REPORT 109

‘All we have is this house’

Consumer experiences with reverse mortgages

November 2007

About this report

Reverse mortgages are relatively new and complex products. This report captures the experiences of 29 borrowers in taking out and living with a reverse mortgage.

Their experiences together with ASIC’s broader work on reverse mortgages suggest that several factors can inhibit good consumer decision-making. These include a lack of familiarity with reverse mortgages, difficulties in estimating how much equity might be available at any future point in time, and a reluctance by consumers to consider the risk of declining health in future years and the impact this may have on their financial needs.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a license or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

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Executive summary

The reverse mortgage market and ASIC's role

Since 11 March 2002, ASIC has had a consumer protection role for credit facilities under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). Reverse mortgages, as a form of credit, fall under this jurisdiction.

In November 2005, we released a report examining reverse mortgages and other types of equity release products.[1] The report:

- identified a number of risks for consumers in general terms; and
- foreshadowed continuing work by ASIC in this area, particularly on developing a better understanding of consumer behaviour and using this knowledge to encourage industry to adopt best practices.

Since that report was released, the reverse mortgage market has more than doubled. Currently the market is worth approximately $1.8 billion, consisting of over 31,000 reverse mortgages.[2]

Because this market has expanded so rapidly and by definition many of the borrowers are elderly and relatively unsophisticated in financial terms, ASIC has been active in this area:

- In 2006, we acted on claims by a lender that its reverse mortgage product protected borrowers from 'runaway or negative equity'. We considered that there was a high risk that consumers could be misled about this feature, given their lack of familiarity with these products.[3]
- Similarly, in June 2007, we made public action we had taken to stop advertising containing statements such as 'There are no repayments', '…no loan repayments ever' and 'No need to make repayments!!'[4]
- We have followed up complaints about reverse mortgages and reviewed contract documents for reverse mortgages.
- We have worked with industry to develop and refine a code of practice and promote external dispute resolution.

[1] See REP 59 *Equity release products—An ASIC report* available on our website at www.asic.gov.au.
[2] Senior Australians Equity Release Association of Lenders (SEQUAL) *SEQUAL Trowbridge Deloitte Research Report*, June 2007.
[3] In March 2006 ASIC accepted an enforceable undertaking from Transcomm Credit Union in relation to misleading and deceptive conduct around their reverse mortgage advertising: see Media Release 06-093 *ASIC stops misleading reverse mortgage advertising*, 29 March 2006.
[4] See Media Release 07-152 *ASIC works with industry to ensure clear reverse mortgage advertising*, 4 June 2007.

Industry's role

Industry is acting to address similar issues by introducing standards of conduct for lenders and intermediaries in this new and evolving marketplace.

For example, the Senior Australians Equity Release Association of Lenders (SEQUAL) has a Code of Conduct that requires its members to take appropriate steps so that borrowers have all costs clearly disclosed and that they receive independent legal advice.[5]

Similarly, industry bodies for intermediaries, the Mortgage and Finance Association of Australia (MFAA) and CPA Australia (CPA), have recently issued detailed guidance to their members to improve the advice and information given to consumers on reverse mortgages.[6]

Our survey of borrowers' experiences

This report builds on our earlier work by detailing the findings of a survey we conducted into the experiences of borrowers who take out reverse mortgages. It sets out the results of detailed interviews with 29 borrowers who took out a reverse mortgage loan in the 3 years before the interview. We also had access to factual information from lenders about each borrower's loan.

We interviewed the borrowers to examine their personal experiences with reverse mortgages, particularly to identify:

- where these products had worked well;
- how borrowers might be vulnerable or easily misled; and
- where changes to industry practice could help consumers make better and more informed decisions.

Because we were collecting comprehensive information in the interviews with the borrowers, the sample size was kept relatively small. The survey was not intended to be representative of the market generally, and should not be seen in this light. We wanted to understand more clearly the factors that can influence consumer decision-making, and the resources that consumers used or failed to use in this process.

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[5] SEQUAL is the key industry body for lenders. In August 2007, SEQUAL issued guidelines addressing some of the issues in this report, and we note this where relevant.
[6] The MFAA guide is 'The Equity Release Code of Proper Process' (February 2007) and the CPA guide is 'Guidance Notes for advising on reverse mortgages' (March 2007).

Key findings

Balancing current and future needs

Our survey found that the borrowers were generally satisfied with the reverse mortgages they had taken out. However, the responses to interview questions suggested some areas where future problems could arise. In particular, borrowers did not always clearly understand the trade-off between accessing loan funds now and having less available in the future.

The risks of reverse mortgages can include:

- having too little equity down the track to move into supported accommodation;
- failing to adjust lifestyle to a reduced income following retirement; and
- leaving a smaller than intended inheritance for the children.

These risks can be addressed by improving consumer understanding of the products to allow more informed decision-making and to help ensure that the loan is used appropriately.

Limited understanding of how a reverse mortgage works

Most of the borrowers we interviewed did not fully understand how a reverse mortgage works. Of the 29 borrowers:

- 14 did not know how much the loan was likely to cost them over time;
- 6 were unaware of how compound interest works;
- 17 did not know what would happen if they breached a loan condition.

Lack of future planning

A reverse mortgage loan is likely to remain with a borrower until they sell their home or die. 14 of the borrowers we surveyed were aged 70 years or less. The average life expectancy for a 65 year-old ranges from 20.9 years (for men) to 24.3 years (for women).[7] Therefore, planning needs to cover a much longer time period than that considered by many of the borrowers we interviewed.

We found:

- Very few of the borrowers had done long-term planning about how their financial needs might change over the next 10 or 15 years. 11 borrowers thought their needs would not change.

[7] Source: http://www.fido.gov.au/fido/fido.nsf/byheadline/Will+your+money+last+as+long+as+you+do%3F?openDocument, Australian Government Actuary 2006.

- 16 borrowers said they had thought about their future needs, but most were only looking 2–3 years ahead. Only 2 of these borrowers indicated that they had considered their longer-term future needs (such as aged-care accommodation, inheritance for their children or other health needs).

SEQUAL has included in its Code of Conduct a guideline for calculators provided by its members that map out future equity in the borrowers' home against the loan balance. The 'Calculator parameters guideline' stipulates that such calculators have a default setting so that the period illustrated '*must be for at least life expectancy plus 5 years, with a minimum period of 10 years'*.[8]

Gaps in information and advice

All borrowers we interviewed said they were satisfied with the service from the lender, broker or financial planner. However:

- only 4 reported that they discussed alternatives to reverse mortgages;
- 20 did not recall receiving any information about the risks involved;
- none received financial advice that focused on planning for their longer-term future;
- only 1 borrower was provided with a document setting out the advantages and disadvantages of taking out a reverse mortgage.

Most borrowers had received legal advice and had discussed the loan with their family. Around half of the borrowers on a pension had sought advice from Centrelink about possible impacts on their pension.

Product suitability and use

The borrowers we interviewed were all in the first 3 years of their loan and 26 of the 29 borrowers said it had performed as expected so far.

10 of the borrowers said lenders had approved more credit than they had initially requested, and half of these borrowers took the higher amount.

Several borrowers commented about how difficult it had been to resist the constant availability of credit. A small number were already expressing regrets about how they had used their reverse mortgage and how quickly they had exhausted the funds they had borrowed.

[8] The 'Calculator parameters guideline' came into effect on 1 August 2007.

Conclusions and recommendations

The borrowers we interviewed had only recently taken out their reverse mortgages. They were satisfied in having money to spend and, for most people, any potential problems had not yet become apparent.

However, our survey and broader work on reverse mortgages suggest that several factors can inhibit good decision-making by consumers and increase the risk of future problems. Our recommendations in Section C of this report seek to address these issues and improve overall outcomes for consumers in taking out reverse mortgages.

Table 1: Key factors and recommendations

Factors that inhibit good decision-making	• Reverse mortgages are complex financial products and different from normal credit products. • It is difficult to estimate the long-term cost of a reverse mortgage and how much equity might be left to fund future needs. • Most borrowers had done little or no long-term planning and had an entirely understandable emotional resistance to thinking what their future life might be like if their health declined and they became less able to look after themselves. • With access to a large amount of credit, some people have difficulty budgeting for the long term. The need to budget is greatest when the family home is the only significant financial asset. • Some older consumers may be encouraged by their children to take out a reverse mortgage, or use the funds for the benefit of their children, in inappropriate circumstances.
Recommendations	• Encourage lenders and intermediaries to tailor sales practices and product design to the particular consumer issues this product raises: see Recommendations 1 and 2. • Improve information to consumers: see Recommendations 3–6. • Improve access to advice for consumers: see Recommendations 7–10.

Our recommendations also acknowledge that both state and Australian government agencies and industry bodies have a role to play in improving outcomes for consumers:

- ASIC is responsible for encouraging an efficient market where consumers can make informed decisions and for preventing misleading and unconscionable conduct in relation to financial products;
- state Fair Trading agencies regulate consumer lending through the Uniform Credit Code; and
- individual lenders and industry associations (such as SEQUAL) are involved in setting minimum and good practice standards.

A Our survey

Key points

Our survey explored the experiences of a group of borrowers who took out a reverse mortgage loan. It deliberately focused on potential problem areas.

We conducted detailed interviews with 29 borrowers in NSW. We also had access to factual information from lenders about each borrower's loan.

Research objective

The objective of the survey was to build on our existing work on reverse mortgages including our earlier report into these products. We wanted deepen our understanding of the issues for consumers by examining the experiences of borrowers who have taken out a reverse mortgage loan.

The key issues we examined were:

- how borrowers found out about reverse mortgage loans;
- why borrowers took out a reverse mortgage;
- what advice was provided by lenders and intermediaries;
- what borrowers understood about reverse mortgages before they signed up;
- whether borrowers sought legal or financial advice;
- whether borrowers had considered how the reverse mortgage would fit with their potential future needs;
- whether borrowers were offered and accessed more credit than they had initially applied for; and
- whether issues had emerged for borrowers since they took out their loan.

Methodology

Between August and October 2006, we conducted detailed interviews with 29 consumers who had taken out a reverse mortgage since 2003. The interview questions were developed to capture the participants' experiences of the process of taking out and living with a reverse mortgage, with particular reference to risk factors.

To ensure we included a range of borrowers, we used our regulatory powers under the ASIC Act to obtain copies of client files from 3 reverse mortgage lenders. The borrowers were fairly evenly spread between these lenders (Lender A: 11 borrowers, Lender B: 11 borrowers, and Lender C: 7 borrowers).

We asked for files that filled particular criteria including:

- settlement date;
- the age of the consumers;
- the nature of the payment of loan funds (e.g. a lump sum, a series of instalments, drawdown of subsequent amounts after first approval); and
- default status.

The survey was limited to NSW consumers to facilitate face-to-face interviews.[9]

Table 2: Summary of survey sample

Age of borrowers	60 to 85 years of age
Gender	6 single women, 6 single men and 17 couples
Amount borrowed	From $25,000 to $372,000 with an average of $100,000.[10]
How the loan was taken out	Half of the loans were taken as a lump sum. The rest were mainly a combination of a lump sum with later drawdowns.
Provider	13 of the borrowers dealt directly with the loan provider, 8 went through a broker and 8 applied via a financial planner.

Using details provided by the lenders, potential participants were sent a letter outlining the project and then contacted by telephone to check if they wanted to participate. 65% accepted the invitation and the response rate was 85% among this group.

Interviews followed the survey script, which consisted of 57 closed and open-ended questions. Interviews were conducted on the telephone or face-to-face by an ASIC representative. Each interview took between 20 and 70 minutes to complete and verbatim responses were recorded where possible.

Survey participants were invited to provide copies of their loan documents to us, where relevant. These documents, along with the files provided by the lenders, were used to help analyse the interview responses.

Given the relatively small number of borrowers and the fact they had loans with only 3 different lenders, the findings in this report should not be taken as indicative of the overall general market.

[9] For further details on the surveyed borrowers, see Appendix 1. For a summary of the survey questions, see Appendix 2. For a summary of the features of the reverse mortgage products offered by the 3 lenders, see Appendix 3.
[10] This compares to an industry average loan size at June 2007 of $57,350; see reverse mortgage study, *SEQUAL Trowbridge Deloitte Research Report June 2007*.

B Key findings

Key points

Nearly half of the borrowers in our sample took out the loan for capital expenditure (e.g. home renovations, car purchase). Other reasons for taking out the loan included to help with living expenses and to consolidate debt.

Very few borrowers had done long-term planning about how their financial needs might change over time. 11 borrowers thought their needs would not change over time. 16 borrowers said they had planned, but this was generally only looking 2–3 years ahead. Half the borrowers did or could not calculate how much the loan was likely to cost in the long term.

All borrowers said they were satisfied with the service from the lender, broker or financial planner. However, 20 borrowers did not recall receiving any information about the risks involved.

Most borrowers had legal advice and discussed the loan with their family. However, only half had independent financial advice and only half of those on a pension had sought advice from Centrelink about any possible impact on their pension.

All borrowers were in the first 3 years of their loan, and all but 3 said it had performed as expected so far. Several borrowers commented about how difficult it had been to resist the constant availability of credit.

Generally, borrowers had a patchy awareness of the conditions of their loan, even though the consequences of not meeting these conditions could be significant. All the loans had a 'no negative equity guarantee', but half the borrowers were not aware of this important feature. 17 borrowers did not know what could happen if they breached a loan condition.

Why a reverse mortgage?

Participants in the survey were asked why they needed a reverse mortgage. The most common response was that borrowers wanted to complete renovations or undertake maintenance on their home. Table 1 summarises all the responses.

Table 3: Reasons borrowers applied for a reverse mortgage[11]

Purpose	Number of borrowers
Modify/renovate home	11
Supplement income	10
Buy car	9

[11] Borrowers could select more than one option.

Purpose	Number of borrowers
Consolidate debt	7
Financially assist relatives	6
Pay aged-care accommodation bond	2
Other	3

10 borrowers took out the reverse mortgage to supplement their income (in many cases, these borrowers also took out a lump sum for capital expenditure as well). Many of these borrowers reported that they found living on the age pension very difficult and felt accessing the equity in their home was preferable to going without things they needed. Others who reported taking out a reverse mortgage to supplement their income were not necessarily age pension recipients, but wanted to improve their standard of living in general.

9 borrowers took out a reverse mortgage to buy a car. Some of these borrowers said they made the decision to buy the last car they would need.

7 borrowers reported that at least part of the reason they took out the reverse mortgage was to consolidate their debts. Several borrowers said that paying off their outstanding debts freed them up to survive more easily on the age pension. Others reported that they were required to pay out their existing minor debts as a condition of finalising the reverse mortgage.

6 of the borrowers used the money to financially assist relatives, most often their adult children who needed funds for business or housing purposes. Some of these borrowers had expected that this debt would be repaid, but in some of these cases, repayments looked unlikely.

2 borrowers took out reverse mortgages on behalf of their parents to fund aged-care accommodation bonds. One of these was as a 'bridging loan' until the house could be sold.

3 borrowers reported that they took out the reverse mortgage for other reasons such as to prepay their own funerals, cover the cost of health care or to pay legal fees. The survey did not identify anyone who was borrowing for investment purposes or, conversely, for some immediate consumption purpose such as to embark on a major overseas holiday.

In some cases, the responses in the interview varied significantly from the reasons recorded in the loan documents. For example, in one file, there was no evidence on loan documents that people were borrowing to assist family members, even though this was given as the reason in the interview.

Particular product choice

Advertising

16 of the borrowers first found out about reverse mortgages through advertising. 20 remembered seeing reverse mortgage product advertising before applying for their loan. Of those who saw reverse mortgage advertising, 10 saw an advertisement from the provider with whom they ultimately finalised their loan. Advertising was seen or heard on television, radio, newspapers, magazines or billboards.

The words ‘equity’ and ‘no repayment until after death’ used in advertisements were particularly noticed by borrowers. They also learned from advertisements that the loan did not have to be paid back (i.e. until they moved out of the home or sold it themselves) and that reverse mortgages were ‘for those who have paid off their home and need to get cash’.

2 borrowers said that they saw the advertisements but did not understand what they meant.

The 2 borrowers who took out reverse mortgage loans on behalf of their parents noticed the advertising reference to accommodation bonds.

Referral

23 borrowers found their way to the loan provider without a referral, either by approaching their own bank or in response to advertising.

6 borrowers were referred to the loan provider. Referrals came from financial advisers, superannuation providers, solicitors and accountants.

Extent of planning

Balancing current and future needs

Just over half (16) of the borrowers stated that they had considered their future needs when they took out their reverse mortgage. However, 14 of these borrowers revealed that *immediate* future needs motivated their application (e.g. to clear debts, to buy what they needed, or so that they didn’t have to ‘count pennies’). Many borrowers appeared to have thought only 2–3 years ahead.

Only a minority (2 borrowers) indicated that they had considered the implications of taking out the reverse mortgage in terms of their longer-term future needs of aged-care accommodation, inheritance for their children or possible health care requirements.

Several borrowers only realised the impact of the reverse mortgage on their future choices after they had taken out the loan. They expressed concern about the amount of equity that would be left in their home over time, and how this could affect their ability to buy another property or pay for aged-care accommodation. One borrower said:

> *'If I want to sell and this loan goes on too long I'm not going to have anything left to get a smaller place.'*

Several borrowers were apprehensive about the rate at which their equity was diminishing and the impact of this on their beneficiaries. For example, one borrower said:

> *'… if we live for a quite a few more years there won't be much left to leave to my son.'*

Impact of ageing

Borrowers were specifically asked how their financial needs might change as they aged. 11 borrowers stated that their financial needs would not change. Reasons for this view included:

- they felt they had set themselves up for life by renovating and making major purchases so nothing else of significant cost would be needed;
- they were confident that their health was good;
- they felt that they were living comfortably on the age pension;
- they had private health insurance that would cover any health costs.

13 borrowers believed their financial needs would increase as they aged. Of those borrowers, health concerns and related care needs were cited as the main reasons that financial needs would increase. A small number of borrowers said that they might have to pay for home help at some stage. One borrower with a sick spouse said:

> *'From bad to worse in the long run. We can only hope [my partner] does get better and our money lasts out.'*

3 borrowers replied that they could not know whether their financial needs would change as they aged. One had an unused line of credit through a reverse mortgage in case they needed it in the future:

> *'Who knows? That's why we took out the loan. Maybe medical costs, sudden accident, maintenance of dwelling, taxis if we can't drive. There will be expenses but we don't know what they are—we thought it wise to get cushioning against the unknown.'*

2 borrowers stated that they believed their financial needs would decrease as they aged.

Only 2 borrowers spontaneously noted that aged-care accommodation might be necessary at some stage. When asked directly about the possibility of needing to access aged care in the future, most borrowers had not considered this possibility or admitted not wanting to have to access aged-care accommodation at all:

> *'Haven't really thought about it too deeply—we have the house, would probably have to sell. Who needs to think about it? We have a good life, we are busy.'*

Research by the Department of Health and Ageing indicates that approximately 1 in 10 people aged 70 years or over are likely to need to leave their home to move into residential care. In 2004–05 the average cost of a low-level care accommodation bond was $127,618.[12] These figures suggest that it is clearly desirable for borrowers to both inquire into the amount of any potential costs and consider whether it is necessary to make provision for this figure before deciding whether or not to take out a reverse mortgage.

Calculating the long-term cost

Estimating the long-term cost of a reverse mortgage is inherently complex: the borrower's remaining equity is equal to the house value minus the loan advance and growing interest. The calculation depends on the interaction of 3 factors, all uncertain when the loan is taken out:

- future interest rates (unless the consumer obtains a fixed rate of interest);
- duration of the reverse mortgage contract (until the consumer moves out of the home or dies); and
- future changes in housing prices (to calculate the borrower's remaining equity).

The complexity of this calculation puts it beyond the ability of most consumers unless they have expert assistance or access to specially-designed calculators. It is not surprising, though it is of concern, that 14 borrowers in our survey had taken out a reverse mortgage without an estimate of how much the loan may cost them over the long term.

Some borrowers noted that they would leave that detail to another family member to 'sort out'. Others commented that they really didn't want to know or there were just too many unknowns to be able to calculate the cost.

15 of the borrowers said they had calculated how much the loan is likely to cost them all up. They were asked how they had made the calculation.

[12] 'Aged Care in Australia' May 2006.

Their responses fell into 3 broad categories:

- the loan balance was calculated using the compounding interest rate (i.e. it roughly doubled after 10–12 years);
- a lender representative or financial adviser provided a print-out, graphs or figures;
- if the borrower pays the interest as it accumulates, the total owing will only ever be the amount borrowed.

One borrower said:

> *'… the person I saw before the loan—he advised me how the interest compounds and in 12 years it [the debt] would double. We thought we would pay the loan back before now. So we went ahead.'*

Projections

A number of borrowers forwarded the printed material they had collected about their reverse mortgage. In addition to this, we compiled advertising material from a variety of reverse mortgage providers. While one lender provided personalised projections of the cost of the loan and remaining equity over the long term (we saw examples of 20 and 22 years), all advertising material we saw projected only 5, 10 or 15 years into the future (with house price inflation assumptions between 3–6%).

While it is difficult to deal with such unknowns as life expectancy, a 15-year projection does not adequately address the situation of a borrower who is 60 or even 70 years old.

> *'[the representative] had graphs made showing [housing values and interest rates] 10 years past and 10 years future. I said, "This is only a guess isn't it?" He said "yes".'*

Several borrowers had attempted to calculate how much equity would be left in their home over time and were confident that they would always maintain the *same* amount of equity as they had when they applied for the loan. This seems to be because they believed that the value of their home would always increase in line with the compounding debt. Some of these borrowers stated that they based this assumption on what the broker or lender's representative had said:

> *'As the years go on, the value of the home must go up. In 20 years time the value of the house will increase and what we owe and the increasing value of the home mean what's left over will be approximately the same value.'*

In contrast, the formal documents warn of the risk that there may be no equity remaining when the loan is repaid.

Considering other options

Several questions addressed the issue of whether borrowers had considered, or been advised to consider, alternatives to reverse mortgages. It should be stressed that by definition the sample did not include any consumers who had pursued options other than taking up a reverse mortgage.

21 borrowers stated that they had not considered options other than reverse mortgages. The remaining 8 borrowers had considered other options, including:

- selling their home and downsizing or renting;
- arranging a personal loan; or
- borrowing from family.

The borrowers rejected these options because they didn't want to move, they didn't believe moving and downsizing would be financially beneficial, or they couldn't access a standard loan due to insufficient income. 4 borrowers reported that the lender's representative offered them alternatives to reverse mortgages to obtain the money they needed. The suggestions offered at this point included moving to a cheaper area or taking out a personal loan.

One borrower said:

> *'[We considered] everything—went to our local credit union—all they did was offer us a [personal] loan. Giving a loan to a pensioner is like waving a bankruptcy notice in your face.'*

18 borrowers had seen a financial adviser but only one borrower reported that their financial adviser asked them if they had considered selling or downsizing rather than taking out a reverse mortgage.

26 borrowers sought independent legal advice in the course of applying for the reverse mortgage. Of these, only 3 reported that their legal adviser had suggested alternatives such as downsizing or reconsidering their decision to take out the loan. In one instance, this resulted in the borrower deciding against drawing a second lump sum.

Information and advice

Contact with lender or intermediary

26 borrowers met face-to-face with either a representative of the lender or an intermediary (e.g. broker, financial planner or employee). The other 3 borrowers applied for and finalised the loan by mail and phone. The borrowers who met with the lender's representative or intermediary had an average of 3 meetings and met for an average of 3 hours in total.

20 borrowers said they were 'very satisfied' with the service they received from the representative. The remaining 9 said they were 'satisfied'. In no case study did a borrower rate the service unsatisfactory.

Borrowers were asked a range of questions about what happened when they applied for the reverse mortgage. Their recollections of what the representative (or intermediary) discussed with them are summarised in Table 4.

Table 4: Issues raised by lender or intermediary

Did the representative …	Borrower recall/agree		
	Yes	No	Not sure/not relevant
Encourage or require them to seek independent financial advice?	20	8	1
Encourage or require them to discuss the loan with their family?	22	4	3
Encourage them to seek advice from Centrelink before finalising the loan?	14	8	7
Ask questions about their financial situation and lifestyle when they applied for the reverse mortgage?	11	13	5
Clearly explain how the loan would work?	28	—	1
Explain how the loan would be repaid?	28	—	1
Explain the cost of all fees and charges?	27	1	1
Explain how varying interest rates and housing prices might affect the loan?	16	11	2
Explain the impact the loan would have on pensions?	10	15	4
Show them a projection of how much the loan might cost over time?	16	12	1
Show them a projection of how much equity might be left in the home over time?	12	13	4
Ask about their family situation and whether it is important for them to leave an inheritance to their children?	12	14	3

In addition, 15 borrowers reported that they remembered the representative describing how compound interest works and a further 8 said that they already knew and did not need to have it explained.

Some of these borrowers commented that the interest rate was high, that there had been increases to the variable interest rate recently, and that the ultimate cost of compounding interest was very high. One borrower said:

> *'Compounding interest—it still boils me a bit—that I am paying interest on interest.'*

The remaining 6 borrowers may be unaware of how compound interest works (i.e. that the borrower is charged interest on interest, and the total debt can increase rapidly). For example, when asked to describe how interest worked on the loan, one borrower said:

> *'I just don't know how it works properly—but it's the interest they have to charge doing business over the year.'*

Commissions

13 borrowers dealt directly with lenders so no commission would have been payable. The transactions for the other 16 did involve commission payments to an intermediary. Only 6 of these borrowers remembered being told that the representative would receive a commission. Several others said that they would assume a commission would be paid.

By way of example, commission payable by one provider to the 'introducer' is 2.6% of the total amount of credit up front and 0.3% per annum ongoing. So on a $100,000 loan, the intermediary would receive $2,600 when the loan was taken out and at least $300 per year thereafter. Over 20 years, we calculate that the commission would be over $15,000.

Awareness of risk

Most borrowers (20) said that from their recollection, the representative did not outline any risks in taking out a reverse mortgage and one could not remember. Of the 8 who recalled that the representative did outline risks, the risks included:

- that reducing equity might mean that there may not be enough to go into aged-care accommodation (1 borrower);
- a warning to take care to not borrow more than the value of the property (1 borrower);
- that the compounding interest can increase rapidly (4 borrowers);
- that equity will diminish (2 borrowers).

One borrower received a written list of pros and cons from the representative.

Legal advice

Borrowers were asked if they sought legal advice before finalising their reverse mortgage. 25 borrowers did obtain legal advice and 4 did not.

It should be noted that all 3 lenders that provided reverse mortgages to these borrowers now require all borrowers obtain independent legal advice. The 4 borrowers who did not receive legal advice took out their reverse mortgages before this requirement was introduced.[13] The borrowers who did not receive independent legal advice were asked why they elected not to do so and they

[13] The Code of Conduct adopted by SEQUAL members requires them to ensure that all borrowers receive independent legal advice from a solicitor of their choice before entering into a reverse mortgage.

answered that they trusted the bank, had faith in their own reading of the terms and conditions, or trusted the advice of a financial adviser. For example, one borrower said:

> *'I thought it was straightforward and the financial adviser felt it was no problem.'*

When asked what would have prompted them to seek legal advice, they said they would have sought advice if they were not satisfied with the answers from the bank, if they had any doubts, or if someone told them it was risky.

The borrowers who sought independent legal advice were asked how they located their legal adviser:

- 15 used an adviser that they had used previously;
- 4 used a local solicitor;
- 4 used a family member or someone referred by a family member;
- 2 used an adviser to whom they were referred by the loan broker or provider.

Issues discussed with the legal adviser ranged from going through the contract page-by-page to asking for advice about possible risks and pitfalls of the loan and seeking reassurance that the product was 'safe' and 'not dodgy'. For example, one borrower said:

> *'Most solicitors are against reverse mortgages but she was coming around by the end—she could see we knew what we were doing. She read through the contract … all the detail, interest etc. She suggested downsizing.'*

10 of the borrowers who sought legal advice said that the advice influenced their decision, even if only to the extent that it reassured them that they had made the right choice.

There was evidence of a mismatch in borrowers' expectations of legal advice. Solicitors appeared cautious about reverse mortgages and encouraged clients to think deeply about the consequences. Borrowers appeared to be relying on solicitors for an 'OK' signal on both legal and financial issues, rather than also getting advice from a financial specialist.

Case study 1

An 83 year-old pensioner couple received a $100,000 lump sum in 2003 via a reverse mortgage to undertake some repairs to their home and purchase a new car. Two years later they approached the provider to borrow a further $20,000. After being offered $350,000 by the lender, they consulted a recommended solicitor for advice. The couple reported that the solicitor encouraged them to think about what they really needed and advised them to use a small investment to pay back part of the loan and decline the offer of a further $350,000.

Financial advice

Borrowers were asked if they sought independent financial advice before finalising their reverse mortgage. It seems some borrowers may have overlooked or misinterpreted the 'independent' aspect of the question but most borrowers did receive some kind of financial advice. In our sample:

- 14 borrowers clearly received independent financial advice;
- 5 borrowers received advice but it is unclear whether the status of the adviser was independent or not;
- 3 borrowers received advice that, while useful, was not independent in the sense that the adviser would receive a commission if the reverse mortgage went ahead;
- 7 borrowers did not seek financial advice.

The Code of Conduct for the industry body, SEQUAL, currently states that seeking financial advice is strongly encouraged, but not required. We note that 7 borrowers involved in this research were required to obtain financial advice at the time the loans were taken out. Borrowers who did not seek financial advice were asked why they elected not to do so. Several borrowers indicated that there was no need to get further financial advice because they were satisfied with the advice/assistance provided to them by the loan provider. For example, one borrower said:

> *'I didn't think it was necessary—I was dealing with a bank—they know about finances.'*

3 borrowers said that they thought they had enough knowledge to understand the financial implications of the loan. One pointed out that getting financial advice was too expensive:

> *'Financial advisers can't help anyone on the basic pension. Also they are expensive to visit when you are broke.'*

Other borrowers noted that they thought it was sufficient to have been advised by a lawyer or Centrelink. For example:

> *'I don't have an adviser—I am my own adviser—I don't see the point. It suits me and if my solicitor advises me, that is good.'*

One borrower said that she was referred to the reverse mortgage provider by a financial adviser so she didn't feel she needed to visit another financial adviser.

When asked what would have prompted them to seek independent financial advice, borrowers said they would have sought advice if they felt something was 'not right', if they had more assets or investments, or if their solicitor said 'something untoward' about the loan.

The 22 borrowers who sought financial advice were asked about the main thing they discussed with the financial adviser. Responses fell into the following categories:

- whether the particular product nominated was a good choice (6 borrowers);
- whether it was a good idea to take out a reverse mortgage in general (5 borrowers);
- how the loan worked and how much it would cost (5 borrowers);
- the obligatory financial advice required as a condition of the loan (2 borrowers)
- no recall or not answered (4 borrowers).

None of the borrowers indicated that their financial advice focused on planning for their longer-term future. Of the borrowers who sought advice, 13 said the advice they received influenced, confirmed or reinforced their decision to finalise the reverse mortgage application.

One borrower said that she probably should have obtained independent financial advice but was apprehensive that she may be pressured to take up a product that would be more expensive.

Case study 2

A woman aged 60 took out a reverse mortgage to the value of 10% of her home to cover legal fees and court costs. She was referred to the loan product by a solicitor and did not seek any other advice. When asked how interest on the reverse mortgage is calculated, she answered that she didn't know and had not attempted to calculate the ultimate full cost of the loan.

She indicated that she had not sought independent financial advice even though it is the policy of the lender to strongly advise customers to do this. When asked why not and what might have prompted her to do this before finalising the loan she said:

> *'I thought "here goes" and we'll just leave it at that … I should have, but I thought they might make you go onto another thing that costs more.'*

This borrower said that the reverse mortgage representative did not show her how much the loan would cost over time or how much equity would be left in the home over time. She did however recall being told that *'equity would build up by doing things to it [renovating the home] all the time'* and that she could go back and get another loan at a later date to do this.

While a reverse mortgage may have been the best option for this relatively young borrower, she is unaware of the detail of the commitment she has made. According to the information collected, this borrower has committed to a reverse mortgage she knows very little about without considering alternatives and without independent legal or financial advice about future implications.

Family support

Of the 25 borrowers who had children, 21 talked to their family about taking out a reverse mortgage before they applied. Of the remaining 4 borrowers:

- 1 borrower told their family afterwards;
- 1 borrower used the money to help one son but indicated that the other son had not been consulted; and
- 1 borrower told only one of her adult children but only because the lender required her to do this because this son was living with her.

All borrowers who discussed the loan with their family before applying reported that their family had been supportive. One noted that after her family discussed her initial plan, she borrowed a significantly lower sum.

4 borrowers applied for money to help adult children or another family member. Reverse mortgages which benefit adult children of the home owners can be advantageous to both parent and child. However, in some circumstances, parents may find it difficult to resist requests from children.

While there is no evidence that any of the loans in our survey were not freely entered into and based on an independent decision by the parent, we found some responses revealed risks that, in other circumstances, would leave open the possibility of the parent being exploited:

- Some of the adult children were involved in organising the reverse mortgage.
- 1 borrower was vague about the amount borrowed and the terms of the loan.
- In some cases, the borrowers described the funds given to their children as a loan to be repaid over time, rather than a gift. However, at the time of our survey, these loans had not been repaid.

In some instances, the lenders had taken great care to facilitate a balanced independent decision by the borrower where a third party was benefiting from the mortgage. In other cases, procedures were less stringent about ensuring this.

Understanding the product

Default conditions

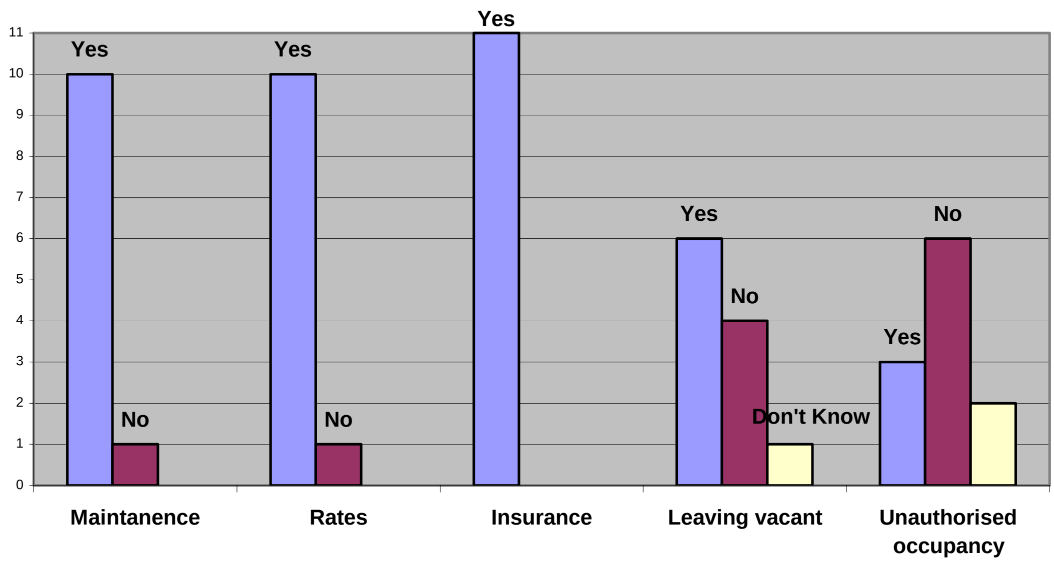
Generally, borrowers had a patchy awareness of the terms and conditions of their reverse mortgage, even though the consequences of not meeting these terms and conditions could be severe. For example, a borrower would be in default under their reverse mortgage with one lender in the survey when:

- other people were living in the house without the lender's authority;
- outgoings were not paid (e.g. rates);

- insurance was not paid;
- the property was left vacant for 6 months; or
- the value of the property had been allowed to become materially reduced.

The 11 borrowers who had a reverse mortgage from this provider were asked if they knew of each of these conditions. The results are outlined in Figure 1. While almost all borrowers were aware that they had to maintain the home, pay council rates and pay insurance as a condition of the loan, only 6 of the 11 were aware that they could not leave the property vacant and only 3 were aware that they could not allow anyone else to move into the home without authorisation.

Figure 1: Knowledge of default conditions for one product (11 borrowers)



For the borrowers in our survey, breach of default conditions can trigger total repayment of the loan, sale of the property, enforcement costs and loss of the 'no negative equity guarantee'.[14]

Survey participants were asked what would happen if they did not meet the obligations they identified. 17 borrowers stated that they did not know. Other responses fell into the following broad categories:

- the borrower presumed they would be asked to do what was required or repay the money;
- the home would be lost;
- the borrower felt sure they would always meet these obligations, even without the loan.

[14] Changes to SEQUAL's Code of Practice have subsequently modified this: see Section C of this report.

One borrower said:

> *'I presume—it was never mentioned—common sense says that they can request for you to do it or they can ask you to return borrowed money. It was never spelled out.'*

Residents not included on loan documents

14 borrowers had a loan condition that banned other people living in the home unless the lender gave approval. Of these 14 borrowers, only 3 were fully aware of the condition and the serious potential consequences for breaching it.

Of the 14 borrowers to whom this condition was applicable, 8 thought it was not a condition of their loan and 2 said they didn't know. Only 4 out of 14 correctly identified that this condition applied to them. Of the 4 borrowers who knew this was a condition, one was not aware of the consequences of not complying.

One borrower reported that she had her adult son living with her for 6 weeks and observed that the lender 'kept querying me'. For this particular lender, unauthorised occupancy is a default condition and being in default can trigger loan repayment and loss of the no negative equity guarantee.

No negative equity guarantee

All reverse mortgages in this survey had a 'no negative equity guarantee'. This means the loan provider guarantees that the amount the borrower owes on the loan will never exceed the value of their home. However, many borrowers were not aware of this feature.

Most borrowers did not recognise the phrase 'no negative equity guarantee' until it was defined. Of the 29 borrowers surveyed, 7 were not aware that the no negative equity guarantee was a feature of their reverse mortgage, 6 were unsure and 16 were aware that this was a feature of their loan.

In fact one borrower assumed that she could lose her house if the value of the loan became higher than the value of the house:

> *'I thought if it went higher than the house they would sell. They never said it but I thought they wouldn't want to lose money.'*

Of the 16 borrowers who were aware of the no negative equity guarantee feature and its definition, 4 could not explain how it worked. Of the 12 borrowers who attempted to describe it, 7 gave an accurate description and 5 gave an unclear or inaccurate description. 3 of the 5 inaccurate descriptions indicated that these borrowers fundamentally misunderstood the nature of loan repayment calculations.

Case study 3

A couple in their early 60s took out a reverse mortgage to enable them to complete home renovations. The loan was for 17% of the value of the home.

Neither borrower had worked for over 6 years, and their only income was from Centrelink benefits. They had a good understanding of the conditions of the loan and were resigned to the rate at which the outstanding balance would increase over time.

This couple felt they had little choice but to access the equity in their home and found the guarantee of no negative equity extremely comforting so that they did not have to worry that their children would ever have to pay any outstanding amounts:

> *'This way we know that no matter what, we've got a home until we die and the children won't carry any debt.'*

Other issues about the product

One borrower was surprised at the fees and charges that were taken from the funds she was expecting to receive. She said:

> *'I actually got less money than I expected—because the fees came out of the amount I thought I was getting— it was a bit of a shock. Stamp duty should be distinctly stated.'*

One borrower was concerned at the wide range of the lender's power of attorney if the loan falls into default:

> *'This is the biggest issue that worried us—that their powers of attorney are endless.'*

Product suitability and use of proceeds

Satisfaction with product

All borrowers in the survey had had their reverse mortgage for less than 3 years. In fact, most had had their loan for less than a year. Their main experience of a reverse mortgage had been applying for the loan and spending the money. Therefore, it was too early for any long-term issues, such as the increasing value of compound interest or changes in life circumstances, to have emerged.

26 borrowers answered with an unreserved 'yes' when asked if their reverse mortgage had performed as well as expected. Another 2 borrowers said the loan had performed as expected to date, but recent interest rate rises and the administration fees were a surprise. One borrower said that so far the performance was fine, but it would only be at the end that they would have an accurate impression.

2 borrowers noted that they had exhausted their line-of-credit reverse mortgage much faster than they anticipated. Other borrowers also identified running out of credit faster than expected as a potential pitfall.

Suitability of amount borrowed

We asked borrowers how much money they had asked for when enquiring about a reverse mortgage. They were then asked if that amount was approved by the lender, or if more or less was approved:

- 17 said the amount they wanted was the amount approved;
- 2 said the full amount they wanted was not approved;
- 10 said more was approved.

Of the 10 borrowers who indicated that more was approved than they requested, 5 accepted the higher amount (sometimes in the form of a credit limit). One borrower was offered $135,000 more than originally requested and after 2½ years had spent almost all of the available credit: see Case study 4.

22 borrowers took out their loans relatively recently (within the last 2 years) so the effect of the reverse mortgage on any need for additional borrowing in the future had not yet become an issue.

When one couple requested a second drawdown, they were offered a much higher amount. They became concerned, consulted a solicitor and decided to decline the offer completely: see Case study 1.

One borrower had borrowed $50,000 on top of existing needs, in anticipation of needing it over the next 3–5 years. The money had been put in a term deposit, but she seemed unaware that this immediate drawdown would cost her thousands of dollars in extra interest, and an amount greater than the interest earned on the funds.

Impact on pensions and taxation

26 borrowers were receiving social security benefits when they applied for the loan. 19 borrowers were eligible for the full-age pension and 4 were eligible for a partial-age pension. In addition to this, one borrower couple was receiving the mature-age Newstart allowance and 2 were receiving a disability pension.

After finalising their reverse mortgage, there was no reduction in the pension payment for 17 of the borrowers who had been eligible to receive the full-age pension. 2 experienced a reduction. There was also a slight reduction for one borrower receiving a partial-age pension.

One borrower had taken out the reverse mortgage to pay for an aged-care accommodation bond. There was a delay moving into the aged-care hostel because she needed time in hospital and the loan proceeds were in her bank account longer than expected. As a result, she failed the Centrelink means test and lost her age pension for a period.

Just under half of the borrowers (14) spoke to Centrelink advisers to assess how their reverse mortgage would impact on any current or future Centrelink benefits before finalising their application.

26 borrowers said that their reverse mortgage did not have any taxation implications. These borrowers reported that this is because their low income meant they did not have to lodge tax returns. The remaining 3 said they did not yet know if their reverse mortgage had tax implications.

Using the credit and long-term budgeting

Even where a reverse mortgage appeared, in abstract, a suitable product to meet the borrowers' needs, we found that some borrowers appeared to have difficulty in budgeting or using the available credit appropriately:

- A few were using credit to mask the fact that they could not maintain their current living arrangements and lifestyle indefinitely after retirement.
- Some borrowers drew down lump sums where an income stream may have been more appropriate. Drawing a lump sum meant they incurred unnecessary interest and potentially jeopardised Centrelink benefits.
- Some borrowers drained funds faster than planned because they were finding it hard to resist easy access to a large amount of cash. This was more of a problem where lenders offered more credit than was needed and/or the borrower lacked experience in budgeting.

Borrowers' use of credit appeared to be more under control where the borrower had a clear idea of their needs before they took out the reverse mortgage. These borrowers used funds for:

- modest one-off capital expenditure (e.g. home renovations);
- modest monthly income supplements that would last for many years;
- bridging finance to quickly pay for aged-care accommodation, pending a home sale.

There are several key risks to taking out a reverse mortgage:

- You use your credit for living expenses. When you hit your credit limit, you then have a sudden drop in income and may have to sell your house to cover living expenses.
- You use your credit for discretionary spending such as holidays, 4WD and caravan, or helping family members. When you hit your credit limit, you have no credit in reserve for emergency needs (e.g. health expenses, home care).

- You hit your credit limit and are unable to afford essential house maintenance and modifications. You may have to sell your home and move somewhere much cheaper.
- The combination of spending and compounded interest could absorb most of the equity in your home and, even after selling your home, you may have insufficient money for your desired aged-care accommodation (e.g. bond for nursing hostel, buy into retirement village).

Access to loan funds without disciplined budgeting or some mechanism to help people ration their credit over time can create major problems. Some responses suggested that borrowers found access to a substantial amount of funds a difficult temptation to resist. One borrower said:

> *'In principle, yes [the loan] has [met my needs]—if I hadn't been so stupid and helped a few people out. I used the money very quickly—otherwise it would have gone as expected. I thought I would get that money back but it never happened. I didn't quite comprehend the amount that would have to be paid back.'*

The worry about over-spending was greater where the lender had approved more credit than the consumer needed or had provided a flexible line-of-credit, which the borrower had not managed well. One borrower who had a reverse mortgage provided through a line of credit said:

> *'[It was] like having a credit card with a $100,000 credit limit and no repayments.'*

One borrower reported that after 2 years with a reverse mortgage he needed to sell his home and downsize because he had spent all available equity very quickly.

Case study 4

A retired man in his 70s applied for a reverse mortgage to help him with a range of commitments: to assist a son's business, consolidate debts, buy a new car and renovate the home. The approved credit limit was $135,000 more than he originally indicated he needed.

After 2½ years and additional lifestyle spending, he has accessed almost all of the credit available. The borrower now says he wishes he never took out the loan and has put the house on the market to relieve the debt. He plans to buy a smaller house in a different area. He said:

'I've never been a person to dwell too much on what will happen in the future. I've been in business all my life and never had to budget. I might have to budget more now. I just thought, "I can improve my standard of living", that's what it's all about … You do have a false sense of security … interest keeps compounding. Then your standard of living will drop.'

In at least 2 cases a different factor was at play: the borrower was reluctant to address the need to make changes to their lifestyle following retirement and adjust to a lower level of income.

Case study 5

A couple aged in their late 60s took out a reverse mortgage line-of-credit to the maximum the lender would advance, 20% of the value of their home. After 14 months, they had spent more than half the credit available, primarily to cover the difference between their income from the age pension and their current living expenses.

The couple did visit an accountant for advice before finalising their reverse mortgage. The accountant told them that the loan would be expensive and that they would lose equity and 'be back to where they were years ago'. They were also aware that their future long-term needs may include having to 'buy in' to aged-care accommodation and reported that 'we should have enough left in equity to be able to afford this'. Nevertheless this couple reported that they were not shown any projections by the lender's representative and had not tried to calculate the total cost of the loan. One of them said:

> *'I daren't. It's shocking. I don't go there.'*

If they continue to spend at the rate they are spending now, this couple will have reached their credit limit within 3 years, when they will be around 70 years old. They will then be in the position of having to get by on a third of their current budget (unless the value of their property has increased sufficiently to enable them to obtain a further substantial advance). This will force a major rearrangement of their lifestyle and living arrangements.

C Conclusions and recommendations

Key points

The borrowers in our survey had only recently taken out reverse mortgages. They were satisfied in having money to spend and, for most people, any potential problems were ahead of them.

However, our survey, and ASIC's broader work on reverse mortgages, suggests several factors that can inhibit good decision-making by consumers when assessing these products, which may lead to future problems.

To reduce the risk of these problems arising, we recommend improving:

- the structure and operation of these products;
- the information available to consumers; and
- consumers' access to financial advice.

Improving outcomes for consumers

When considering a reverse mortgage, consumers need to make a series of financial decisions. This report has identified several factors that may affect consumers' lending decisions and the loans they take out: see Table 5. Our recommendations in this section seek to address these issues and improve overall outcomes for consumers in taking out reverse mortgages.

Table 5: Key factors in consumer decision-making

Decisions consumers need to make	Factors inhibiting good decision-making
• Is a reverse mortgage the best option (e.g. compared to moving to a cheaper residence)? • Is the balance right between trading off current expenditure against future (as yet undetermined) needs? • If a reverse mortgage is the best option: – which product is most suitable? – how should I receive loan funds (e.g. lump sum or periodic payments)? – how much credit should be accessed and when is it needed? – can and should some equity be protected?	• Reverse mortgages are complex, and different from normal credit products. In particular, it is difficult to estimate the long-term cost of a reverse mortgage and how much equity might be left for future needs. • Borrowers find it hard to do long-term planning. Some will have an emotional resistance to thinking what their future life might be like if their health declined and they became less able to look after themselves. • Even if they undertake planning for future needs, some borrowers find it difficult to budget, and, given access to a large amount of credit, use it more quickly than intended. A small proportion of older consumers may be vulnerable to exploitation by family members.

Structure and operation of products

It is hard for people to anticipate how the conditions of a reverse mortgage might affect their life circumstances in 20 years time. It is therefore crucial that the product has contract terms adapted to elderly borrowers, particularly for those clauses that enable the lender to sell the borrowers' home.[15] SEQUAL has recently addressed this issue through its guideline on default conditions for a no negative equity guarantee (NNEG).[16]

Recommendation 1

We encourage all lenders to adopt procedures in the event of default that are appropriate to the age and vulnerabilities of this group of borrowers.

We encourage all lenders to include a no negative equity guarantee in their reverse mortgage products. This guarantee:

- should be expressed in simple language;
- should only be lost in limited circumstances where the lender's security is at significant risk (in line with SEQUAL guidelines);
- should not be lost where the lender can take simple action to protect their interests (e.g. adding the cost of unpaid council rates to the balance of the loan).[17]

Recommendation 2

We encourage all lenders to consider structuring their reverse mortgages to facilitate disciplined money management and planning, for example:

- not granting more credit than the borrower applies for;
- where loans are primarily for living expenses, offering the option of regular fortnightly or monthly payments;
- including a projection in the monthly statement 'Based on your average monthly spending, your credit will be used up in (month, year)';
- having responsible advertising, so short-term spending is not encouraged to the detriment of meeting longer-term but more essential needs;
- providing access to relevant tools and information (such as budgeting tools, information about the statistical likelihood of needing, and potential costs of, such things as supported accommodation, and information about taking credit by a lump sum or instalments);
- allowing for a percentage of equity to be protected (e.g. to meet a wish by the borrower to leave some inheritance for their children).

[15] It is proposed that unfair contract terms provisions of the *Fair Trading Act 1999* (Vic) will apply to credit from the end of next year. If this is the case, contracts for reverse mortgages are likely to be examined for fairness.
[16] Under SEQUAL's 'NNEG and default conditions guideline', the no negative equity guarantee will only be invalid if the property is not sold in an arms length transaction where the lender has been notified of the sale, or the borrower has put the value of the security at risk due to fraud or wilful damage. If the borrower is in default under the loan for any other reason, the lender cannot use this as a reason to invalidate the guarantee.
[17] In response to concerns raised about reverse mortgages, the Ministerial Council on Consumer Affairs has agreed that there should be amendments to the Uniform Consumer Credit Code to provide for a prescribed Information Statement for reverse mortgages and a statutory protection against negative equity.

Improved information

Very few borrowers were aware of all of conditions of their loan and the serious consequences of not meeting these obligations. Most people did not have tailored projections about the likely long-term cost of a reverse mortgage.

SEQUAL's 'Calculator parameters guideline' provides that calculators for estimating the effect of the loan on future equity should use the following default parameters: property prices should increase by a maximum of 4%, the interest rate should be that currently applying to the loan, and the period illustrated should be life expectancy plus 5 years.

SEQUAL guidelines also require the lender to both write to the borrowers and speak to them directly before taking action on a loan default, reflecting the importance of tailoring procedures to meet the needs of retirees.

Most reverse mortgage lenders are members of a free external dispute resolution (EDR) scheme for when problems arise. However, the level of membership of EDR schemes by intermediaries is less consistent.[18]

Recommendation 3

Lenders should consider reminding borrowers annually (in plain language) about their key obligations, especially those that trigger a loan default or jeopardise the no negative equity guarantee.

Recommendation 4

Personalised projections are a valuable tool and would be useful for every reverse mortgage applicant. Where provided they should be based on the applicant's age, amount borrowed, current house value and a conservative estimate of the future property values. Projections should cover long-term scenarios (e.g. to age 90 or for 10 years, whichever is longer, or to zero equity).

Recommendation 5

Based on the consumer's pattern of drawdowns, lenders could consider including projections in each annual statement of:

- dollar debt in absolute terms;
- debt in relation to credit limit;
- owner's share of home equity against various house price inflation scenarios.

Recommendation 6

Lenders and intermediaries should have internal and external dispute resolution procedures appropriate to the needs of older borrowers.

[18] The projected introduction of national finance broker legislation by the States and Territories would address this issue if, as contemplated, it introduces a mandatory requirement on intermediaries to be a member of an EDR scheme.

Improved access to advice

The borrowers making the most informed decisions were people who had a range of quality advice:

- independent legal advice;
- advice from Centrelink officers;
- financial advice that considered long-term needs and risks; and
- discussions of their options with family members.

Consumers have difficulty in modelling their future financial needs by themselves, so it is in their best interests to obtain independent financial advice. They also need to have ready access to information about the statistical likelihood of needing, and potential costs of, such things as aged-care accommodation.[19]

Recommendation 7

Training should be developed for financial advisers so that they can better help consumers understand the implications of reverse mortgages.

Recommendation 8

Lenders should strongly recommend that potential borrowers seek financial advice/counselling by trained advisers, and adopt easy referral processes.

Recommendation 9

Lenders should adopt and monitor effective procedures to reduce the chance of vulnerable older consumers being exploited by other family members. Solicitors advising intending borrowers also need to be aware of this risk.

Recommendation 10

Lenders should monitor brokers and intermediaries arranging reverse mortgages to ensure they are complying with their procedures and requirements. Lenders should ensure they have the capacity to sanction or discipline brokers if they do not comply (e.g. if they regularly submit inappropriate applications).

[19] We note this issue has been identified by SEQUAL who have taken steps recently to introduce an educational program for brokers, financial planners, accountants and solicitors.

Appendix 1: Profile of borrowers and loans

		Number out of 29
Gender and relationship status	Couple	17
	Single female	6
	Single male	6
Borrower's age Note: If borrower is a couple, the youngest age is represented	Less than 65	6
	65–69	8
	70–75	6
	75–79	4
	Greater than 80	5
Borrower's location	Metropolitan NSW	17
	Regional NSW	12
Amount borrowed	Less than $49,999	8
	$50,000–$99,999	12
	$100,000–$149.999	5
	$150,000–$199,999	1
	Greater than $200,000	3
Age of loan	Less than 6 months	13
	6 months–2 years	9
	More than 2 years	7
Type of interest rate	Standard variable rate	15
	Capped variable rate	2
	Fixed interest rate (2–4 years)	9
	Fixed interest rate (for life)	3
Type of loan	Lump sum	16
	Lump sum + income stream	3
	Income stream only	1
	Line of credit	9

Appendix 2: Summary of questions

How and why the product was found/chosen

- How did you first find out about reverse mortgages?
- Did you see/hear any advertising about reverse mortgages before you applied for one?
- Did someone refer you to the provider?
- How many reverse mortgages did you find out about before you decided to apply for the loan?
- Did you consider any options other than reverse mortgages?
- For what reason did you borrow the money?

Financial circumstances

- Excluding your home, what was the total amount of assets (cash, shares, other investments) you had before getting a reverse mortgage?
- How do you think your financial needs may change as you age? (prompt—e.g. aged care accommodation, medical needs, wanting to leave an inheritance)
- Did you consider these needs when you took out the reverse mortgage?
- How much money did you need when you decided to apply for the reverse mortgage?
- Was this amount approved?
- Is the amount approved the amount you borrowed?
- Have you drawn subsequent amounts since the first amount was approved?

Understanding of the product

- What do you think the advantages of taking out a reverse mortgage are for you?
- What do you think the disadvantages of taking out a reverse mortgages are for you?
- Can you describe how you think the following elements of the reverse mortgage work?
  - when and in what circumstances the loan must be repaid
  - terms and conditions of the loan that affect your rights in regard to your home
  - interest on the loan
  - is your loan calculated using a fixed or variable interest rate?
- Are you required to:
  - maintain your home
  - renovate your home if directed
  - pay the council rates
  - pay insurance
  - ensure your home is not left vacant for an extended period of time
  - provide any paperwork after the initial application
  - not allow anyone else to move into your home?
- What will happen if you don't meet these obligations?
- Does anyone who is not included on the loan documents live in your home?

Information and advice provided at the time of application

- Did you meet with a representative of the loan provider?
- From when you first enquired, how long did you take to finalise your decision to take out this loan?
- How satisfied were you with the service you received?
- Did the representative encourage/require you to:
  - seek independent advice from a lawyer
  - seek independent financial advice
  - discuss the loan with your family
  - seek advice about impact on Centrelink payments (if relevant)?
- Did the representative ask any questions about your financial situation and lifestyle?
- Did the representative offer alternative ways for you to borrow the money you needed?
- Do you think the representative clearly explained how the loan would work?
- Did the representative describe how 'compound interest' works?
- If yes, do you feel the representative clearly explained this concept?
- Did the representative tell you:
  - the cost of all fees and charges
  - how varying interest rates and housing prices might affect the loan

Understanding of the product (cont.)

- Were you offered a 'no negative equity' or 'no recourse' guarantee?
- Under the conditions of the loan, what happens to your home when it is passed to your estate?
- Under the conditions of the loan, what happens to your home/the loan if you [and your partner] move into an aged-care facility?
- Is there any penalty if you want to pay out your loan early?
- Have you calculated how much the loan is likely to cost you all up?

Information and advice provided at the time of application (cont.)

  – whether they were going to receive commission
  – about any impact the loan would have on taxation
  – about any impact the loan would have on pensions (if applicable)?
- If there are residents in the home other than the loan applicant/s, did the representative explain what their legal position will be when you leave the home?
- Did the representative explain how the loan would be repaid?
- Did the representative ask you about your family situation and whether it is important to you to leave an inheritance for your children?
- Did the representative outline any risks of taking out a reverse mortgage loan?
- Did the representative show you a projection of:
  – how much the loan might cost over time
  – how much equity might be left in your home over time?
- Did you feel you had a clear picture of the conditions of the loan after meeting the representative?
- What printed information was given to you when you met with the reverse mortgage representative?

Steps taken/advice sought before finalising the application

- Did you seek independent legal advice about the loan conditions/contract?
- Did you seek independent financial advice before finalising the loan?
- Before getting a reverse mortgage were you eligible for the aged pension?
- Did finalising your reverse mortgage impact on your aged pension eligibility?
- Did you speak to Centrelink advisors to assess how this loan would impact on any current or future Centrelink benefits before finalising your application?
- Was your family supportive of your loan application?
- Did you consult anyone else for advice or information or use any other financial information sources?
- Did you have superannuation at the time of applying for the loan?
- Does your reverse mortgage loan have taxation implications?

Interaction with the provider since the loan was finalised

- Have you had any contact with the provider since the loan was approved?
- Have you been required to undertake any maintenance or repair work on your property since you took out the reverse mortgage?
- Have you wanted or needed to renovate your home since taking out the reverse mortgage loan?
- Have any new details about the loan conditions come to your attention since taking out the loan?

Satisfaction with the product

- Has your reverse mortgage loan performed as well as you expected?

Appendix 3: Summary of loan features

These are the features of loans taken out by borrowers in our sample, at the time of the survey (current at 8 September 2006).

	Lender A	Lender B	Lender C
Product features			
Max. loan (all age dependent)	45% of property value	45% of property value to $425,000	50% of property value
Payment options	Lump sum/ regular payments (or both)	Lump sum/ regular payment (or both)	Lump sum/ regular payments (or both)
Lender guarantee	No negative equity guarantee	No negative equity guarantee	No negative equity guarantee
% protected equity	Option	Not available	Option
Guarantee/s do not apply:	On default/ property sale (not lender approved)	Borrower misrepresentation/ breach of undertaking	On default/ property sale (not lender approved)
Loan portability	Yes	Yes	Not specified
Other			Available to fund an accommodation bond by non-resident borrower
Eligibility criteria			
Minimum age	60	65	60
Borrowers must own and occupy home	Yes	Yes, unless have consent from bank	No
Fees and charges			
Break costs	For early repayment or on default	No penalty	On default or if during fixed rate period
Interest options	Fixed or variable rates available	Variable rates only	Fixed or variable rates available
Advice provided to client			
Independent legal advice	Required	Required	Required
Independent financial advice	Strongly advised	Strongly recommended	Strongly recommended
Triggers for loan repayment			
Death of borrower	6 months after death	On death	10 months after death
Default by borrower	On default	On default	On default

	Lender A	Lender B	Lender C
Property sale	6 months after sale	On sale	On sale
Cease living in property	6 months after move to age care	12 months after	Borrower need not live in property
Product conditions			
Revaluation	Every 3 years	Every 2 years	Every 3 yrs (each year after 15 years)
If borrower does not maintain property	Lender repairs—adds cost to loan (Also default event)	Bank repairs—adds cost to loan (Credit limit may be cancelled)	
Default events			
Property sold		Default	Default
Unauthorised interest in property			Default
Unauthorised occupation property	Default		
Outgoings not paid	Default		
No insurance	Default	Default	
Fraud/ misrepresentation	Default	Default	Default
Leave property vacant	Default (6 month vacancy)	Default (12 month vacancy)	
Bankruptcy	Default		Default
Overdue payment		Default	Default
Other	Debt not repaid within 6 months of trigger event		Actions result in material decrease in prop value
Allowing property to become materially reduced	Default	Default	Default
Effects of default			
Default notice	Not specified	Yes	
Total repayment of loan	Yes	Yes	Yes
Sale of property	Yes	Yes	Yes
Enforcement cost	Yes	Yes	Yes
Default interest	Yes	Yes	Yes

