP Act and the National Credit Code. In their submission to the inquiry, the Redfern Legal Centre provided the following summary of the regulations currently applying to reverse mortgages.

Under the current law, the NCCP Act regulates reverse mortgages contracts consistently with all other credit contracts. It does not include any additional responsible lending conduct obligations or requirements in relation to reverse mortgages. In addition it does not include any disclosure requirements specific to reverse mortgages, nor does it include any maximum limitations with respect to a borrower's liability in relation to the debt. Further, the obligations imposed on lenders do not require the disclosure of either projections of future enquiry or certain information on the contract nor do they require the provision of a reverse mortgage information sheet.¹

3.2 The Enhancements Bill would introduce the following requirements specific to reverse mortgages. As outlined in the Explanatory Memorandum,² the Bill would:

- introduce a 'no negative equity guarantee' that would prohibit credit providers from requiring or accepting loan repayments exceeding the market value of the property (subject to certain exceptions);
- require borrowers to receive legal advice before entering into a reverse mortgage contract;
- require credit providers to disclose the way the reverse mortgage would apply to non-title holding occupants;
- require credit providers to attempt to contact borrowers in person where the reverse mortgage is in default; and
- exclude the following circumstances from constituting default under the loan:
 - the borrower failing to inform the credit provider that another person occupies the property;
 - the borrower failing to provide the credit provider evidence of who lives at the property;
 - the borrower leaving the property unoccupied while the property was the borrower's principal place of residence;

1 Redfern Legal Centre, *Submission 18*, p. 7.

2 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.1.

- the borrower failing to pay a cost to a person other than the credit provider (for example rates);
- the borrower failing to comply with a provision of the credit contract, if the credit contract is unclear about what is required; and
- the borrower breaching another credit contract with the credit provider.

3.3 The Bill would also require credit providers to undertake the following steps before making an assessment or pre-assessment of a borrower's application. Credit providers would be required to provide prospective borrowers:

- an equity projection calculated through a website approved by ASIC;
- a reverse mortgage information statement; and
- a notification of additional information that will assist the borrower to determine whether to enter into a reverse mortgage contract.

In-principle support for the proposed regulation of reverse mortgages

3.4 The proposal for a separate regulatory scheme for reverse mortgages received approval from consumer advocates and industry representatives. All three consumer advocates that commented broadly supported the proposal.³ The Consumer Credit Legal Centre (NSW) submitted that reverse mortgages are 'a complicated area of credit' and therefore should be distinguished from other credit contracts.⁴ Similarly, the Redfern Legal Centre stated that the Centre 'is strongly supportive of creating additional product specific obligations and protections to address the particular risks associated with reverse mortgages.'⁵

3.5 Industry representatives SEQUAL and Australian Seniors Finance (ASF) also supported the proposal.⁶ Both organisations commented that the proposal broadly reflects best-practice industry standards. Mrs Julie Campbell, General Manager, ASF, informed the committee that 'the bill mainly covers what we already do'.⁷ Mr Kevin Conlon, Chief Executive, SEQUAL, stated 'we commend the government for having proper regard for [industry] high standards of practice when developing the legislation.'⁸

3 Consumer Action Legal Centre, *Submission 20*, p. 19; Consumer Credit Legal Centre (NSW), *Submission 47*, p. 12; Redfern Legal Centre, *Submission 18*, p. 7.

4 Consumer Credit Legal Centre (NSW), *Submission 47*, p. 12.

5 Redfern Legal Centre, *Submission 18*, p. 7.

6 SEQUAL, *Submission 44*, p. 13; Australian Seniors Finance, *Submission 4*, p. 3.

7 Mrs Julie Campbell, General Manager, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 3.

8 Mr Kevin Conlon, Chief Executive, SEQUAL, *Committee Hansard*, 24 October 2011, p. 8.

3.6 While the proposal was supported, the committee's attention was drawn to concerns with technical aspects of the provisions as drafted. It was put to the committee that to ensure that the provisions are practical and will best meet the needs of industry and consumers, '[t]here is some common sense to come into these provisions.'⁹ However, as reflected in the statement by the ASF, while concerns were raised with technical aspects, this did not detract from the general approval for a separate legislative scheme and the high lending standards proposed:

Overall, we believe that the approach in the Enhancements Bill is positive and we remain supportive of the additional consumer protection, however, it is important to ensure that there are no unintended consequences that could jeopardise consumer access to a competitive market place and robust products.¹⁰

Concerns raised with technical aspects of provisions

3.7 Concerns were raised with the practicality of the following provisions.

Requirement to provide projections

3.8 SEQUAL and the ASF both supported the proposal under clause 133DB to provide prospective borrowers projections of equity before providing credit assistance or entering into a credit contract. In the ASF's view, potential borrowers 'certainly should get an illustration at the very beginning.'¹¹ SEQUAL submitted that:

...there can be no doubt that consumers are better placed to make informed decisions if they are provided with the opportunity to develop and consider projections (based on reasonable assumptions) that may impact their expectations for preserving some level of home equity.¹²

3.9 However, concerns were raised with the drafting of the provision. As evident in the following statement by SEQUAL, the committee was informed of industry concerns that 133DB would require the projections to be provided in-person:

...it may not always be practical for such projections to be "shown" to the borrower in a "face to face" meeting and it should be possible for an equity release provider to make available an ASIC approved calculator on their own website. There are a number of compelling reasons why there should be some flexibility as to the method of delivering this information to the consumer including, but not limited to, costs to the consumer and preserving consumer choice.¹³

9 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, 24 October 2011, p. 10.

10 Australian Seniors Finance, *Submission 4*, p. 3.

11 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 4.

12 SEQUAL, *Submission 44*, p. 13.

13 SEQUAL, *Submission 44*, p. 13.

3.10 The ASF provided further details of industry concerns with a requirement that projections be provided in-person:

Mrs Campbell: ...I pointed that out because we do have many people who are in regional areas and for them to access face-to-face appointments is often not easy.

Mr FLETCHER: Is it fair to say that you are making the point that the principle of the applicant seeing a projection in advance is one that you support?

Mrs Campbell: Absolutely.

Mr FLETCHER: But the precise way in which the provision has been drafted would impose cost and compliance burdens and might, in fact, lead to some applicants being denied the service because you would simply have to refuse to engage with them?

Mrs Campbell: Yes. It is about having choice on how they engage initially.¹⁴

3.11 The ASF and SEQUAL also noted the general nature of equity projections that would be provided before a preliminary assessment was made. SEQUAL advised that:

[i]t is important to note that in the initial stages of the application process, the projections would be generic in nature due to the absence of more detailed underwriting information that would normally be collected as the application process proceeded.¹⁵

3.12 Accordingly, industry representatives advocated that a further projection should be provided.¹⁶ As SEQUAL submitted:

Once an application has been confirmed and the details of the loan have been confirmed, a more personalized illustration should be provided as part of the loan documentation covered in the legal advice process.¹⁷

ASIC approved website

3.13 The Australian Bankers Association (ABA) noted that the requirement that lenders calculate equity projects through the use of an 'ASIC-approved website' is unclear and therefore open to interpretation. The ABA submitted that as the Bill does not give guidance as to which websites may be ASIC approved, it is unclear whether credit providers are required to construct a website and submit it for ASIC's approval,

14 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 4.

15 SEQUAL, *Submission 44*, p. 13.

16 SEQUAL, *Submission 44*, p. 13; Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 4.

17 SEQUAL, *Submission 44*, p. 13.

or whether ASIC will provide guidance on which websites may be used.¹⁸ The ABA further argued that requiring providers to develop websites would impose significant costs and increase the lead time required to comply with the equity projection requirements.¹⁹

Circumstances constituting default

3.14 SEQUAL and the ASF were also concerned with subclause 18A(3), which would exclude certain circumstances from the factors that constitute default under a reverse mortgage. While not expressly stated, the Explanatory Memorandum implies that the exclusions are not intended to risk the credit provider's security interests:

As a result of the exclusion of these terms from reverse mortgage contracts borrowers should not be in default (and at risk of enforcement action) because of minor oversights or for reasons which bear no relationship to the risk to the credit provider from the default.²⁰

3.15 The ASF and SEQUAL raised concerns with three circumstances that, under clause 18A, could no longer be considered to constitute default. First, failure on the part of the borrower to inform the credit provider of changes in occupancy; second, failure by the borrower to pay costs to third parties, for example rates; third, the property being left unoccupied. Evidence provided to the committee indicates that industry disagreed that these three circumstances have no bearing on risks to the credit providers' security interests.

3.16 It was put to the committee that failure to notify the lender of changes to occupancy is at odds with standard industry practices designed to protect the lender's security interests. The ASF provided an extensive explanation of industry's concerns with the proposed exclusion.

...when read literally the clause also means that the borrower or their estate has no obligation to advise the provider when the residence is no longer inhabited. When the borrower no longer resides in the property through a lifestyle decision, ill health or death this provides the key trigger for loan repayment under reverse mortgage and hence it is of fundamental importance [...]

Introduction of this clause could mean that a client could no longer be in the home for many years, building up a negative equity issue for the provider, and have no legal obligation to advise the provider of that circumstance [...]

Whilst this is clearly a breach of our contract, it may not be a breach of the law in the bill as it stands.

18 Australian Bankers' Association, *Submission 43*, p. 15.

19 Australian Bankers' Association, *Submission 43*, p. 15.

20 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.63.

In addition to the issue of the negative equity position being jeopardised it should also be noted that an unoccupied residence may raise an increased likelihood of vandalism or damage, and may in fact void an insurance policy. This is of serious consequence to both borrower and lender alike, hence we can consider rewriting this clause accordingly as warranted.²¹

3.17 SEQUAL concurred with this view, stating:

This exclusion, as it stands, seems to remove the requirement of borrowers and their beneficiaries from informing lenders that they no longer occupy the property, this is in contradiction to the essence of the trigger for repayment of Reverse Mortgages, that is death or moving into long term care of the surviving nominated resident. In practice this leaves lenders with no recourse if the resident has passed away and a beneficiary chooses not to inform the lender, this would greatly jeopardize the Negative Equity position.²²

3.18 SEQUAL further submitted that a borrower's failure to pay rates, taxes and other costs entails 'a risk that the lender's security interest could be compromised as the property could be sold for rate arrears.'²³

3.19 While being concerned with the operation of clause 18A, the ASF was supportive of the intention to ensure that the factors that may constitute default do not include minor or inconsequential matters:

We understand the clause is trying to protect borrowers from falling into a default situation simply through an extended absence, and additionally that it is ensuring that providers make appropriate efforts to contact the borrowers before enacting a default. We agree with this sentiment.²⁴

3.20 The ASF further submitted that the risks that may result to the credit provider's security interests if clause 18A was introduced in its current form were likely an 'unintended consequence'.²⁵

3.21 SEQUAL proposed two measures to address the concerns. First, that the exception for failure to meet third-party costs such as rates be 'limited to a reasonable period of time of rate non-repayments'.²⁶ Second, that the clause be amended 'so that default only occurs if the property is left vacant without the lender's approval for a

21 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 2.

22 SEQUAL, *Submission 44*, p. 14.

23 SEQUAL, *Submission 44*, p. 14.

24 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 2.

25 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 5.

26 SEQUAL, *Submission 44*, p. 14.

reasonable period of time provided that at all times that period of vacancy does not otherwise cause a fault (e.g. Valid property insurance cover etc.).²⁷

Repayments

3.22 Clause 86A would allow borrowers to end the reverse mortgage at any time by paying the market value of the property. This option would continue to be available where the market value was less than the amount owing. The Explanatory Memorandum explains that this would uphold the 'no negative equity guarantee'.²⁸

3.23 The committee recognised that this provision could lead to borrowers 'playing the market' to avoid repaying the entire amount owing. However, industry did not raise concerns with the introduction of a 'no negative equity guarantee'. As SEQUAL advised, '[w]e believe that that provision can be tolerated by the industry without significant adverse effects.'²⁹

3.24 However, SEQUAL advocated for safeguards to be introduced to mitigate the risk that borrowers would 'play the field':

...we believe there should be a condition on it that the sale in question be at arm's length to a non-related party. We want to make sure that that sale stood the market test.³⁰

3.25 The Consumer Action Law Centre also raised concerns with the provision. In contrast to the views of SEQUAL, the Centre submitted that the circumstances in which the 'no negative equity guarantee' would be available should be broadened. Noting that the provision would not apply in circumstances where the property's value was reduced by deliberate damage on the part of the borrower or where the borrower made a misrepresentation or engaged in fraud at the time the contract was made, the Centre made the following recommendations.

We recommend that:

- section 86E(a) be amended to include the words 'caused with intent to devalue the property' after 'deliberate damage'. Without making this clarification, this paragraph will capture a debtor who innocently or accidentally damages the property (for example, while making repairs or renovations). Alternatively, the Explanatory Memorandum could be amended to clarify that good faith attempts to repair or renovate the property will not be considered 'damage' for the purposes of section 86E.

27 SEQUAL, *Submission 44*, p. 14.

28 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.79.

29 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, 24 October 2011, p. 11.

30 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, 24 October 2011, p. 11.

- section 86E(b) be amended to replace 'misrepresentation' with 'fraudulent misrepresentation'. This is to make clear that this provision is concerned with fraudulent conduct and should not catch innocent or even reckless misrepresentations.³¹

3.26 The Explanatory Memorandum does not clarify what is intended to be encompassed by the term 'misrepresentation', nor does it provide guidance as to whether it is intended that 'misrepresentation' be interpreted with reference to fraud.³²

Definition of reverse mortgages

3.27 The committee's attention was also drawn to concerns with the proposed definition of reverse mortgages. The Bill proposes the following :

13A Reverse mortgages

(1) For the purposes of this Code, an arrangement is a reverse mortgage if the arrangement involves a credit contract, except a bridging finance contract, and a mortgage over a dwelling or land securing a debtor's obligations under the contract and either:

- the conditions in subsections (2) and (3) are met; or
- the arrangement is of a kind declared by ASIC under subsection (4) and is made on or after the commencement of that declaration.

Conditions

(2) The first condition is that the debtor's total liability under the credit contract or mortgage may exceed (to a limited or unlimited extent) the maximum amount of credit that may be provided under the contract without the debtor being obliged to reduce that liability to less than that maximum amount.

Note: The debtor's total liability can exceed the maximum amount of credit because interest and some other fees and charges are not included in an amount of credit: see subsection 3(2).

(3) The second condition is that, if the regulations prescribe any prerequisites for the arrangement to be a reverse mortgage, those prerequisites are met.

Declarations by ASIC

(4) ASIC may by legislative instrument declare specified kinds of arrangements involving a credit contract and a mortgage over a dwelling or land securing a debtor's obligations under the contract to be reverse mortgages.

31 Consumer Action Law Centre, *Submission 20*, p. 19.

32 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.87.

3.28 According to the ABA, the definition would encompass forms of lending that are not intended to operate as reverse mortgages. These include overdrafts and lines of credit, for which 'a bank may normally require that a customer's debt be reduced to the maximum amount of credit and not to an amount less than that maximum.'³³ The ANZ shared this concern, stating that the definition could capture hardship variations to credit contracts.³⁴

Committee view

3.29 The committee supports the proposal for separate regulations tailored to reverse mortgages. The committee approves the adoption of the industry-developed best-practice standards, and notes that their incorporation into national consumer legislation will ensure that the standards are required for all product providers. The measures set a high bar for industry, which, on the basis of evidence received, the committee is confident will be embraced by product providers.

3.30 However, the committee considers that the high standards that the Bill seeks to support may be jeopardised by the technical deficiencies in the Bill as currently drafted. These should be corrected to ensure that the proposed consumer protections can be promptly and effectively implemented.

3.31 The committee acknowledges the concerns raised by the ASF and SEQUAL regarding the provision of equity projections to potential borrowers. In the committee's view, the measure is intended to ensure that potential borrowers are fully informed before entering into reverse mortgage contracts. The committee therefore supports flexibility in the method of providing projections. The key matter is that the prospective borrower receives and understands the projection. Accordingly, the committee considers that the Bill should not be prescriptive in the method of delivery, but rather require the credit provider to ensure that the borrower receives and understands the projection before the reverse mortgage contract is entered into.

3.32 The committee supports the proposal that an additional projection be provided as part of the loan documentation. However, the committee notes that in the absence of an Australian Financial Services Licence, legal advisers are not in a position to provide financial advice. Therefore, the committee considers that it is appropriate for the credit provider to ensure borrowers understand the equity projections.

3.33 In line with the principles of Commonwealth criminal law best practice, as outlined in the Commonwealth Attorney-General Department's *A guide to framing Commonwealth criminal offences, civil penalties and enforcement powers*,³⁵ the committee considers that criminal offences should be clear, being simple to read and

33 ABA, *Submission 43*, p. 15.

34 ANZ, *Submission 41*, p. 5.

35 Attorney-General Department, *A guide to framing Commonwealth criminal offences, civil penalties and enforcement powers*, December 2007, pp 14, 16–17.

comprehend. The committee notes the ABA's concerns that the requirement to calculate a projection through an 'ASIC approved website' is unclear. The committee draws the concerns to the Government's attention, for its consideration as to whether the clause 133DB could be improved to provide further clarity as to the steps required of credit providers, and to take into account time required by credit providers to ensure they will be in a position to comply with the procedural requirements.

3.34 The committee agrees that defaults should not be triggered by minor and inconsequential matters. However, on the evidence before the committee it is not clear that all the circumstances covered by clause 18A are of a minor nature or pose no measurable risk to the credit provider's interest. The committee recommends that the Government undertake further consultations with industry to ensure that clause 18A only excludes matters that are of a minor nature and that do not pose measurable risk to the credit provider's interests.

3.35 The committee agrees that safeguards should be introduced to ensure the 'no negative equity guarantee' does not provide an opportunity for borrowers to 'play the field'. Accordingly, the committee recommends clause 86A and related provisions in Subdivision B, Division 1, Schedule 2 be amended to ensure that the sale stands the market test.

3.36 The committee would be concerned if the no negative equity guarantee was undermined by unintended misrepresentations, particularly in circumstances where the misinformation was minor and inconsequential. The committee draws the Government's attention to the Consumer Action Law Centre's recommendation regarding subclause 86E(b), and recommends that the Government consult stakeholders as to whether clause 86E should be amended to refer only to fraud and deliberate misrepresentations.

3.37 The committee notes concerns that the definition of reverse mortgages may capture credit products other than what industry and consumers understand to be reverse mortgages. To avoid this undesirable outcome, the committee recommends the definition be amended to clearly exclude other forms of credit contracts that provide the option of interest only repayments.

Recommendation 5

3.38 The committee recommends that clause 133DB be amended to not prescribe the method by which a credit provider must provide projections to potential borrowers, but rather to require credit providers to ensure that a potential borrower receives and understands the projections before entering into the reverse mortgage contract.

Recommendation 6

3.39 The committee recommends that the Government consider whether clause 133DB can be improved to provide further clarity as to the conduct required of credit providers, and to take into account time required by credit providers to ensure they will be in a position to comply with the procedural requirements.

Recommendation 7

3.40 The committee recommends that the Government consult industry to ensure that clause 18A only excludes matters that are of a minor nature and that do not pose measurable risk to the credit provider's interests.

Recommendation 8

3.41 The committee recommends that Subdivision B, Division 1, Schedule 2, be amended to ensure that sales, particularly between related parties, stand the market test of fair market value.

Recommendation 9

3.42 The committee recommends that the definition of reverse mortgages at item 2 of Schedule 2 be amended to clearly exclude other forms of credit arrangements that provide the option of interest only repayments.

