DWYER HARRIS

Briefing paper

November 2016

Regulation of reverse mortgages in Australia

1. Introduction

As the Australian population ages and lives longer, and the national budget comes under pressure to provide for payments and services to the elderly, there is likely to be renewed interest in unlocking the value of residential properties through arrangements such as reverse mortgages.

Australians have high rates of home ownership. According to the Australian Bureau of Statistics, owner occupied properties are the largest asset held by households, representing more than 40% of total household assets, with capital gains on these assets exempt from tax. In 2011-12, while balances superannuation funds averaged $132,000 per household, the average dwelling value for owner occupiers without a mortgage was $546,000, more than four times greater.

This briefing paper examines how reverse mortgages are regulated in Australia.

2. Regulation under the NCCP Act

In 2012, amendments to the *National Consumer Credit Protection Act 2009* (Cth) (the **NCCP Act**) were introduced to regulate reverse mortgages. These provisions only apply to a reverse mortgage if the underlying credit contract is one that is regulated by the *National Credit Code* (**Code**). (The Code is a schedule to the NCCP Act).

The reverse mortgage provisions in the NCCP Act are in addition to the general provisions in the NCCP Act and the Code that apply to all regulated credit contracts. These are not covered in this paper.

Not all credit contracts are regulated by the Code. For a credit contract to be Code regulated, the credit must be provided or intended to be provided wholly or predominantly for personal, domestic or household purposes, or to purchase renovate or improve residential property for investment purposes, or to refinance credit that has been provided wholly or predominantly to purchase, renovate or improve residential property for investment purposes.[1] The debtor must also be a natural person or a strata corporation and there must be a charge for the provision of credit.[2]

Therefore if the funds for a reverse mortgage were to be used, for example, to provide for capital to invest in a family commercial enterprise, the reverse mortgage would not be regulated by the Code.

The reverse mortgage provisions in the Code and the NCCP Act also do not regulate other forms of “equity release” schemes, although these may be caught by the general provisions of those laws when the contract for the finance is regulated by the Code.

3. Other regulation

The focus of this paper is on regulation under the NCCP Act. However other laws may affect reverse

[1] Code s 5.

[2] Code s 5.

Dwyer Harris Pty Ltd ABN 56 159 256 121
www.dwyerharris.com
Suite 602, 161 Walker St
North Sydney NSW 2060
Australia
T +61 2 8912 2500 F +61 2 9460 1416

mortgages. For example, the *Australian Securities and Investments Commission Act (2001)* (Cth) (the **ASIC Act**) has consumer protection provisions which prohibit unconscionable conduct in relation to financial services, among other things. This paper does not examine other legislation such as the ASIC Act or common law or equity.

SEQUAL is the industry association for providers of equity release products and has a code of conduct for its members.[3]

4. What is a reverse mortgage under the Code?

The Code defines a reverse mortgage as an arrangement that involves a credit contract (other than a bridging finance contract) and a mortgage over a dwelling or land securing a debtor's obligations under the contract where the debtor's total liability under the credit contract or mortgage may exceed the maximum amount of credit that may be provided under the contract without the debtor being obliged to reduce their liability to or below that maximum amount.[4]

The Code also allows for the Australian Securities and Investments Commission (**ASIC**) by a legislative instrument to declare specified kinds of arrangements to be reverse mortgages if they involve a credit contract and a mortgage over a dwelling or land securing a debtor's obligations under the contract.[5] ASIC has not exercised this power to date.

If the credit contract requires the debtor to reduce his or her liability to or below the maximum amount of credit when the debtor's liability exceeded that amount, the credit contract would not be part of a reverse mortgage arrangement for the purposes of the Code. This would seem to be the case even If the contract required the debtor to reduce his or her liability but the credit provider did not enforce this right or waived this right, although the courts might regard such a provision as a sham to avoid the operation of the Code if the contract requirement was routinely not enforced, or waived.

It is not necessary that the debtor be the mortgagor for a Code regulated reverse mortgage. For example, an arrangement would still be a reverse mortgage within the Code definition where the credit contract was in the name of X and secured by mortgage by Y over the land of Y. (In this scenario, Y would have to be a guarantor, because the Code prohibits third party mortgages.)[6]

5. Responsible lending inquiries

Under the responsible lending provisions of the NCCP Act, credit providers and credit assistance providers must make reasonable inquiries about the requirements and objectives and the financial situation of the consumer.[7]

If the credit to be provided under the credit contract will be used to secure a reverse mortgage over a dwelling or land, the licensee must also make reasonable inquiries about the consumer's requirements and objectives in meeting possible future needs, including a possible need for aged care accommodation, and whether the consumer prefers to leave equity in the dwelling or land to the consumer's estate.[8]

6. Unsuitability

Under the NCCP Act there is a general obligation of a credit provider not to enter into an unsuitable credit contract or increase.[9] Similarly, a credit assistance provider must not suggest or assist for a particular credit contract or increase that would be unsuitable.[10]

The NCCP Regulations modify the NCCP Act in relation to unsuitability for reverse mortgages. The regulations provide that a credit contract under a reverse mortgage arrangement will be deemed unsuitable unless the contrary is proved, if at the time the credit contract is entered into:

- the youngest borrower under the reverse mortgage is 55 or younger, and the loan to value ratio (**LVR**) of the mortgage is higher than 15%; or
- the youngest borrower under the reverse mortgage is older than 55 and the LVR is 15% plus 1% for each year that the youngest borrower is older than 55.[11] For example, if the youngest borrower is 60, an LVR that exceeds 20% is unsuitable unless the contrary is proved, and if the youngest borrower is 70, an LVR that exceeds 30% is unsuitable unless the contrary is proved.

7. Precontractual disclosure

The NCCP Act imposes additional consumer disclosure obligations for reverse mortgages.

Before the suitability assessment is made by a credit provider or a credit assistance provider, the credit licensee must show the consumer projections relating to the value of the dwelling or land and the consumer's indebtedness over time if the reverse mortgage was entered into.[12] These must be made

[3] Available at: http://www.sequal.com.au/code-of-conduct
[4] Code s 13A.
[5] Code s 13A(4).
[6] Code s 48.
[7] NCCP Act ss 117, 130.
[8] *National Consumer Credit Protection Regulations 2010* (Cth) (**NCCP Regulations**) r 28HA.
[9] NCCP Act s 133.
[10] NCCP Act s 123.
[11] NCCP Regulations r 28LC.
[12] NCCP Act s 133DB.

using a website approved by ASIC[13] and in accordance with any instructions for the making of projections included on the website.[14] Instead of the projections being shown in person,[15] they may be given by mail, by email or another form of written or electronic communication agreed to by the consumer.[16] However a printed copy must also be given to the consumer.[17]

ASIC has published and approved its own calculator of equity projections, which is available on the ASIC MoneySmart website. ASIC information sheet INFO 185 sets out how licensees should use the calculator.

The credit licensee must also tell the consumer in person those things (if any) that relate to reverse mortgages prescribed by the regulations (nothing is currently prescribed), and give the consumer a reverse mortgage information statement.[18] The form of this statement is set out in the NCCP Regulations.[19] The statement is in a similar format to the home loan key facts sheet.

If a credit licensee provides credit assistance relating to reverse mortgages or is a credit provider for reverse mortgages, and has a website with information about reverse mortgages, it must also make available a reverse mortgage information statement through the website.[20]

Where such a licensee receives an inquiry from a consumer for a reverse mortgage information statement and the consumer gives their name and contact details, the licensee must give the consumer a reverse mortgage information statement.[21]

There are also disclosures required before the contract is entered into when there is no protected tenancy clause – see section 9 below for further details. The form of disclosure is *Form 7A - Disclosure about credit contracts (reverse mortgages)*.[22]

A credit provider may enter into a credit contract for a reverse mortgage even if the debtor has not obtained legal advice, but the NCCP Act allows for regulations to be made to regulate or prohibit entry into the contract without such advice.[23] The Form 7A also recommends that the debtor obtain advice.

8. Representations about reverse mortgages

The NCCP Act prohibits the use of the term "reverse mortgage" or another term of similar import in providing or offering to provide credit services or in relation to a credit contract or mortgage, unless the representation truly represents that a credit contract is or will be a credit contract for a reverse mortgage, (or is not or will not be a credit contract for a reverse mortgage), or that a mortgage is or will be part of a reverse mortgage (or is not or will not be part of a reverse mortgage).[24]

9. Contract requirements – protected tenancy

If the credit contract for a reverse mortgage provides for a person other than the debtor to occupy the property (e.g. the spouse of the debtor) (a **Tenancy Protection Provision**), the contract document must contain provisions that the debtor may at any time nominate a person who is to be allowed to occupy the property (either alone or with other persons) and may at any time revoke such a nomination by notice given to the credit provider.[25] It must also provide that while such a nomination is in force, the nominated person has the same rights against the credit provider to occupy the property as the debtor has or would have apart from the death of the debtor or vacation of the property by the debtor.[26]

If the proposed credit contract for a reverse mortgage does not include a Tenancy Protection Provision, a person must not provide a credit service relating to the contract unless the person has told the debtor in writing in the prescribed form that the contract does not include a Tenancy Protection Provision.[27] (Form 7A is the prescribed form).

This does not apply if the person providing the credit service is or will be the credit provider under the contract. In other words it would only apply to a person introducing or acting as an intermediary between the customer and the credit provider and providing a credit service.[28] However the credit provider must not enter into the contract unless it has also told the debtor in writing in the prescribed form that the contract does not include a Tenancy Protection Provision.[29]

Failure to comply with these provisions is an offence of strict liability.[30]

A credit provider under a credit contract for a reverse mortgage that includes a Tenancy Protection Provision with the right to nominate and

[13] NCCP Act s 133DB(1)(a)(ii).
[14] NCCP Regulations r 28LD(2).
[15] NCCP Act s 133DB(1).
[16] NCCP Regulations r 28LD(1).
[17] NCCP Act s 133DB(1)(b).
[18] NCCP Act s 133DB(1)(c) and (d).
[19] NCCP Regulations r 28LE and Schedule 5A.
[20] NCCP Act s 133DC.
[21] NCCP Act s 133DD.
[22] NCCP Act s 18B.
[23] NCCP Act s 18C.
[24] NCCP Act s 133DE.
[25] Code s 17(15A).
[26] Code s 17(15A).
[27] NCCP Act s 18B(2).
[28] NCCP Act s 18B(3).
[29] NCCP Act s 18B(4).
[30] NCCP Act s 18B(5).

revoke a nomination of a person must keep a record of any such nominations and revocations.[31]

10. Contract requirements – limits on enforcement

The credit contract for a reverse mortgage must not give the credit provider the basis for beginning enforcement proceedings for any of the following:

- the debtor failing to inform the credit provider that another person occupies the reverse mortgaged property;
- the debtor failing, when the debtor occupies the reverse mortgaged property, to give the credit provider evidence that the debtor, or another person nominated by the debtor, occupies or occupied the reverse mortgaged property;
- the debtor leaving the reverse mortgaged property unoccupied while it is the debtor's principal place of residence;
- the debtor failing to pay a cost to a person other than the credit provider within three years after the payment became due;
- the debtor failing to comply with a provision of the credit contract if the contract does not make clear how the debtor is to comply with the provision;
- the debtor breaching another credit contract with the credit provider; or
- an event involving an act or omission by the debtor and prescribed by the regulations (none is currently prescribed).[32]

11. Statements and fees

The maximum period for a statement of account is 12 months in the case of a credit contract for a reverse mortgage, whether or not it is a continuing credit contract.[33]

A credit contract for a reverse mortgage may not prohibit an early payment when the debtor's accrued liability is more than the adjusted market value (see section 13 below) and the payment is a payment by the debtor or the proceeds of sale.[34]

12. Changes

If a credit contract for a reverse mortgage has a Tenancy Protection Provision, it cannot be amended to remove the required terms for a Tenancy Protection Provision (see section 9 above)[35] or to vary the contract so as to limit the ability of the debtor to nominate a person allowed to occupy the reverse mortgaged property, or limit the rights of the person nominated by the debtor to occupy the property.[36]

13. No negative equity guarantee

There are special provisions dealing with enforcement of a reverse mortgage under the Code. They provide the debtor with a "no negative equity guarantee".

These provisions apply if the debtor's accrued liability (whether or not due and payable) is more than the adjusted market value of the property and the credit provider receives an amount at least equal to the adjusted market value for the reverse mortgaged property either as a payment from the debtor under the credit contract or as proceeds of the sale by the credit provider of the reverse mortgaged property (**Negative Equity**).[37]

The adjusted market value is the market value of the property, adjusted in accordance with the regulations.[38] The NCCP Regulations provide that the market value of a reverse mortgaged property is:

- if the property has not been sold - the property's market value, as determined by an accredited valuer within 3 months before the credit provider receives an amount from the debtor to discharge the reverse mortgage; or
- if the property has been sold - the property's sale price.[39]

However, if the market value as calculated above is reduced because:

- the debtor, or a person who occupied the property with the debtor's consent, deliberately damaged the property;
- the sale was not conducted in good faith; or
- the sale was not conducted on fair and reasonable terms,

the market value of the property will be the market value at the time of the sale as determined by an accredited valuer.[40]

If there is Negative Equity, the debtor's obligations under the credit contract are discharged and the mortgage securing those obligations is discharged,[41] and if the amount received by the credit provider exceeds the adjusted market value, the excess must be paid by the credit provider to the debtor.[42] These protections do not apply, however, if the debtor engaged in fraud or made a misrepresentation relating to the reverse mortgage

[31] Code s 185A, NCCP Regulations r 110A.
[32] Code s 18A.
[33] Code s 33(2).
[34] Code s 26(6).
[35] Code ss 17(15A) and 67A.
[36] Code s 67A.
[37] Code s 86A(1).
[38] Code s 86A(2).
[39] NCCP Regulations r 84A(2).
[40] NCCP Regulations r 84A(3).
[41] Code s 86B.
[42] Code s 86C.

before, at the time or after the credit contract was made.[43]

14. Enforcing a reverse mortgage

Before enforcing a reverse mortgage credit contract, if a default notice has been issued, the credit provider must have spoken by telephone or in person to the debtor, a practising lawyer representing the debtor, or a person with power of attorney relating to the debtor's financial affairs within the period during which the default may be remedied under the default notice, and must have confirmed that the debtor has received the default notice and informed the person of the consequences of failure to remedy the default (or have made reasonable efforts to do so).[44]

If a default notice alleges default because of one of the prohibited default events (see section 10 above), the notice is not a valid default notice for the purpose of enforcement or acceleration of the debt.[45]

If there is Negative Equity after the credit provider has received an amount by payment from the debtor or proceeds of sale, but the debtor has engaged in fraud or misrepresentation and a default notice must be given to the debtor or mortgagor before beginning enforcement proceedings to recover any of the excess, the credit provider must not begin them unless the default notice specifies the amount received by the credit provider and the debtor's accrued liability just before that amount was received. It must also specify the conditions of the fraud or misrepresentation by the debtor.[46]

Another requirement before commencing enforcement proceedings in this situation applies where the credit provider knows of a lawyer acting for the debtor or mortgagor and the credit provider did not give the debtor or mortgagor the default notice by giving it to the lawyer. In that case, the credit provider must also give the lawyer a copy of the default notice at the same time as, or as soon as practicable after, giving the debtor or mortgagor the notice.[47]

15. Orders to compensate loss or damage

Under the NCCP Act, the court may make orders to compensate a person for loss or damage, or to prevent or reduce loss or damage to a person, caused by another person contravening a civil penalty provision in the NCCP Act or committing an offence against the NCCP Act (other than the Code).[48]

There are special provisions that apply in the case where a person applies for an order to be able to stay in their home, or where ASIC applies for such an order on the person's behalf. In that situation, provided that certain conditions are met, the court must consider the order appropriate to prevent or reduce the loss or damage and make the order unless the court is satisfied that the order would adversely affect a person other than the debtor and the defendant.[49]

The conditions that must be met for this protection of the resident are as follows:

- the credit provider has contravened the NCCP Act by entering into, or increasing the credit limit of, a credit contract (the **Illegal Contract**) that is <u>not</u> a credit contract for a reverse mortgage, where the credit contract or increase is unsuitable for the debtor;
- the debtor's obligations under the Illegal Contract are secured by a mortgage over the debtor's principal place of residence;
- the court is satisfied that, at any time in the period in which a suitability assessment needed to be made to comply with the NCCP Act:
    - there was a credit provider (whether the defendant or not) offering credit through a reverse mortgage (whether or not it actually made an offer to the debtor);
    - the debtor would have been eligible to enter into a credit contract for the reverse mortgage; and
    - the credit contract for the reverse mortgage would not have been unsuitable for the debtor.[50]

The effect of this provision is that a debtor who does not have a reverse mortgage may be able to get a court order to stay in the property if the credit contract is unsuitable and the debtor hypothetically could have had a reverse mortgage instead that would not have been unsuitable. This provision could provide an incentive for credit providers to consider offering a reverse mortgage when it may be difficult to offer a conventional credit contract that is not unsuitable for the debtor.

Further information:

Patrick Dwyer
Legal Director
patrick.dwyer@dwyerharris.com
0406 404 892

[43] Code s 86E.
[44] Code s 88(2)(d).
[45] Code s 88(7A).
[46] Code s 93A(2)(a).
[47] Code s 93A(2)(b).
[48] NCCP Act s 179(1).
[49] NCCP Act s 179(7).
[50] Code s 179(6).