

National Consumer Credit Protection Bill 2009 – Exposure Draft

Comments on draft

First Mortgage Services Pty Limited ABN 49 110 202 429

Application of Chapter 3 - Responsible Lending Conduct to reverse mortgages

A. Background to the commentator

First Mortgage Services Pty Ltd (FMS) is a mortgage servicing company, based in Melbourne that provides mortgage servicing to two providers of reverse mortgages, Australian Seniors Finance and RBS (formerly ABN AMRO). These two lenders provide the largest proportion of reverse mortgages in Australia outside of the major banks.

The services provided by FMS include the review of the loan applications and information provided by applicants and presentation of the application to its clients for formal approval. As such, FMS is responsible for ensuring that the information is complete and sufficient and complies with the relevant lender's lending criteria applicable to the reverse mortgage product applied for. For this reason it has a strong interest in ensuring that the provisions of the proposed bill are practical and provide the appropriate degree of consumer protection.

FMS first became involved with the reverse mortgage product in New Zealand and developed and drafted the reverse mortgage guidelines that were adopted by the New Zealand Law Society. It is very much aware of the need for reverse mortgage lenders to follow a very strict and ethical process and procedure when reviewing applications and approving loans. Its client's have been instrumental in the development of the reverse mortgage industry bodies in both countries.

FMS welcomes the introduction of the proposed chapter 3 on responsible lending conduct and is concerned to ensure that these address appropriately the rather special requirements for reverse mortgages. These comments are therefore limited to this chapter.

While it appreciates that reverse mortgages will be more closely reviewed in phase two of the reforms, there are some elements of phase one that we believe need to be tailored to address reverse mortgages. This may be achieved in a simple and effective way through regulations that the proposed bill anticipates.

B. Responsible Lending Conduct.

Borrowers of reverse mortgages, by their age and nature, may be regarded as a vulnerable group and as such it is critical that they be provided with protection against inappropriate lending activities.

Chapter 3 introduces legislation to regulate responsible lending conduct and requires information to be provided to consumers in advance and for lenders and person providing credit assistance to take steps to determine that the lending proposed is not unsuitable for the particular consumer.

The following comments on Chapter three are directed to two areas that we believe need to be clarified in order to ensure that with respect to reverse mortgages:

- the elderly consumer is protected from financial abuse from others who have a degree of control over the consumer or the consumer's affairs and that the credit is provided for the benefit of the consumer; and
- in assessing a reverse mortgage loan application for unsuitability the relevant criteria is clear and relevant to the product.

B1. Elder Abuse

Reverse mortgage applicants are required to be over the age of 60 or 65 and the majority own unencumbered properties. Often the persons showing the greatest interest in the use of the property for the purposes of raising money tend to be the children of the owners.

In many cases there is nothing wrong with seniors borrowing funds to assist their children to purchase their own homes. In many cases the seniors derive great benefit and satisfaction out of being able to provide this assistance. But this may not always be the case and in some cases the elderly parents may be unduly influenced by the children into raising money on their property to on-lend to the children.

This is currently addressed at present by requiring all borrowers to obtain independent legal advice and either requiring or making a strong recommendation that the borrowers obtain independent financial advice.

If the owners are elderly and infirm and their affairs are managed or supervised by a person holding an enduring power of attorney, the circumstances may be such that the legal or financial advice is provided to the attorney and not the donor of the power of attorney. In that case, if the attorney is the person to whom the funds will ultimately be on-lent, there is the potential for financial abuse.

FMS and its clients operate under Agreed Procedures that have strict requirements when applications are made by attorneys. These require that the attorney must hold an enduring power of attorney, that a full explanation be obtained from the consumer's lawyer explaining the circumstances and confirming that the borrowing is for the benefit of the borrower and not a third party.

Nevertheless, we consider that it would be appropriate for the responsible lending conduct provisions to address this issue and provide us with assistance to identify and intercept any potential issues. This could be achieved in the following way:

R130 / R 230 – Credit guide

Paragraph 3.27 of the commentary suggests that R130 and R230 apply where a person provides credit assistance whether they deal with the consumer or with the consumer's agent.

R130(3) and R230(3) anticipates that regulations may prescribe additional information.

We would recommend that the regulations provide that in the case of credit assistance being given in respect of a reverse mortgage, the licensee is required to ensure that a copy of the guide is given to the consumer, notwithstanding that the consumer is acting through an agent.

R160 / R260 – Reasonable enquiries

We would recommend that the regulations contain specific steps that relate to the assessment of unsuitability for a reverse mortgage. These should address not only the issue of elder abuse but all other issues that are specific to reverse mortgages. These should include:

- (a) If the consumer providing the mortgage is acting through an agent:
 - that agent must hold a valid enduring power of attorney; and
 - the lending must be for the direct benefit of the consumer and not a third party unless the third party is not the attorney and the consumer has provided a written memorandum of wishes that indicates the consumers wish to benefit the third party.
- (b) One of the matters to be addressed when considering the consumer's requirements and objectives is whether the consumer has considered protecting a percentage of equity in the property to ensure an amount is available to meet any legacies provide for in the consumer's will.
- (c) Provided the terms of the reverse mortgage contain an enforceable no negative equity guarantee by the lender, the requirement to verify the consumer's financial situation should not apply for reverse mortgages other than for the purposes outlined in (d) below – this is because there are no – or very limited financial obligations on the consumer under a reverse mortgage and the consumer can not suffer financial hardship if the financial risk has been effectively passed to the lender under the no negative equity guarantee.
- (d) The obligation to verify the consumer's financial situation:

- should be limited to obtaining satisfactory information to demonstrate that the consumer will be able to meet basic obligations in relation to the property, namely the payment of rates and covering the cost of basic maintenance and upkeep; and
- that requirement to meet such basic property obligations may be met by ensuring that the amount borrowed does not exhaust the consumer's ability to draw additional funds in the future to meet these obligations.

B2. Assessment for unsuitability

Until such time as phase two is implemented and regulations specific to reverse mortgages are introduced, we would recommend that the general regulations under R130 and R260 include the elements set out above. With respect to these elements we comment:

- (b) Both of the lenders for whom we provide servicing offer an option for the consumer to protect a portion of their equity.

An Equity Protection Option of 20%, for example, means that if the consumer selects the option, as a minimum, at least 20% of the value of the property will be available for legacies upon the consumer's death. The contract provides that the borrower will never be required to pay from the proceeds of the sale of the property after death or moving into permanent care, more than 80% of the net proceeds of the sale of the property.

The lender protects its risk by adjusting the maximum amount that it will lend to the appropriate LVR based on 80% of the registered value of the property.

- (c) The effect of the no negative equity guarantee in a reverse mortgage is that the borrower need not suffer any financial hardship when repaying the loan. The repayment is essentially limited in recourse to the net sale proceeds of the property and there is no personal liability on the consumer or the consumer's estate to repay any additional sum, even if the value of the loan exceeds the value of the property.
- (d) The consumer still has financial obligations to pay rates and ensure that the property is properly maintained and therefore the financial obligations are limited to ensuring these can be met without hardship. It may be that instead of borrowing the maximum amount available to the consumer at the time, this financial obligation could be met by ensuring that there is room available for the borrower to increase the borrowing in the future to meet the financial obligation.

C. Definition of Reverse Mortgage.

In order to provide regulations that govern responsible lending in relation to reverse mortgages it will be necessary to define what is meant by a reverse mortgage.

By doing so the reverse mortgage industry will vicariously be regulated under phase one for we would assume that the definition of a reverse mortgage would incorporate the key elements that provide consumer protection such as:

- the mortgage must only be available to persons over a specified age;
- the lender must guarantee that the consumer may reside in the property until the happening of specified events such as death or moving into permanent care;
- the amount payable on the happening of the specified event must be limited in recourse to and must not exceed the net sale value of the property; and
- the events of default must be limited to those relating to fraud or wilful default.

Jonathan Flaws

Melbourne: 22 May 2009