REPORT 586

Review of reverse mortgage lending in Australia

August 2018

About this report

This report summarises the findings and recommendations from ASIC's review of lending practices for reverse mortgages.

Reverse mortgages can play an important role in helping older Australians improve their standard of living in retirement while remaining in their homes.

Our review found that reverse mortgages are playing this role, but that lenders can do more to improve long-term consumer outcomes and help potential borrowers make informed decisions about their immediate and future financial needs.

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- 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 licence 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.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

Executive summary

1 Reverse mortgages allow older Australians to borrow against the equity in their home through a loan that does not require repayment until a later time, typically when the borrower has vacated the property or passed away.

2 These products are one of the main options available to older Australians who want to draw on the equity in their home while continuing to live in their property. Research suggests that 83% of older Australians strongly prefer to 'age in place'.

Note: See the Treasury, *2015 Intergenerational report* (March 2015).

3 In mid-2017, ASIC commenced a review of lending for reverse mortgages. The aim of our review was to examine this market after the introduction in 2012 of enhanced responsible lending obligations and consumer protections for reverse mortgages (enhanced consumer protections): see paragraphs 14–16.

Note: For a full summary of responsible lending obligations and protections under the *National Consumer Credit Protection Act 2009* (National Credit Act), see Section D of the report.

4 Our review looked at reverse mortgage lending from 2013–17, drawing on quantitative and qualitative data to understand how this market is working in practice. This included granular data on over 17,000 reverse mortgages, 111 consumer loan files, the policies and procedures of lenders in our review, and complaints from internal dispute resolution (IDR) and external dispute resolution (EDR) databases. We also commissioned in-depth interviews with 30 borrowers and consulted over 30 industry and consumer stakeholders.

Note: For a detailed methodology, see Appendix 1 of the report.

5 For our review, we assessed five groups of lending brands separately, each of which are referred to in this report as a 'lender':

(a) Bankwest;

(b) Commonwealth Bank;

(c) Heartland Seniors Finance;

(d) Macquarie Bank; and

(e) the Westpac brands comprising St George Bank, the Bank of Melbourne and BankSA.

6 This review forms part of ASIC's broader work to address key issues that affect older Australians and to help bring about positive changes for these consumers in credit and financial services: see Report 550 *ASIC's work for older Australians* (REP 550).

7 Our broader work on these issues is consistent with growing efforts by the Australian Government and the state governments to address issues relating to Australia's ageing population.

8 In May 2018, the Australian Government announced a package of reforms as part of the 2018–19 Federal Budget to support the skills, finance, health and safety of older Australians. This includes plans to expand the Pension Loans Scheme, the establishment of an independent Aged Care Quality and Safety Commission, improvements to the My Aged Care website, and a number of financial measures and incentives.

Note: See Australian Government, *Fact Sheet 1: More choices for a longer life package overview* (May 2018).

9 The Productivity Commission has released various studies on issues relating to older Australians, including aged care, the economic implications of an ageing Australia, and housing. The Australian Government has also commenced a 10-year program of reforms to improve the sustainability and affordability of the aged care system.

Note: See Productivity Commission, *Housing decisions of older Australians* (December 2015) (Productivity Commission report); Productivity Commission, *Caring for older Australians draft report* (January 2011); Productivity Commission, *Economic implications of an ageing Australia* (April 2015); Department of Health, *Legislated review of aged care* (September 2017) (PDF, 2.87 MB).

An increasing role for equity release products

10 The population of older Australians is growing at an increasing rate. From 2014 to 2054, the number of people in Australia between 65 and 84 years of age is likely to more than double (increasing by over 4 million, from 3.1 million in 2014 to 7.0 million), and the number of people over 85 years is expected to more than quadruple.

Note: See the Treasury, *2015 Intergenerational report* (March 2015).

11 These trends will affect demand for equity release products. More than $500 billion of Australia's home equity is held by consumers aged over 65, and about 70% of Australians aged 55–85 own their home outright. In 2014, only 62% of couples and 38% of single people were on track to reach a comfortable retirement income.

Note: Productivity Commission report, p. 145; Deloitte Australia, *Deloitte Australian mortgage report 2018* (Deloitte report); University of Melbourne and Towers Watson, *View: Retirement adequacy—Are we making progress?* (August 2016).

12 While consumer demand for reverse mortgages has risen gradually since the 2008 global financial crisis, most consumers still have negative overall perceptions about equity release products such as reverse mortgages.

> ‘A common view amongst retirees—and even many finance brokers and lenders—tends to be that equity release products take advantage of vulnerable elderly people, or that they are often used by family members to do so.’

> Note: See Productivity Commission report, p. 154. See also ASIC, *Managing change in retirement: Related financial issues and implications*, September 2017.

13 Despite this, the Productivity Commission report has noted that the family home remains an untapped source of retirement income.

> ‘Most older Australian home owners on low incomes could achieve a modest retirement living standard over the remainder of their lives by drawing on their home equity.’

> Note: See Productivity Commission report, p. 2.

The enhanced consumer protections

14 In 2012, the Australian Government introduced the enhanced consumer protections to help consumers make more informed choices about reverse mortgages and protect them from potential harm: see Table 1.

15 These measures were introduced to address the unique nature of reverse mortgages compared with other types of credit contracts: the product is marketed exclusively towards older Australians who are at or approaching retirement age, repayments are not required until specified events occur, the long-term effect of the loan is difficult to predict, and, before these protections, borrowers (or their dependents) might have been required to repay more than the value of their secured property at the end of the loan.

> Note: See Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Enhancements Bill), pp. 3 and 32–33.

16 Our consumer research indicated that while consumers generally could not recall some of the mandatory disclosure documents that credit licensees are required to give consumers, the no negative equity guarantee has reduced risks to consumers. However, more can be done to achieve the intended objectives of these measures.

Table 1: Overview of the enhanced consumer protections

Issue	Summary of protection
Responsible lending	Licensees must inquire about the possible future needs of potential borrowers, which includes but is not limited to their needs for aged care and leaving equity to their estate. Note: See reg 28HA, National Consumer Credit Protection Regulations (National Credit Regulations). Proposed loans with a loan-to-valuation ratio (LVR) above prescribed percentages are presumed to be unsuitable. Note: See s93A, National Credit Code (Sch 1 of the National Credit Act) and reg 28LC, National Credit Regulations.
The 'no negative equity guarantee' (NNEG)	Borrowers cannot owe more than the market value of their secured property when it is sold. Lenders must return any amount paid in excess of the market value. Note: See Pt 5, Subdiv 1-A, National Credit Code.
Mandatory disclosures	Licensees must give borrowers: • projections of home equity taken from the reverse mortgage calculator on ASIC's MoneySmart website; • an information statement; • a tenancy protection warning; and • annual account statements. Note: See s133DB and 133D, National Credit Act and s18B, National Credit Code.
Enforcing a reverse mortgage	Reverse mortgage credit contracts must not provide that certain events will be a basis to start enforcement proceedings, such as a borrower failing to inform a lender that another person occupies the property. Note: See s133DB and 133D, National Credit Act and s18B, National Credit Code. Enforcement proceedings must not be commenced unless the lender has spoken to the borrower by telephone or in person about the default notice and the consequences of failing to remedy the default. Note: See s88(1)(d) and 88(2)(d), National Credit Code.

Summary of findings

Finding 1: Reverse mortgages helped older Australians achieve their immediate financial objectives

17 Each of the 30 borrowers in our consumer research indicated that their reverse mortgage enabled them to achieve their original objectives for the loan. Borrowers reported that one or more unforeseen events (e.g. divorce, losses in superannuation, poor health, early retirement and higher costs of living) had driven them to consider a reverse mortgage.

18 Our loan file review also identified several loans for borrowers who showed indicators of financial need before taking out the loan.

Case study 1: A loan for day-to-day expenses

Jenny was 74 years old and living solely on a pension. Her loan documents indicated that she had only $664 in her transaction account and $15,260 of credit card debt when she applied for a reverse mortgage.

The documents stated that she took out a $50,000 reverse mortgage to refinance her credit card debt, make home improvements, and cover day-to-day living expenses.

19 The consumer research indicated that reverse mortgages enabled borrowers to:

(a) maintain their current living arrangements with less financial stress;

(b) obtain short-term finance;

(c) have a general safety net for living expenses; or

(d) afford a better quality of life.

Case study 2: Extra money for a better quality of life

Caroline moved to her current home to be close to her children, but found her pension did not allow her to spend time with them or go on holidays.

> 'I thought why should I sit here and twiddle my thumbs when I've only a few years left, so I arranged for some extra money to allow me to just enjoy my time.'

20 Each of these borrowers reported believing that a reverse mortgage had been their 'only option' for achieving their immediate financial objectives. A strong emotional attachment to the home and a desire to continue ageing in place was frequently cited as a significant priority, which ruled out downsizing as an alternative option.

> 'It's a big stretch to say just uproot everything and move up North [to Queensland]. While I might have family there, they have their own lives and friends and I'd have nothing and no one familiar so I'd just be sitting in an apartment by myself staring at the wall.'

Finding 2: The enhanced consumer protections have eliminated the risk of negative equity

21 Before the introduction of a 'no negative equity guarantee' (NNEG), borrowers faced a risk of eventually owing more on their loan than they could recover from selling the secured property. Because this risk was borne entirely by borrowers, the Australian Government observed that, in the absence of the NNEG, lenders can be 'less conservative in their lending practices and more aggressive in enforcement actions'.

Note: See Explanatory Memorandum, Enhancements Bill, p. 206.

22 The NNEG was introduced to protect borrowers from this risk by preventing lenders from receiving more from the loan than the market value of the secured property. This means that borrowers can continue living in their home without any risk of being unable to pay off the loan balance when they sell it.

23 Our findings suggest that the intended objectives of the NNEG have been achieved. During the period we reviewed, lenders imposed limits on the maximum LVR of new loans. These limits were more conservative than the rebuttable LVRs that are prescribed in the enhanced consumer protections, and limited the interest charges that could accrue to new loans.

24 As a result, our data analysis suggests that only two out of 15,053 loans are likely to reach a loan balance that exceeds the market value of the secured property by the time the borrower reaches 84 years of age, assuming that interest rates on these loans stay the same and property prices rise by 3% per annum.

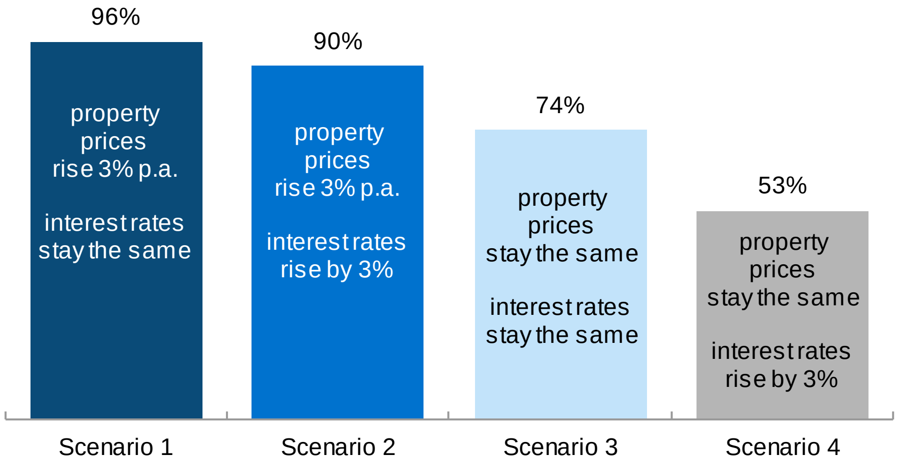
25 Our data analysis also indicated that the NNEG may protect a small minority of borrowers if interest rates rise substantially, if residential property prices do not grow (or fall), or if a combination of these events occur. For example, if the interest rate on all the reverse mortgages in our review rise by 3%, and property prices stay the same, then 6% of borrowers are likely to benefit from the NNEG by the time they are 84 years old.

Finding 3: Some borrowers may not recognise the impact of equity erosion on their possible future needs

26 Despite the introduction of the NNEG, borrowers still faced a risk of being left with insufficient equity in their homes to pay for their future financial needs. In particular, our data analysis indicated that a substantial proportion of borrowers may be at risk of being left with substantially less home equity if the interest rate on their loan rises, or if property prices grow more slowly than expected.

27 For example, we tested a fixed amount of equity that a borrower might require when they reach the age of 84, the average age of entering into aged care. Figure 1 illustrates how fewer borrowers will have at least $200,000 of remaining home equity by age 84, if one or both of these events occur.

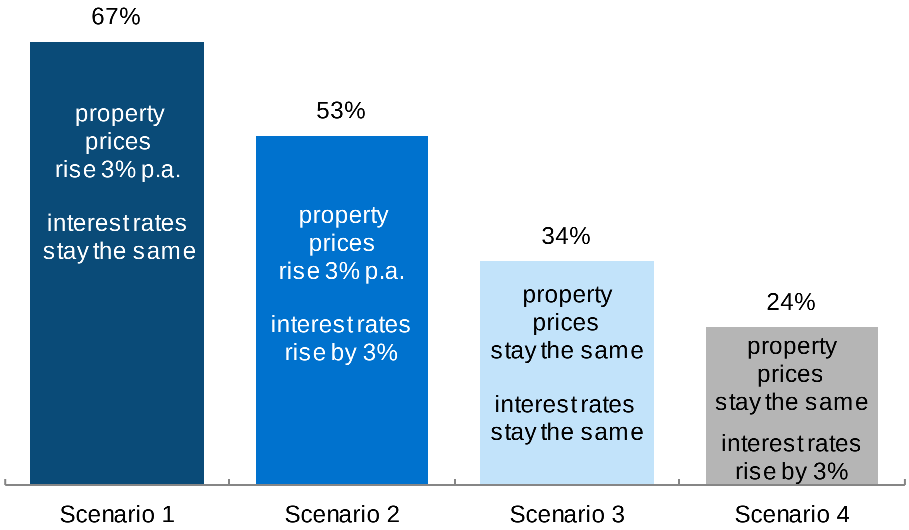
Figure 1: Percentage of borrowers with at least $200,000 of remaining home equity by age 84, if economic conditions change



Note: See Table 18 in Appendix 3 of the report for the underlying data shown in this figure (accessible version).

28 Figure 2 illustrates that even fewer borrowers will have at least $380,000, which is the average self-funded upfront cost of aged care for one person.

Figure 2: Percentage of borrowers with at least $380,000 of remaining home equity by age 84, if economic conditions change



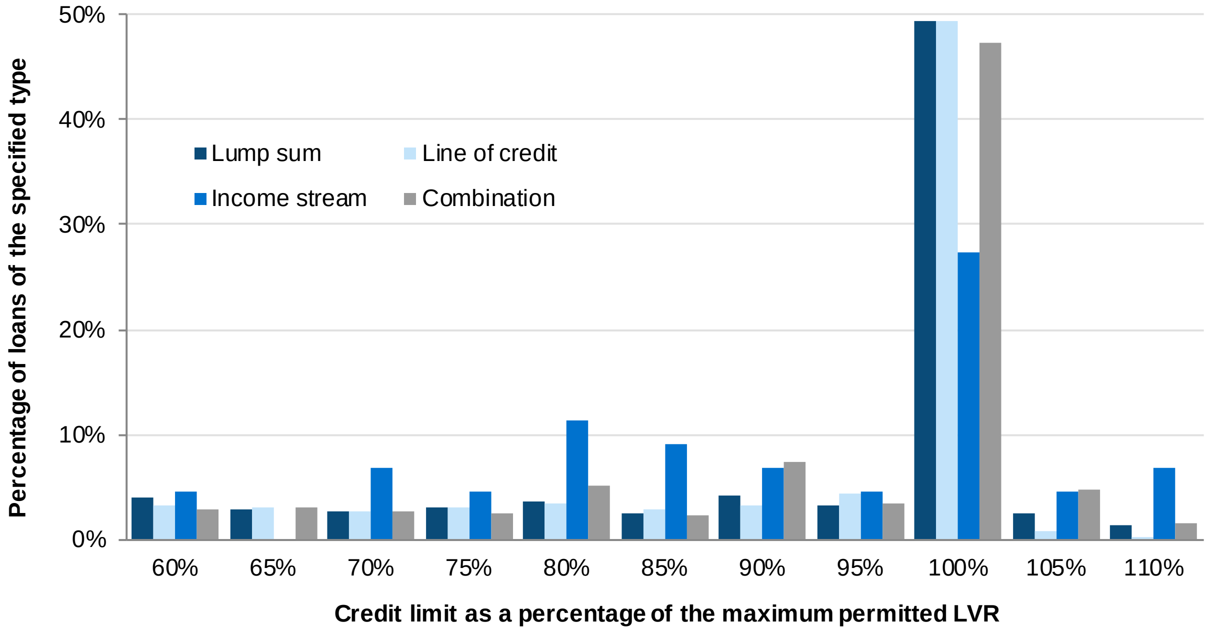
Note: See Table 19 in Appendix 3 of the report for the underlying data shown in this figure (accessible version).

29 Poor awareness of this risk can lead borrowers to take out a larger reverse mortgage, or to withdraw money more quickly from a line-of-credit facility in a reverse mortgage. The interest charges that accrue over time can reduce the capacity of these borrowers to afford important future expenses, such as aged care accommodation, medical treatment, and day-to-day living expenses.

30 This is concerning because our data analysis indicates that borrowers tended to apply for the maximum credit limit that had been permitted by their lender, as illustrated in Figure 3. Most borrowers in our consumer research reported that they had been happy to accept whatever loan amount they were offered, and some borrowers reported that their broker or lender had recommended applying for the maximum possible credit limit.

Note: Some borrowers may have applied for the maximum credit limit due to the conservative loan limits introduced by lenders in response to the NNEG. Some lenders occasionally exceeded these credit limits on an exceptional case-by-case basis.

Figure 3: Credit limit as a percentage of the maximum permitted loan size (by loan type)



Note: See Table 20 in Appendix 3 of the report for the underlying data shown in this figure (accessible version).

31 This lack of long-term planning can particularly affect younger borrowers who are more likely to remain in their home for longer before discharging their loan.

32 When we asked borrowers about how their decision to take out a reverse mortgage might affect their long-term financial situation, many indicated that they had not seriously considered their possible future needs. Our loan file review also suggested that most borrowers had not considered the long-term implications of taking out a reverse mortgage.

33 The borrowers in our consumer research did not express any concern that the compound interest on their reverse mortgage could make it more difficult for them to afford future expenses after their loan is paid off.

Note: This behaviour is consistent with our previous findings in REP 537 that only 32% of borrowers have a financial plan for the next 10–15 years: see Report 537 *Building seniors' financial capability* (REP 537) at p. 14.

34 Licensees are required to take reasonable steps to inquire into a borrower's future needs and objectives. This additional requirement is imposed because the effect of compound interest and the potential impact of a reverse mortgage on a borrower's ability to afford future expenses can be significant. If a proposed loan makes it difficult for them to meet their long-term needs, the loan may be unsuitable.

35 Our loan file review indicated that the application processes of all five lenders focused primarily on the borrower's short-term objectives, while limited or no attention was paid to their possible future needs. Inquiries made by licensees lacked sufficient detail and followed a 'tick-box' formula. Lenders also did not document any inquiries about whether borrowers had a short-term exit strategy or intended to remain in the loan indefinitely.

36 Approximately 92% of the loan files we reviewed did not record the possible future needs of the borrower in sufficient detail and contained no evidence that the broker or lender had discussed how a loan may affect the borrower's ability to afford possible future needs.

37 Licensees have an important role to play in ensuring that potential reverse mortgages are not unsuitable, particularly since borrowers also faced obstacles to receiving independent professional guidance about these risks. Our consultations with lenders and industry bodies representing brokers, financial advisers, accountants, legal practitioners and financial counsellors found that these professionals (referred to in this report as 'guidance providers') had been reluctant to give guidance about reverse mortgages.

38 This reluctance was attributable to negative perceptions about the product, limited awareness about the product, and a desire to avoid the perceived risk of providing unlicensed credit assistance by recommending the product. Comprehensive financial advice can also cost $2,500–3,500, which can be too expensive for some borrowers, especially those who are already showing indicators of financial need.

Note: See Report 224 *Access to financial advice in Australia* (REP 224).

39 Under the enhanced consumer protections, licensees must give potential borrowers a printed copy of projections that illustrate the possible effect of a reverse mortgage on the equity that a borrower will have in their home. Our loan file review indicated that some licensees could have done more to match the default assumptions in these projections to suit the specific circumstances of each potential loan. We recognise that our guidance will need to be updated to reflect this finding.

Note: See Information Sheet 185 *Using ASIC's reverse mortgage calculator* (INFO 185).

Finding 4: Options for borrowers were limited due to a lack of competition

40 Our data analysis indicated that the market for reverse mortgages is highly concentrated. Application fees, transaction fees and interest rates for reverse mortgages were generally higher than for other types of consumer credit, such as standard home loans.

Case study 3: Reverse mortgages and standard home loans

In 2017, one lender in our review charged a $950 establishment fee and a $12 monthly service fee for a reverse mortgage, compared to a $600 establishment fee and a $8 monthly service fee for a standard home loan. The interest rate on this product was also higher than the variable rate for an interest-only home loan.

41 Few alternatives to a reverse mortgage are available for older Australians who would like to draw on the equity in their home while continuing to live there. Lenders and other industry participants cited more intensive capital adequacy requirements, longevity risk, limited access to wholesale funding and low interest rates as reasons why many new lenders are unlikely to offer a reverse mortgage or other equity release product in the near future.

42 In the 2018–19 Federal Budget, the Australian Government announced that it will extend the current Pension Loans Scheme. Those on a full or part age pension and eligible self-funded retirees will be able to use home equity to receive a fortnightly payment (including age pension payment) of 150% of the maximum age pension. These loans are offered at a lower interest rate (currently 5.25%) compared to commercially available reverse mortgages, but can only be accessed as an income stream.

43 We note that new types of equity release products, such as fractional equity release products, are also emerging in this market, but these products may also have risks such as the reduction of equity over time.

Finding 5: Lenders have a role in reducing the risk of financial elder abuse

44 Financial elder abuse occurs when one person illegally or improperly exploits or uses the money or resources of an older consumer. Borrowers were on average 75 years old when they took out a reverse mortgage, which can place them at high risk for financial elder abuse.

45 Our loan file review identified 15 loan applications where a lender could have detected a sign of possible financial elder abuse and made further inquiries to identify whether abuse may have been occurring.

46 Possible signs included:

(a) repayment on a loan being made by an adult child;

(b) money transferred to a non-borrower;

(c) money provided to a child;

(d) the involvement of children in the application;

(e) only non-borrowers receiving mandatory independent advice; and

(f) file notes indicating abuse by a sibling of the borrower.

Case study 4: Loan application initiated by family member

John, aged 86, took out a $50,000 reverse mortgage. He had a power of attorney established in August 2015, two months before his reverse mortgage was approved in October 2015.

The lender required borrowers to obtain independent legal advice and the declaration for this advice was signed by John's grandson. Another grandson who was a financial adviser signed the independent financial advice declaration.

47 However, in each loan where we detected a sign of possible financial elder abuse, we found no documented evidence that the lender had made or documented any further inquiries into whether the borrower may have been taken advantage of by a caregiver or family member.

48 Although our review identified a potential risk of financial elder abuse, our review of the loan files identified no evidence of actual financial elder abuse.

49 Industry bodies are recognising the significant role that licensees should play in reducing the risk of financial elder abuse. The Australian Law Reform Commission (ALRC) has highlighted that financial institutions are in a 'good position to detect and prevent the financial abuse of their older and at-risk customers'. The Australian Banking Association (ABA) has issued a revised Banking Code of Practice that commits members to take 'extra care' with vulnerable customers who are experiencing elder abuse or financial abuse.

Note: See ALRC, Report 131, *Elder abuse: A national legal response* (June 2017), p. 299. See also ABA, Banking Code of Practice (issued July 2018).

Finding 6: Some loans might not protect other residents in the home

50 If the borrower vacates the property or passes away, borrowers or their estate can often only afford to pay off the loan balance of a reverse mortgage by selling the secured property. This can require non-borrowers still living in the home (non-borrower residents) to move out unless the contract contains a 'tenancy protection' provision allowing them to remain in the home for a period of time.

Case study 5: No tenancy protection for non-borrower spouse

Married couple Ali and Brenda lived in their own home, but had few other assets besides a car and caravan valued at $18,000 and negligible savings. Their only income was the age pension.

Ali took out a reverse mortgage for $30,0000 against the family home. The loan was only in his name and did not contain a tenancy protection provision for Brenda.

If Ali passed away or needed to move to aged care, it is likely that the reverse mortgage could only be paid off by selling the property and Brenda would need move out and find a new home.

51 Only one lender in our review offered consumers a limited option to include a tenancy protection provision in their loan contract. This protection lasted for one year after the death of the borrower, the lender could refuse an application seeking tenancy protection, and the nominated non-borrower resident had to be a relative of the borrower and over 70 years old at the time of the application.

52 Borrowers with the other four lenders in our review could protect non-borrower residents only by adding their name to the loan contract.

53 If one or more potential borrowers want to protect the ability of a specified person to continue living on the property even after the borrowers have vacated the home, in some cases a proposed reverse mortgage may be unsuitable if it will endanger the tenancy of that specified person.

54 In 42% of loan files we reviewed, the lender failed to document any inquiries about the suitability of a proposed loan that lacked tenancy protection, where at least one non-borrower resident lived in the home when the loan was taken out.

55 Under the enhanced consumer protections, lenders must give potential borrowers a prescribed tenancy protection warning if the loan does not include a tenancy protection provision. However, most of the borrowers in our consumer research did not recall discussing or considering tenancy protection. Borrowers indicated that they had generally relied on their discussions with other people, rather than the documents they were given, to understand their loan.

56 In our consumer research, only one borrower indicated that they had discussed tenancy protection with their lender and had taken action to protect a non-borrower resident from possible eviction.

Finding 7: Contracts contain potentially unfair terms

57 The standard form terms and conditions in reverse mortgage contracts are subject to laws which prohibit unfair contract terms.

58 We reviewed the most recent version of each lender's standard terms and conditions provided to ASIC. We found all five lenders' contracts contained terms that have the potential to be unfair.

59 Table 2 summarises several potentially unfair contract terms we identified in our loan file review, including:

(a) entire agreement clauses in three lenders' contracts;

(b) a broad indemnification clause in one lender's contract that they have agreed to remove;

(c) broadly drafted unilateral variation clauses; and

(d) clauses of non-monetary default that potentially allow lenders to take actions that are disproportionate to the nature of the breach.

Note: For full details of these terms, why we consider them to be potentially unfair, what action we have taken to date and what further action we will take, see Table 13.

60 Where a contract contains a clause that is potentially unfair, we will ensure it is removed or modified by the lender. Some lenders have already made these changes to their contracts.

Table 2: Potentially unfair terms in reverse mortgage contracts

Type of clause	What we found
Entire agreement clauses These clauses absolve the lender from responsibility for conduct, statements or representations that the lender makes to the borrower outside of the contract.	Three lenders' contracts contained an entire agreement clause. One of these three lenders has removed this term and the second is reviewing this clause; the third no longer provides reverse mortgages.
Unilateral variation clauses These clauses give lenders (but not borrowers) a broad discretion to unilaterally vary terms and conditions of the contract, without the consent of the borrower. They are not necessarily unfair but can be if they are drafted broadly and go beyond what is reasonably necessary to protect the legitimate interests of the lender.	All lenders' contracts contained unilateral variation clauses. Three contracts had broad variation clauses allowing them an unfettered discretion to vary any term or condition of the contract without borrower consent. These clauses are particularly concerning in reverse mortgage contracts. Although borrowers can terminate the contract by repaying the loan balance in full at any time, in practical terms borrowers who wish to remain in their own home may have limited options to refinance due to lender market concentration or equity erosion. Some elderly borrowers may also be dealing with physical or mental decline, which may inhibit their ability to refinance.
Non-monetary default clauses These clauses are problematic where they give lenders a broad discretion about whether to treat an event or circumstance as an actual default. Contracts should not contain clauses that allow lenders to respond to a default in a way that is disproportionate to the nature of the breach.	Four of the five lenders' contracts contained a clause of default relating to borrower misrepresentation, which had the potential to operate in an unfair manner by capturing inadvertent minor untrue statements that do not materially alter the lender's credit risk. Three lenders' contracts contained broad default clauses for any breach of contract which encompassed a range of breaches with varying degrees of severity that did not always pose a material risk to the lender.

Further action

61 Older Australians should have fair and equitable access to equity release options such as reverse mortgages.

62 Although our findings indicate that reverse mortgages helped most borrowers achieve their immediate financial goals, we also identified several actions that we will require lenders to adopt to ensure that loans are not unsuitable for the longer-term needs and objectives of borrowers.

63 Table 3 summarises further action for:

(a) lenders to improve their approach to meeting the responsible lending obligations and to address the risks for consumers when they make decisions about potential reverse mortgages; and

(b) those who give guidance to consumers about a reverse mortgage (e.g. financial counsellors, financial advisers, lawyers and accountants) to improve their ability to help clients understand the choices available.

64 Lenders have already made some changes in response to ASIC's concerns about potentially unfair contract terms and we will ensure that all remaining terms are removed.

65 To help ensure that potential borrowers are adequately equipped to make fully informed choices about benefits, cost, risks and alternatives, we will:

(a) commence a working group involving lenders and other industry participants to ensure that our expectations for improved lending practices for reverse mortgages are satisfied;

(b) monitor the protections that lenders implement or have implemented to reduce the risk of financial elder abuse; and

(c) review the design of ASIC's MoneySmart reverse mortgage calculator within the next six months, to help prompt potential borrowers to consider the features and risks of a reverse mortgage.

Table 3: Key issues for lenders and guidance providers

Issue	Key actions for lenders	Key areas of focus for guidance providers
Findings 1 and 2: Borrowers achieved their immediate objectives, without a risk of owing more than the value of their property (See Sections B–C of the report)	N/A	N/A
Finding 3: Some borrowers may not recognise the impact of equity erosion on their possible future needs (See Section D of the report)	Lenders should document more detailed inquiries about consumers' future needs and objectives, including (but not limited) to their needs and objectives for aged care and inheritance. Applications and questions in loan interviews should be framed in ways that facilitate genuine discussion and reflection by the borrowers about these issues. If a borrower cannot afford or locate a paid financial guidance, lenders should refer them to free information sources where appropriate.	Guidance providers should help potential borrowers: • calculate and develop a long-term understanding of their possible future financial needs and objectives in specific (not abstract) detail; • estimate the effect that a proposed loan could have on borrowers' ability to afford these long-term needs and objectives; and • consider whether alternative solutions such as downsizing and receiving family support are preferable to a reverse mortgage.
Finding 4: Borrowers had limited options due to market concentration (See Section E of the report)	N/A	N/A
Finding 5: Lenders have a role in reducing the risk of financial elder abuse (See Section F of the report)	Lenders should implement training and have effective procedures in place to detect and address possible instances of financial elder abuse.	Guidance providers should be alert to indicators of possible financial elder abuse and know how to approach this issue with clients if indicators are apparent.
Finding 6: Some loans might not protect other residents (See Section G of the report)	Lenders should inquire and record whether a consumer needs tenancy protection, or whether the loan should have several borrowers. If a borrower wants to protect a non-borrower resident, without tenancy protection the loan may be unsuitable.	Guidance providers should investigate whether their client may require some form of tenancy protection.
Finding 7: Contracts contain potentially unfair terms (See Section H of the report)	Lenders should remove potentially unfair contract terms.	N/A

A The reverse mortgage lending market

Key points

A reverse mortgage allows the borrower to use the equity in their home as security to borrow money. It is usually only available to older homeowners.

The effect of compound interest over a relatively long loan term, which is characteristic of these and other equity release products, means that borrowers may face an erosion of equity in their home among other risks.

Reverse mortgages are the only type of equity release product that are subject to consumer credit regulation in Australia.

Features and risks of a reverse mortgage

66 A reverse mortgage is a credit facility that is typically secured against residential property. Reverse mortgages are a type of 'equity release product' as they allow borrowers to release the equity in their home without losing possession of the property. They are the only type of equity release product that are regulated as credit products under the National Credit Act.

67 With a reverse mortgage, borrowers do not need to make repayments until a specified event occurs (typically when all borrowers under the loan have vacated the property or passed away): see Table 4.

68 Borrowers can also take out a special reverse mortgage that is generally referred to as an 'aged care loan'. These loans are designed to help borrowers pay upfront for the aged care accommodation deposit and are identical to a standard reverse mortgage except that they are limited by lenders to a maximum term of five years. This means that the borrower can move into aged care without needing to immediately sell their home.

Table 4: Key features of standard reverse mortgage products

Feature	Description
Loan eligibility	The borrower must have an unencumbered interest over the security property, or must discharge any pre-existing encumbrances as part of taking out the loan. Most lenders require the borrower to be at least 65 years of age.
Loan amount	The amount that can be borrowed under a reverse mortgage will be a certain percentage of the total value of the borrower's home equity. This is known as the 'loan-to-valuation' ratio (LVR). Note: The National Credit Act prescribes limits on LVR based on borrower age above which there is a rebuttable presumption the loan is unsuitable on LVR depending on their age.

Feature	Description
Loan structure	The loan may be taken as a lump sum, a line of credit, an income stream, or a combination of these options. The most appropriate option for the borrower will depend on their circumstances and the purpose of the loan. Some lenders only offer one or a limited range of options. Lines of credit allow borrowers to drawn down money as and when it is needed. Only the amount drawn down accrues interest. One lender in our review offered loans as progressive drawdowns. These allow borrowers to draw down funds progressively as and when required, until the loan amount has been reached. These loans are similar to lines of credit, except that: • borrowers may still make voluntary repayments on these loans, but the loan must be fully drawn down before any request for access to voluntary repayments will be considered; and • there is a minimum draw down amount per transaction. An income stream provides 'periodic income for consumers that do not need large lump sums immediately'. It is different to a line of credit in that money is drawn down at regular intervals and in regular amounts.
Repayments	No repayments are required while the borrower lives in the home (although borrowers are usually allowed to voluntarily repay the loan balance). If no repayments are made, the loan balance (representing the debt owed to the lender) will continue to capitalise and increase at a compounding rate, reducing the equity in the home. The loan must be repaid in full when the borrower vacates their home, moves into aged care, sells their home or dies.
Interest	Interest is compounding, typically at a variable rate and 1–2% higher than a standard home loan.

Risks of a reverse mortgage

Erosion of equity in the home

69 Due to the effect of compound interest over a relatively long loan term, borrowers who keep the loan for a longer period of time can face an erosion of their wealth (equity) in their home. If too much wealth is eroded, there is a risk that the borrower will find it more difficult to afford future needs when the home is ultimately sold to repay the loan.

70 The ultimate effect of a reverse mortgage on the borrower's remaining equity depends on any changes in the interest rate for the loan, changes in the value of the property, and the duration of the loan. These factors can be difficult to predict in the long term.

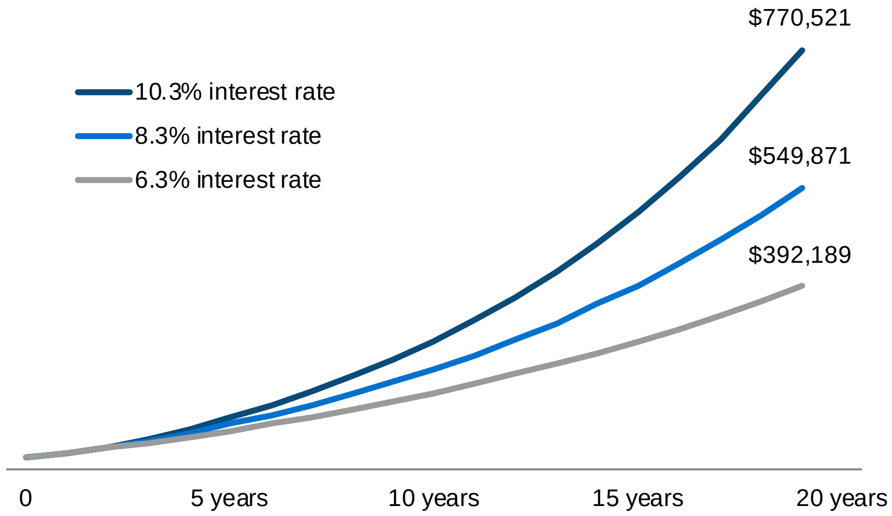
71 Figure 4–Figure 7 illustrate how these factors can substantially influence the effect of a reverse mortgage.

72 These scenarios are based on a 65-year old borrower who takes out a loan of $118,627 (the average loan size) at an interest rate of 6.31%, secured against a

property valued at $632,598 (the average value of the secured property), and repays this loan at age 84 (the average age at which Australians go into aged care).

73 Figure 4 illustrates that if the interest rate rises by 2% after the third year of the loan, the borrower will pay $157,683 more in interest on the loan. If interest rates rise by 4%, the borrower will pay $378,332 more in interest.

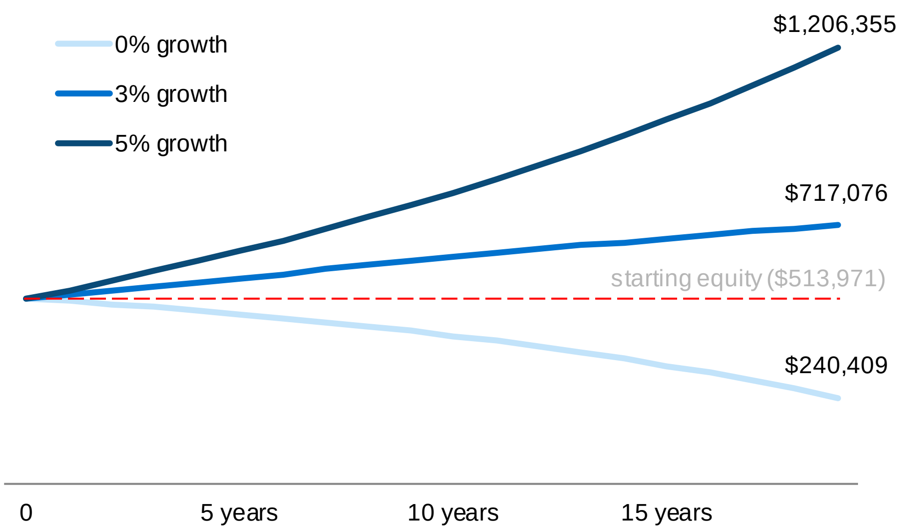
Figure 4: Effect of interest rate on total interest charges (year 3)



Note: See Table 21 in Appendix 3 for the underlying data shown in this figure (accessible version).

74 Figure 5 illustrates the effect of changes in the value of the secured property on the borrower's equity in their home after repaying the loan. If the value of the property increases by 5% a year, the borrower will have $1,206,335 equity. However, if the value only increases by 3%, the borrower will have $489,279 less equity (or $717,076) and if the value of the property stays the same, they will have $965,946 less equity (or only $240,409) to cover future needs.

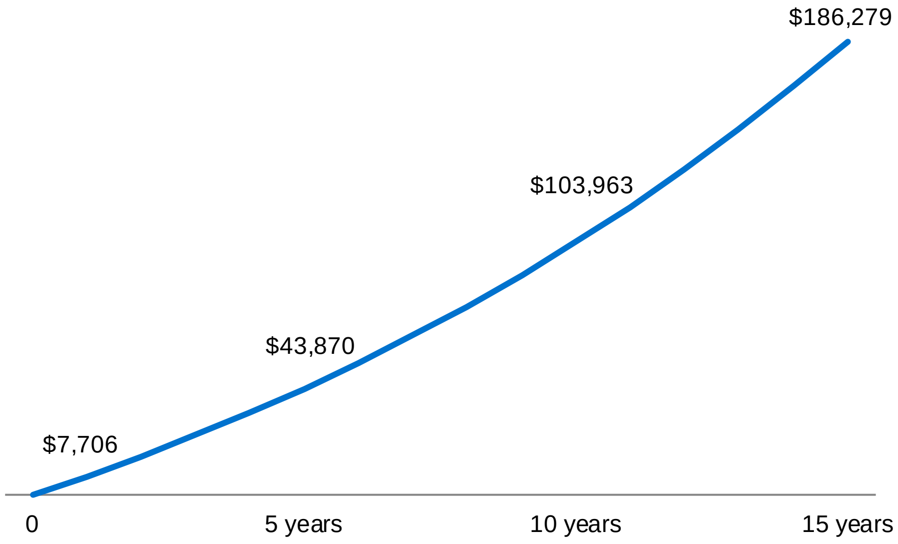
Figure 5: Effect of house price growth on remaining equity



Note: See Table 22 in Appendix 3 for the underlying data shown in this figure (accessible version).

75 Figure 6 illustrates the effect of loan duration on the interest the borrower pays, given the compound interest on reverse mortgage. If the borrower repays the loan within one year, they will pay $7,706 in interest. However, this increases to $43,870 after five years and $186,279 after 15 years.

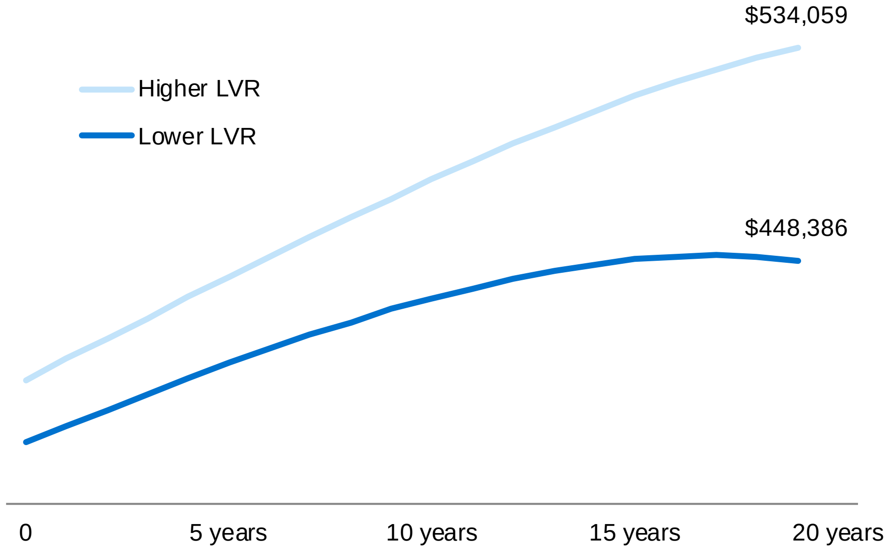
Figure 6: Effect of loan duration on total interest charges



Note: See Table 23 in Appendix 3 for the underlying data shown in this figure (accessible version).

76 Figure 7 illustrates how taking out a larger loan relative to the initial value of the secured property will result in the borrower paying more interest over the life of the loan, which will reduce the amount of remaining home equity. This example assumes a starting property value of $500,000 and compares a $100,000 loan against a loan for $125,000.

Figure 7: Effect of LVR on remaining equity



Note: See Table 24 in Appendix 3 for the underlying data shown in this figure (accessible version).

Impact on Centrelink payments and other entitlements

77 A reverse mortgage may affect a borrower's age pension or other government benefits. This is because amounts received under a reverse mortgage may be subject to the income and assets tests for Centrelink payments under the *Social Security Act 1991* (Social Security Act): see Table 5.

78 It is a particular risk if the loan is provided as an upfront lump sum, or if the pensioner gifts the money from a reverse mortgage to other people because gifts are also counted towards the assets and income tests. The risk for these borrowers is greater as they may lose part of their pension without having the benefit of the money borrowed.

Table 5: How a reverse mortgage can affect Centrelink payments

Type of test	How it applies
Income test	A reverse mortgage falls within the definition of a 'home equity conversion agreement'. Such agreements are excluded from the definition of 'income' but will be subject to deeming provisions while it is held as a financial investment (e.g. held in a bank account earning interest). Note: See s8(1), (4)–(5) and 1073 of the Social Security Act.
Assets test	Ordinarily, amounts equal to or less than $40,000 received from a reverse mortgage will be exempt if held for less than 90 days, it will also be excluded from Centrelink's assets test. Any amount more than $40,000 or less than $40,000 but held for more than 90 days (e.g. in a separate account or put into a financial investment), it will be counted in the assets test and may reduce the borrower's age pension. Note: A person's principal place of residence is excluded from the assets test: see s1118(1)(a)–(b) of the Social Security Act.

Accumulation of interest

79 If a consumer takes an upfront lump sum and does not use it straight away, they will immediately begin paying interest on the entire amount, rather than only on the amount they have spent. Taking a lump sum upfront will lead to faster equity erosion.

80 A loan structure that gives the borrower access to the money on demand, such as a line of credit, may be more appropriate where the consumer does not plan to use the loan amount upfront.

Consequences for non-borrower residents

81 When a borrower passes away or moves into aged care, the loan must be repaid typically by selling the secured property. This means that other residents who are not borrowers, such as spouses and children, may have to move out.

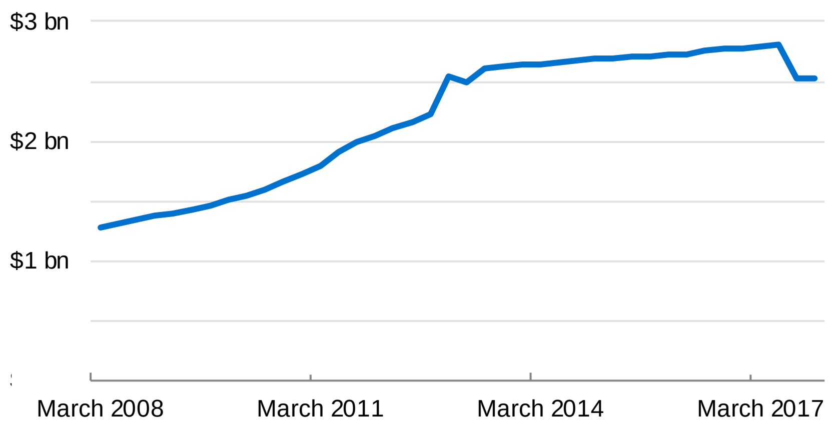
Market, borrower and loan characteristics

Market characteristics

82 When we published REP 109 in 2007, at least 15 lenders offered reverse mortgages. Many of these lenders stopped offering new reverse mortgages after the financial crisis in 2008. Since then, the volume of activity in this market has gradually grown from $1.3 billion in March 2008 to $2.5 billion by December 2017: see Figure 8.

Note: These figures are only for reverse mortgages provided by Australian deposit taking institutions (ADIs).

Figure 8: Residential property exposure of ADIs to reverse mortgages



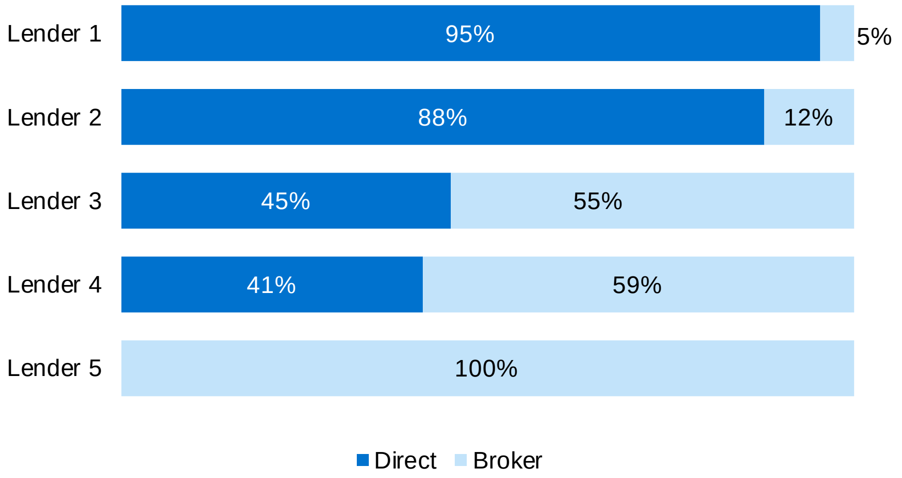
Source: Australian Prudential Regulation Authority (APRA)

Note: See paragraph 83 for a description of the trends shown in this figure (accessible version).

83 Figure 8 illustrates that the total property exposure of ADIs to reverse mortgages rose steadily from $1.3 billion in March 2008 to $2.1 billion by December 2012, then rose more gradually to $2.8 billion by June 2017. This value fell to $2.5 billion by September 2017 and remained unchanged at December 2017.

84 The lenders in our review used a variety of distribution strategies. One lender relied primarily on in-person sales at bank branches, while another offered reverse mortgages to attract brokers to its distribution network. Three lenders had a mix of both broker and lender-originated loans: see Figure 9.

Figure 9: Distribution channels for reverse mortgages



Note: See Table 25 in Appendix 3 for the underlying data shown in this figure (accessible version).

85 Many of the brokers that distributed reverse mortgages specialised in providing credit assistance specifically for reverse mortgages. A minority of brokers were large aggregators that offered both equity release and other conventional credit products.

86 Remuneration structures can shape incentives which, in turn, can affect consumer outcomes. In 2017, ASIC published Report 516 *Review of mortgage broker remuneration* (REP 516), which found that consumers who went through broker channels obtained loans with higher LVRs and larger loans in dollar terms.

87 The lenders in our review had varied commission arrangements, including:

(a) upfront commissions, which were often paid as a percentage of the amount of credit approved for the loan;

(b) trail commissions, which when paid, were based on the amount of the loan balance; and

(c) for some lenders, clawback of commissions if the loan was paid off within a certain time after loan origination.

88 The average loan amount for broker-originated loans was approximately $147,646, which is significantly higher than the average for loans provided directly by lenders ($106,373). This is consistent with our finding in REP 516 that borrowers who took out loans through brokers had larger loans. However, we have not statistically controlled for any differences in borrower characteristics that may have contributed to this difference.

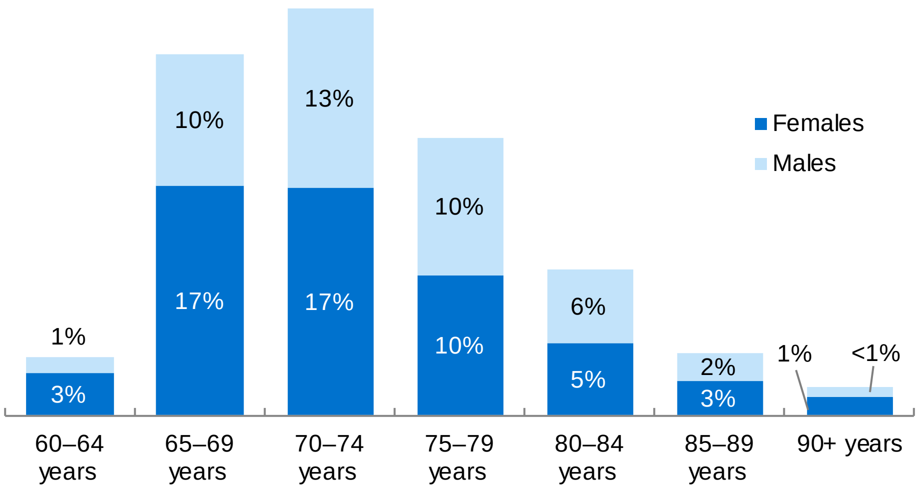
Note: In REP 516, we found that borrowers who went through a broker tended to be younger and have lower incomes.

Borrower characteristics

89 While there is a higher incidence of sole female borrowers compared to sole male borrowers, this is consistent with Australia's population generally.

90 The most common age group to obtain a reverse mortgage was 65–74 years for women and 65–79 years for men: see Figure 10.

Figure 10: Percentage of borrowers at origination (by age and gender)



Note: See Table 26 in Appendix 3 for the underlying data shown in this figure (accessible version).

Loan characteristics

91 Our review of the loan data indicated that:

(a) few borrowers have LVRs above the legislated LVR presumption because of lender policies;

(b) nearly half of loans (45.5%) are finalised within four years; and

(c) most loans are lines of credit (70.2%), with the next most common payment type being a lump sum.

Loan size

92 The average loan approved during our review period was $118,627 or $123,600 adjusted for CPI in September 2017 (current values). The average approved amount for new loans has been increasing from 2013 to 2017 from $110,983 to $133,113 (in current values): see Table 6.

Table 6: Average credit limit of reverse mortgages

Calendar year	Credit limit	Adjusted credit limit
2013	$103,043	$110,983
2014	$114,018	$119,798
2015	$124,037	$128,314
2016	$128,858	$131,549
2017	$132,031	$133,113

Loan duration

93 Borrowers who pay off their loans soon after commencement raise different concerns compared to borrowers who intend to keep their loan for a longer period. A borrower who pays off their loan within six months or two years is unlikely to suffer substantial equity erosion due to the compounding effect of interest. However, these borrowers may still be paying a relatively high total cost of credit, due to the substantial application fees and other financial costs for taking out a reverse mortgage.

94 Our data analysis indicates that 27.4% of loans ended within 24 months of commencement and 45.5% of loans ended within 48 months: see Table 7.

Table 7: Duration of reverse mortgages

Period	Percentage of loans closed
12 months	14.3%
24 months	27.4%
36 months	37.9%
48 months	45.5%

95 The average age and LVR of borrowers who repaid within 48 months was similar to that of all borrowers. The average approved loan amount was slightly smaller (by $8,361) for borrowers who exited within 48 months compared to all borrowers.

96 Early repayment is not necessarily indicative of a poor consumer outcome. While voluntary early repayment may indicate that the loan did not meet the borrower’s expectations, in some cases the borrower may have planned to repay early at the time they took out the loan.

97 Our consumer research highlighted some examples of consumers who had or who intended to repay their reverse mortgage relatively early.

Case study 6: Waiting on the property market

Kathleen lived by herself and was saving for retirement. She had some credit card debt but was gradually paying this off. When one of her grown children unexpectedly needed extra support, Kathleen had to leave her job.

Without work income, she could not afford to cover her debt repayments. Kathleen took out a reverse mortgage to make these repayments.

Kathleen later re-entered the workforce and made voluntary repayments on her reverse mortgage. She planned to sell her home shortly.

Case study 7: Planning to downsize

Fred was 65 years old and living alone after separating from his partner. He decided to quit his job and redirect his efforts into building his dream home.

Living on the Newstart Allowance, Fred chose to take out a reverse mortgage to cover the shortfall that losing his partner’s savings and wages caused in finishing the new build.

He planned to finish the home, staying in it no more than 12 months, then downsize in the same area to pay off the reverse mortgage. He anticipated that his financial situation would then be comfortable.

Case study 8: Moving overseas

Following her divorce, Melissa took out a reverse mortgage of $40,000 on her family home of 20 years to pay for preparations to move overseas. She planned to sell the house and pay off the loan before leaving Australia. Melissa was very specific about what she needed the money for and knew she was going to sell the house to pay back the loan.

Loan structure

98 Most loans were lines of credit, because the most dominant lender in the market only offered this type of loan structure: see Table 8.

Table 8: How loans were provided

Type of loan	Percentage of loans
Line of credit	70.2%
Lump sum	13.8%
Progressive drawdown	9.2%
Combination of lump sum and line of credit	5.5%
Income stream	0.3%
Other combinations	1.0%

99 There are two risks that particularly apply if a borrower takes a lump sum payment:

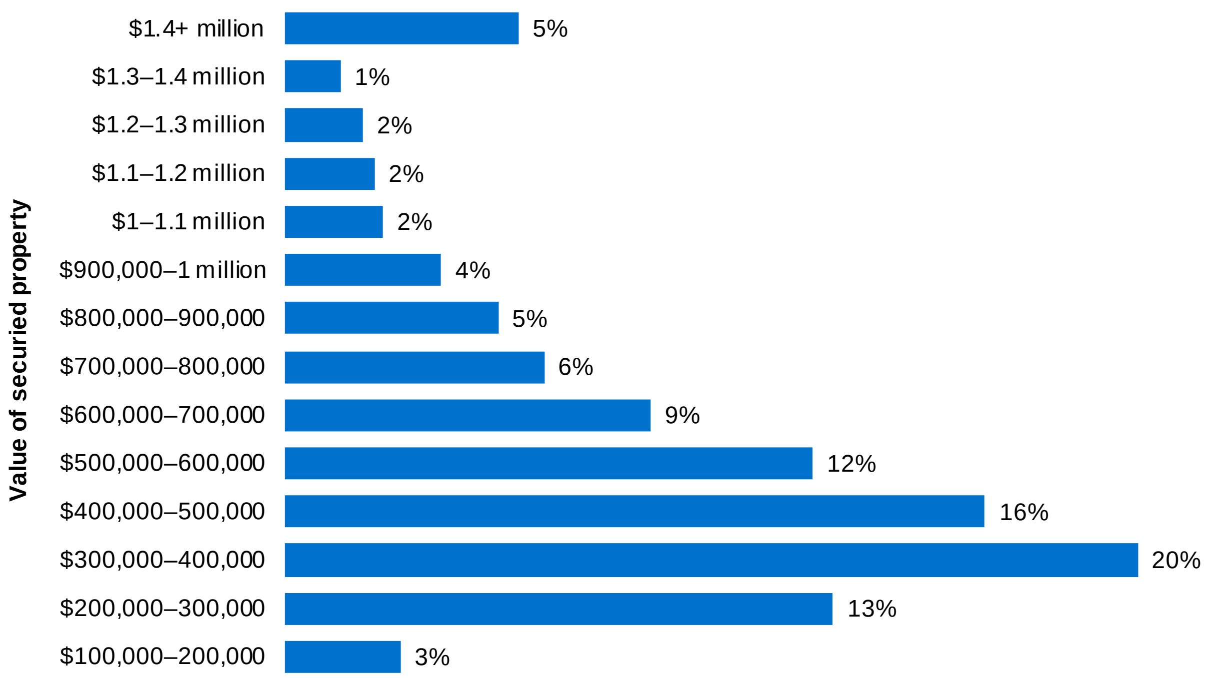
(a) a risk of a decrease in age pension entitlements; and

(b) a risk of unnecessary interest accumulating.

Value of the security property

100 The average valuation of security property for the period we obtained data was $632,598: see Figure 11. This average was skewed by more valuable properties. The location of these properties was consistent with the general population.

Figure 11: Distribution of the market value of the secured properties



Note: See Table 27 in Appendix 3 for the underlying data shown in this figure (accessible version).

B Finding 1: Helping borrowers meet immediate objectives

Key points

Each of the 30 borrowers in our consumer research reported feeling satisfied that their reverse mortgage had enabled them to address their immediate financial objectives.

Each of these borrowers had been focused almost exclusively on resolving their immediate financial needs, and paid little to no attention to the longer-term implications of their loan.

Borrowers believed that a reverse mortgage had been their 'only option' for addressing their immediate financial objectives.

Immediate loan outcomes

101 Our consumer research indicated that the reverse mortgage enabled borrowers to:

(a) maintain their current living arrangements without continuing to experience financial stress;

(b) afford a better quality of life;

(c) obtain short-term finance; or

(d) have a general safety net for living expenses.

Maintaining current living arrangements

102 Some of the borrowers we interviewed told us that their reverse mortgage had allowed them to maintain their current lifestyle. This primarily involved:

(a) holding onto their current home, which was usually the home in which the borrower had anticipated living out their lives;

(b) maintaining the day-to-day lifestyle they currently enjoyed; and

(c) focusing on their short-term goals.

Case study 9: Continuing to live at home

Amy and Roger had lived in the same home for the last 30 years. They took out a reverse mortgage to finance home improvements that they believed would allow them to continue living independently in their home as they grew older. These improvements included building a ramp to replace stairs, replacing ageing carpets, and installing heating and cooling systems.

103 The loan allowed some borrowers to maintain their existing lifestyles by supplementing the shortfall from their pensions and other income.

> 'I'm taking it [the loan] in $20,000 amounts every quarter. It just allowed me to have a cash flow and keep doing what I'm doing, like travel and so on.'

> 'It will allow us to enjoy what time we have left in our own home and not have the stress and concerns of watching things fall apart around us.'

104 Several of the borrowers in our loan file review appeared to be experiencing significant financial need immediately before they took out the loan. These borrowers often had minimal cash, few major assets besides their home, and sometimes large credit card debt.

105 The borrowers we interviewed indicated that their reverse mortgage allowed them to move from a financially strained to an adequately funded lifestyle. The reverse mortgage relieved the stress of finding ways to pay for current lifestyle expenses or larger expenses, such as maintaining a vehicle, refurbishing their home, or managing other debt.

106 Borrowers indicated that these benefits far outweighed any concerns about the future implications of a reverse mortgage.

Achieving a better quality of life

107 Some borrowers said that they took out a reverse mortgage for a slightly more comfortable or enjoyable day-to-day lifestyle. The pension alone, even when supplemented by other income, was often identified as insufficient to enjoy life despite budgeting.

> 'My car was 21 years old and I thought I really only need one more car but it needs to be new now so it will last me for another 20 [years].'

> 'I'd always wanted to go to India and Europe. I've done that now, and the rest of the money is sitting there for me to draw on if I need it.'

> 'I was just sitting here with no cash, watching the kids go off on their overseas trips and here was dear old Mum left here with her knitting. It's no use being asset rich and cash poor and bored, especially when you don't have much time left necessarily.'

108 Not all of the loans we reviewed had been taken out to cover essential goods and services.

Case study 10: A holiday on home equity

Joey was 66 years old, retired, and living primarily off his pension. He had a property valued at $360,000 and only $1,019 of cash in his bank account which was held by a different lender. He borrowed a $70,000 lump sum through a reverse mortgage to pay for a holiday.

Short-term finance

109 Some borrowers took out a reverse mortgage as a temporary financing arrangement (e.g. to provide liquidity before selling a major asset) or to pay for a residential accommodation deposit upfront and help with a gradual transition to aged care before selling their home.

A safety net for the future

110 Several borrowers in our consumer research and loan file review applied for a lump sum to meet their immediate needs and a line of credit to make money available for unexpected future expenses. However, a line of credit was generally not the primary focus or motivation for their loan.

111 When borrowers did this, most applied for a loan of up to the maximum amount of credit that was available to them.

> 'Maybe we might dip into it [the loan] again for travel but it won't be big time. Maybe a cruise. But it might also have to cover our cost of living. We have a small pension but it will run out in a few years so I can see it may end up covering that.'

> 'We were approved for up to $140,000. We used $50,000 of that to do the needed repairs and renovations that the house needed and then the remainder is there if we need it.'

Perceived lack of alternative choices

112 All the borrowers we interviewed expressed a belief that they 'did not have a choice' about whether to take out a reverse mortgage and characterised their loan as 'their saviour' or as the 'only option' available to them.

113 Each of the borrowers we interviewed cited some change or unforeseen impact on their financial situation that had led them to seek additional money through a reverse mortgage, such as:

(a) separation or divorce;

(b) losses in their superannuation fund;

(c) poor health;

(d) costs to support children beyond a normal dependency age;

(e) unexpected residential costs;

(f) early retirement; or

(g) a higher cost of living (e.g. electricity and utility expenses).

Case study 11: Unexpected body corporate fees

To pay for renovations to the exterior façade of the apartment building, the body corporate fees on Anthony's apartment increased significantly and he could no longer afford them. Faced with the idea of being forced to sell his home, he took out a reverse mortgage.

Case study 12: Early loss of employment

Tom worked for the same employer for about 40 years. After taking unpaid leave to recover from an unexpected illness, his employment was terminated with three weeks' salary. Tom was ineligible to receive the age pension, so he took out a reverse mortgage to supplement his superannuation to cover his day-to-day living expenses.

114 These unforeseen changes occurred when some borrowers were either close to or in full retirement and were relying on the age pension to cover their day-to-day living expenses. Some borrowers indicated that they had retirement plans or pensions which could not accommodate unexpected expenses or changes in financial circumstances.

115 For these borrowers, downsizing or relying on assistance from family members were not desirable alternatives. They were also unaware of any other equity release options.

Downsizing

116 Borrowers conveyed a strong preference towards remaining in their home. Selling the property to improve their financial position was unacceptable.

117 Many borrowers highlighted familiarity and emotional attachment to their home, and a desire to continue living in it, as factors that had originally motivated them to consider a reverse mortgage in the first place.

> 'I still love this house it's very precious to us and we want to be here as long as we can.'
>
> 'Here we are amongst friends and family, we don't want to move at this stage in life, we have everything we want and need around us here.'

118 From 1 July 2018, consumers aged over 65 will be able to make non-concessional contributions to their superannuation of up to $300,000 from the sale of their home, subject to eligibility requirements. This was announced in the 2017–18 Federal Budget to encourage older consumers to downsize their homes and to increase the supply of housing for younger families.

Assistance from family members

119 Many of the borrowers we interviewed either did not have family to help them financially, or preferred to borrow against their home equity rather than receive family assistance.

> ‘One of our kids said we’ve got the money dad, we could have given it to you. He was actually really angry with us that we had done it and not told him. But we said we’re fine, we’ve organised it, we don’t want to have them carrying us.’
>
> ‘Possibly I could have asked for a loan from one of my children but I didn’t want to do that because I have no way of paying it back. I want to keep the debt to myself.’
>
> ‘[My daughter’s partner] looked into it for us and… it seemed to offer us a way forward that we could manage on our own.’

120 In some cases, borrowers had taken out the loan to support a family member. We did not consider whether these loan purposes were genuinely held: see our discussion of financial elder abuse in Section D.

> ‘My son came back to live here with his wife—I needed to be able to help support them.’
>
> ‘I wanted to help my daughter pay for some of my grandchildren’s private education.’

Pension Loans Scheme

121 The current Pension Loans Scheme had limited uptake from 2016 to 2017. Payments can only be accessed as an income stream (paid with the fortnightly pension payment) and the amount that can be borrowed is the difference between the full age pension and the current pension payment. This means only those receiving a partial age pension and eligible self-funded retirees can access the scheme. Those on a full age pension are ineligible.

122 While this may be a good option for those looking to cover ongoing living expenses and increase their quality of life, it will not meet the needs of borrowers who require an upfront lump sum for a particular purpose (e.g. renovations, medical expenses, a holiday, or a one-off large item like a car). Our loan file review showed that 40% of borrowers either took all or part of the loan amount as an upfront lump sum.

Other equity release options

123 Equity release products other than reverse mortgages were outside the focus of this review. However, our high-level analysis suggests that the limitations of these options, combined with low awareness among potential borrowers, may have contributed to some borrowers believing that a reverse mortgage was their ‘only option’: see Table 9.

Table 9: Limitations of other equity release options

Product type and description	Limitations
Standard home loans	Borrowers are required to make repayments during the term of the loan.
Home reversion schemes Homeowners sell an agreed percentage of their home's future sale value to the scheme provider in exchange for an upfront payment.	This type of scheme is only offered by one provider and is only available to consumers aged 60 years or over who own property in specific Sydney and Melbourne postcodes. Calculating the amount of the upfront payment can be complex. This is calculated based on the current valuation of the home and other factors that are likely to affect the future value of the home (e.g. the location), the value of retained ownership benefits held by the homeowner (e.g. rent-free tenancy rights) and the duration of the agreement (e.g. the homeowner's age and life expectancy).
Pension Loans Scheme Some pensioners can receive an income stream loan secured against real property with interest compounding on the loan. Note: See Department of Human Services, Pension Loans Scheme.	The borrowable amount is capped at the maximum age pension rate. This means that older Australians who receive the full age pension are currently ineligible for the scheme. The loan can only be drawn as an income stream, which may be unsuitable for pensioners who need money to cover larger expenses such as unexpected health costs or home maintenance and repairs. In May 2018, the Australian Government announced plans to expand the Pension Loans Scheme. From 1 July 2019 the maximum payment under the scheme will increase so that borrowers can supplement their income up to 150% of the full age pension.
Expanded Pension Loans Scheme In the 2018–19 Federal Budget, the Australian Government announced the proposed expansion of the scheme to allow those on the full age pension and self-funded retirees to access the scheme from 1 July 2019. Note: See Fact Sheet 3.3 *Expansion of the pension loans scheme.*	Under the proposal, from July 2019 all age pensioners will be able to use a reverse mortgage to increase their income to up to 150% of the age pension rate. Pensioners on the full rate will be able to increase their income by up to $11,799 (singles) or $17,787 (couples) per year. The income and assets test no longer apply to exclude pensioners who would otherwise be eligible for the scheme. Payments are still limited to a fortnightly income stream.
Rates deferral schemes Pensioners can defer payment on all or part of a rates bill based on the amount of home equity they hold, with the debt balance and interest secured against this equity.	This type of scheme is only available to some pensioners in South Australia, the Australian Capital Territory and some local council areas. Due to its specific purpose, this type of scheme is usually not a practical option for older consumers seeking to release their home equity for any purpose other than to pay rates.

Note 1: ASIC may have limited jurisdiction for these products if they fall within the scope of Ch 7 of the Corporations Act. However, some schemes may fall outside this regime depending on their particular structure and features. Some of these products are also not subject to regulation under the National Credit Act.

Note 2: See Appendix 3 for a summary of the regulation of equity release products in a number of other jurisdictions, including the United States, United Kingdom, New Zealand, Japan and South Korea.

C Finding 2: The 'no negative equity guarantee'

Key points

The NNEG has addressed the risk of negative equity by incentivising more conservative lending practices. The NNEG also protects borrowers in the event of a substantial downturn in property prices.

Purpose of the guarantee

124 Before the introduction of a 'no negative equity guarantee' (NNEG), borrowers faced a risk of eventually owing more on their loan than what they could recover from selling the secured property. Because this risk was borne entirely by borrowers, the Australian Government observed that, in the absence of the NNEG, lenders can be 'less conservative in their lending practices and more aggressive in enforcement actions'.

Note: See Explanatory Memorandum, Enhancements Bill, p. 206.

125 The introduction of a statutory mandatory NNEG in Australia follows similar regulation overseas. The Explanatory Memorandum to the enhanced consumer protections highlights the negative consumer experiences that resulted from the absence of a mandatory NNEG in the United Kingdom.

> 'In the late 1980s[,] thousands of retired people took out variable rate reverse mortgages to invest in stock market related investment bonds. The income from these bonds was expected to be sufficient to pay the interest on the mortgage and provide additional regular income.
>
> 'However, due to poor market performance, coupled with increasing interest rates and decreasing property values, many consumers' debts exceeded the value of their properties, with many borrowers being evicted.'

Note: See Explanatory Memorandum, Enhancements Bill, p. 206. See also Report 59 *Equity release products* (REP 59).

126 The NNEG operates by preventing lenders from collecting more from the loan than the market value of their secured property. This means that borrowers can continue living in their homes without any risk of being unable to pay off the loan balance by using the proceeds of sale.

Outcomes of the guarantee

127 During the period we reviewed, lenders imposed limits on the maximum LVR of new loans, partly to avoid entering into a loan that may trigger the NNEG. These limits were more conservative than the LVRs that are prescribed in the enhanced consumer protections.

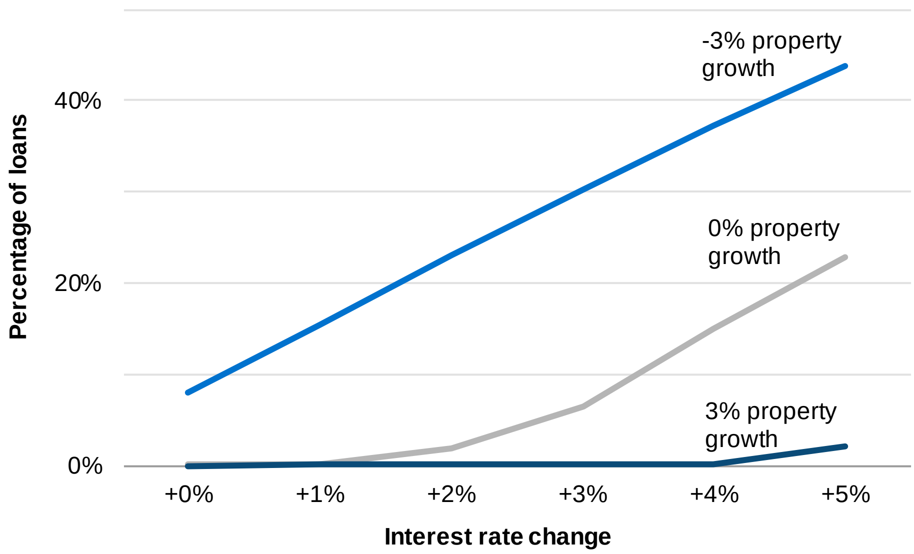
Note: A reverse mortgage is presumed to be unsuitable if the LVR under the loan would exceed the prescribed amount when the loan is taken out (LVR presumption). The prescribed amounts are 15% if the youngest borrower is 55 years or younger, or, if the youngest borrower is over 55 years, 15% plus 1% for each year the borrower is over 55: see reg 28LC of the National Credit Regulations.

128 LVR limits effectively limit the amount of interest that can accrue on new loans, which means that borrowers are less likely to completely deplete the equity in their home because of the loan.

129 As a result, our data analysis suggests that only two out of 15,053 loans are likely to reach a loan balance that exceeds the market value of the secured property by the time the borrower reaches 84 years of age, assuming that interest rates on these loans stay the same and property prices rise by 3% per annum.

130 Borrowers are likely to lose all their equity only if there is a large increase in interest rates or decline in house prices. Even if interest rates increased by 4% and house prices stay the same, only 15% of borrowers will rely on the negative equity guarantee at age 84: see Figure 12.

Figure 12: Percentage of loans with no remaining equity at age 84

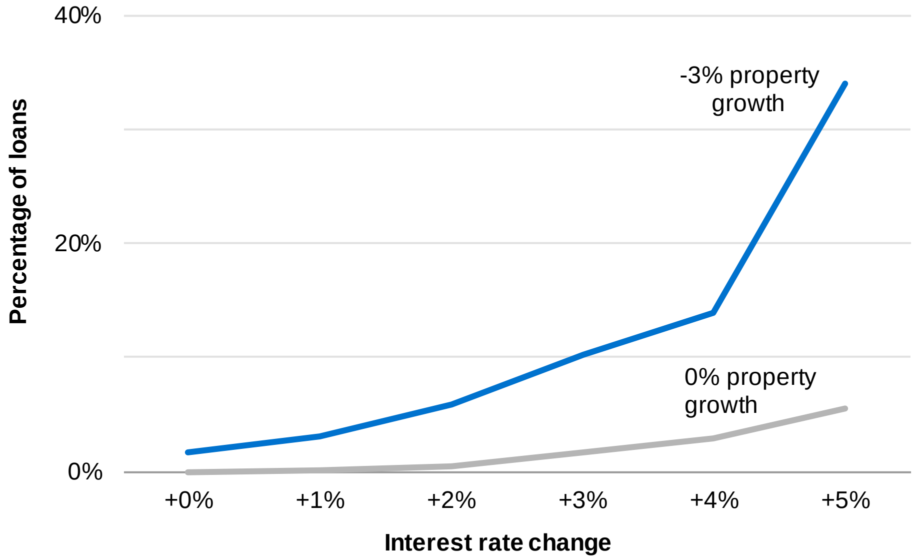


Note: See Table 28 in Appendix 3 for the underlying data shown in this figure (accessible version).

131 Figure 12 also illustrates that the NNEG may also protect a small minority of borrowers if interest rates rise substantially, if residential property prices do not grow, or fall, or if a combination of these events occur. For example, if the interest rate on all the reverse mortgages in our review rise by 3%, and property prices stay the same, then 6% of borrowers are likely to trigger the NNEG by the time they are 84 years old.

132 From another perspective, few borrowers will reach negative equity after five or 10 years, regardless of changes to house prices or interest rates. For example, even if interest rates increase by 4% (to an average of 10.31%) and house prices stay the same over 10 years, only 3% of borrowers will need to rely on the negative equity guarantee: see Figure 13.

Figure 13: Percentage of loans with no remaining equity after 10 years



Note: See Table 29 in Appendix 3 for the underlying data shown in this figure (accessible version).

D Finding 3: The risk of equity erosion

Key points

Borrowers were generally either optimistic about, or not focused on, the amount of equity they would have left, even though our data analysis indicated there was a risk of equity erosion for some borrowers.

Equity erosion may mean borrowers cannot pay the deposit for aged care. This is a real risk for certain types of borrowers. The risk is increased if property prices do not continue to rise or interest rates go up (or a combination of the two).

The requirement that lenders inquire about future needs, including aged care and whether they wish to leave equity in the property, has not prompted meaningful consideration of these future needs by the borrower or lender.

While independent professional guidance could assist borrowers, there are significant barriers that prevent or deter borrowers from finding and receiving this guidance.

Borrower outlook and perceptions

Borrowers were optimistic about the future

133 Nearly all the borrowers we interviewed were highly optimistic about the long-term consequences of their loan. Not a single borrower was concerned about the loan affecting their ability to afford future expenses. Their reasons for this optimism are discussed below.

134 While some aspects of this optimism may be justified, most of the borrowers in our consumer research did not actually consider the possible long-term practical consequences that equity erosion may have on their future financial situation.

135 When we asked borrowers how their decision to take out a reverse mortgage might affect their financial situation in the long term, many indicated that they had not seriously considered their future needs.

136 A number of factors influenced this optimistic outlook.

The belief that property prices will continue to rise

137 Most borrowers believed that the market value of their property would grow and outstrip the growth of their loan balance. This belief was reinforced by continued recent media coverage.

> ‘The mathematics doesn’t perturb me. Toowoomba is developing.’

> 'With Sydney prices continuing to increase, I can't see how there would be nothing left if I needed it.'
>
> 'We don't need to worry about [the negative equity guarantee] because this house goes up more than the interest rate each year.'
>
> 'Yes, the new train line will make a positive difference.'

Failure to consider future expenses

138 Some borrowers only briefly considered their future expenses.

> 'We have talked about aged care, [our daughter] lives close by, if we need help she will sell her house and come and live with us'
>
> 'If I ever have to go into aged care I am assuming my pension will look after that'
>
> 'We've considered our ageing in the refurbishment of our home, it's all one level, and wheelchair access is very feasible.'

Simplistic calculation of equity available

139 Some borrowers suggested that the loan carried few risks simply because the property value was significantly greater than their loan balance.

> 'The house was valued at $650,000 and our loan is only for $120,000, so there is still a lot left.'

Avoiding thinking about the future consequences

140 Most of the borrowers we interviewed had either not considered or actively avoided estimating how much equity would still be available to them several years from now. This may have influenced some borrowers' perceptions about the long-term risks of their loan.

> 'The reverse mortgage means it diminishes in some way what we leave, but on the other side I just live for today and not worry about tomorrow.'
>
> 'I'm not quite sure how much I took out, or the rate of interest in the end. But I don't have any goals really—I haven't got much of a future!'
>
> 'I dismiss the idea of aged care. It's too far in the future, and the sector itself is changing so much.'

141 In several interviews, borrowers dismissed questions about their long-term needs by commenting that they may not be alive to consider these issues.

> 'I don't have expectations of having a very long life.'
>
> 'I won't be here so it won't matter.'
>
> 'We'll be gone by then. It won't matter to us, will it?'
>
> 'From a financial perspective, it is good because it doesn't really affect us until we are dead.'

Lenders' obligation to inquire about requirements and objectives

142 Our loan file review highlighted potential inadequacies in lenders' inquiries, including that:

(a) lenders failed to make or document detailed inquiries into consumers' long-term needs and objectives;

(b) lenders' application processes focused primarily on the borrower's short-term needs; and

(c) questions about aged care and leaving equity in the home were framed in ways that were unlikely to promote real discussion or consideration of these issues.

Responsible lending obligations

143 Under the National Credit Act, lenders (acting as a credit provider) and brokers (providing credit assistance) have responsible lending obligations to:

(a) make reasonable inquiries about both the consumer's requirements and objectives and their financial situation;

(b) take reasonable steps to verify the consumer's financial situation; and

(c) based on that information, make an assessment (final for the lender or preliminary for the broker) about whether the credit contract is 'not unsuitable' for the consumer.

Additional inquiries for reverse mortgages

144 Recognising that reverse mortgages and the consumers who use them are very different to traditional loans and borrowers, additional responsible lending obligations were introduced in 2012. For a reverse mortgage, lenders have an obligation to make additional inquiries about the consumer's requirements and objectives in meeting possible future needs, including (but not limited to):

(a) a possible need for aged care accommodation; and

(b) whether the consumer wants to leave equity in the dwelling or land to the consumer's estate.

145 These additional obligations were imposed to:

> require credit licensees to discuss with reverse mortgage applicants, not just the short term effects of the reverse mortgage, but also how the loan may affect the borrower's options as they age.

Note: See Attachment A of the Explanatory Statement to the National Consumer Credit Protection Amendment Regulation 2013 (No. 2).

146 RG 209 also discusses why we expect a higher standard of investigation and verification to ensure that a reverse mortgage meets the consumer’s requirements and objectives, including that:

(a) reverse mortgages are a complex type of credit product;

(b) consumers are often seniors who are using their primary residence and only significant asset; and

(c) if a reverse mortgage is unsuitable for the consumer, the consequences are potentially severe.

Inquiries into borrowers’ needs lack detail

147 While our loan file review showed that lenders made inquiries into borrowers’ needs and objectives, the level of detail in these inquiries could be improved to ensure the loan is not unsuitable. In particular, inquiries into the borrower’s long-term needs were not conducted in a meaningful way that would cause the borrower to consider these needs.

148 Lenders generally did not inquire about, or differentiate between, borrowers’ short-term and long-term needs. Where long-term needs were considered, the level of detail was very limited given the complex nature of the product and its effect on the borrower’s future equity.

149 In general, discussions focused on the borrower’s short-term needs with questions about future needs (e.g. aged care accommodation and desire to leave equity in the home) treated more as a procedural requirement in the application process. These questions were also framed in ways that were unlikely to promote consideration or discussion about whether the loan would be unsuitable in light of these needs.

Future needs

150 The attachment to the Explanatory Statement to the National Consumer Credit Protection Amendment Regulation 2013 (No. 2) states:

> in relation to a reverse mortgage, credit assistance providers and credit providers will be required to make reasonable inquiries about a consumer’s requirements and objectives in meeting future needs

151 Ageing consumers have different needs and expenses such as increased medical costs and aged care needs. In particular, lenders are required to ask specific questions about the borrower’s future need for aged care accommodation and desire to leave equity in the property for their estate.

152 These requirements are designed to help consumers better balance the short-term need to access equity in their home against the long-term impact of reducing this equity.

153 The Explanatory Statement to the National Consumer Credit Protection Amendment Regulation 2013 (No. 2) recognises that there will be no certainty about the amount of equity that may exist at any point in the future. The intention of these requirements is for the lender to open a discussion of possible future needs with the consumer and the outcome of the conversation is likely to reflect this uncertainty.

154 However, lenders treated these requirements more as procedural steps that needed to be ticked off rather than as a way to open up discussion about the long-term effect the loan could have on the borrower's financial position.

Aged care accommodation

155 Each lender used a tick box to record they had made inquiries about aged care but usually did not record detailed responses. Four lenders had a tick box for the consumer to acknowledge they had considered this issue.

156 In the consumer interviews, borrowers did not recall this topic being discussed. They said that the application was more focused on their current financial situation rather than future needs for aged care or health concerns.

157 We note this does not mean that aged care was not discussed, just that consumers cannot recall the conversation. Our research suggests that consumers were so focused on resolving their immediate financial problems that other issues tended to be filtered out or dismissed by the consumer as irrelevant.

158 Borrowers felt it was hard to plan for the future and in particular did not know how much they would need for aged care or health expenses. Borrowers noted the increase in in-home care services. With the number of these services increasing, it is important that lenders include in-home care in any discussions about costs associated with ageing.

159 An industry stakeholder noted that aged care providers might encourage consumers to pay the accommodation fees by lump sum rather than by the daily amount if they want to get in earlier. If a reverse mortgage is used to fund the lump sum, the interest accruing on that larger amount could end up costing the consumer more than if they paid the daily amount.

Case study 13: Younger borrower with no detailed inquiries into future requirements

A 65-year old borrower took out a reverse mortgage of around $40,000 for personal goods. The borrower ticked several boxes in his application form to indicate that he had considered his needs and objectives, but there were no detailed inquiries on file into possible aged care requirements or whether he wanted to leave a portion of equity in the property. There was also no evidence on file about whether the borrower had been given equity projections, or if there had been a discussion about what the equity projections might look like.

Desire to leave equity in the property

160 In practice, all five lenders recorded inquiries into consumers' desire to leave equity in the property to their estate by a tick a box on the file that they had made the inquiry. Some lenders at times also included acknowledgments to confirm that consumers had considered it. 16% of files did not contain either a consumer acknowledgement or lender tick box recording this inquiry. Only three files, all from the same lender, recorded detailed inquires and responses to this question.

161 While one lender noted that consumers wanted to preserve a certain amount of equity, there was no evidence in the files to show if this issue had been considered by the lender. In three out of four instances, the amount of equity the consumer asked to be preserved was also the application amount. It is not clear whether the consumers misunderstood the question on the form or whether it was actually their intention to preserve that amount of equity.

162 As discussed at paragraph 137, most borrowers believed they would retain some equity in their home as they believed house prices would increase faster than interest accrued on their loan.

Loan purpose, amount, structure and duration

163 Based on our loan file review, lenders made very limited inquiries about the purpose of the loan and often did not specify why the particular loan amount or loan structure was requested or the timeframe that the money was to be used for.

164 Even though reverse mortgages are generally taken out for short-term purposes, they can have a long-term effect on borrowers' equity. From the quantitative data we reviewed, 62% of borrowers kept the loan for more than three years and 54.5% of borrowers kept the loan for more than four years.

165 Given the effect of compounding interest and the reduction of equity in the home over time, it is appropriate for lenders to inquire about the borrower's intended use of the loan. Such inquiries could include:

(a) whether the borrower intends to hold the loan product for a short period only and repay it or whether they intended to use the loan for a longer term;

(b) whether the loan amount is sufficient for their needs, including what it will be used for and how quickly they intend to use the money;

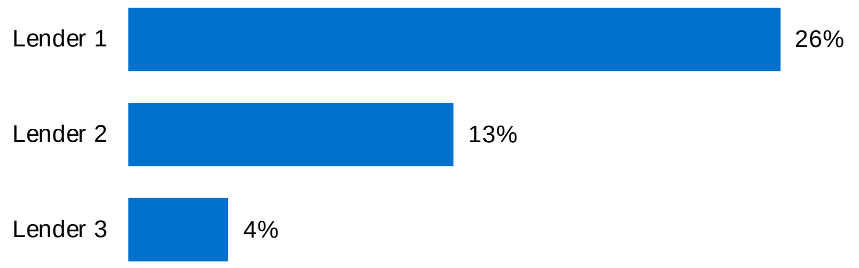
(c) how the consumer intends to use the money and what loan structure will best meet these needs and minimise equity erosion;

(d) if the loan is for a one-off purpose (e.g. buying a car), whether the borrower has enough money to continue making other payments such as maintenance, rates and bills for the property; and

(e) if the loan is for everyday living expenses, whether the money will last only a short time and what the borrower plans to do after it runs out.

166 For 9.7% of loans, the credit limit was increased after the loan was taken out. This suggests that the lender may not have been making enough inquiries into whether the original loan amount would meet the borrower's needs. It could also mean borrowers needed more money than they initially thought. For one lender, just over 26% of the loans we reviewed were topped up after the borrower took out their original loan: see Figure 14.

Figure 14: Percentage of loans where borrowers applied for a top-up shortly after taking out the loan



Note: See Table 30 in Appendix 3 for the underlying data shown in this figure (accessible version).

Case study 14: Limited inquiries into loan purpose and amounts

Jude applied for a loan of about $20,000 for bills and possibly a holiday. There were no inquiries into the amounts she intended to use for each purpose. Jude ended up applying for two top ups to her loan over the next 18 months for personal use and renovations.

Excess interest on lump sum loans

167 Consideration of the requirements and objectives of borrowers should include a consideration of which loan structure best meets the consumer's needs.

168 Of the upfront lump sum loans in our loan file review, 45% were potentially unsuitable for the consumer because of the loan structure (i.e. the recorded purpose did not support the need for the whole amount to be taken upfront). Because the files did not include data on how the consumer actually used the money from the loan, this is only an inference based on the recorded purpose. This exposes the consumer to an increased risk of equity erosion.

Case study 15: Excess interest paid on unsuitable lump sum loan

A married couple aged in their early 70s took out a reverse mortgage of $100,000. The recorded purpose of the loan was for general living expenses. The application contained a specific request for $50,000 of the loan funds to be provided as drawdown facility to be used for future living expenses. The entire loan amount was provided as an upfront lump sum. There were no notes on file to indicate why this was the case.

Two years and nine months after the reverse mortgage was taken out, $18,500 of interest had accrued on the account. This is almost $10,000 more than the consumers would have paid if they had only accessed $50,000 of the loan amount over the same period.

Borrowing trends

Borrowers take close to the maximum amount available

169 Our data analysis indicated that a substantial proportion of borrowers tended to take out a reverse mortgage for a credit limit at or very close to the maximum LVR that had been permitted by their lender. In particular, 41% of loans had a credit limit between 99.9% and 100.1% of the maximum permitted LVR. This was less common for loans that were structured as an income stream: see Figure 3.

170 This behaviour could suggest that:

(a) some borrowers would like to borrow more than the amount permitted by lender policy, but are restricted to the lender maximum; or

(b) borrowers are encouraged, either by lenders or brokers or for other reasons, to borrow the maximum allowable.

171 One lender had set a fixed maximum LVR for all borrowers irrespective of their age. Loans by this lender were around the maximum lender LVR, even for older borrowers who could have obtained a higher LVR by applying to a different lender. This may suggest that some borrowers tended to apply for the largest possible credit limit, or that some only approached one lender when looking into a reverse mortgage.

Analysis of loan data

172 We used the data obtained from lenders and some basic assumptions to test how much equity borrowers will actually have left at the end of their loan. We tested this against several benchmarks:

(a) whether they will have enough for the average upfront cost of residential aged care; and

(b) whether they will have 50% of the equity in their home left.

Paying for aged care

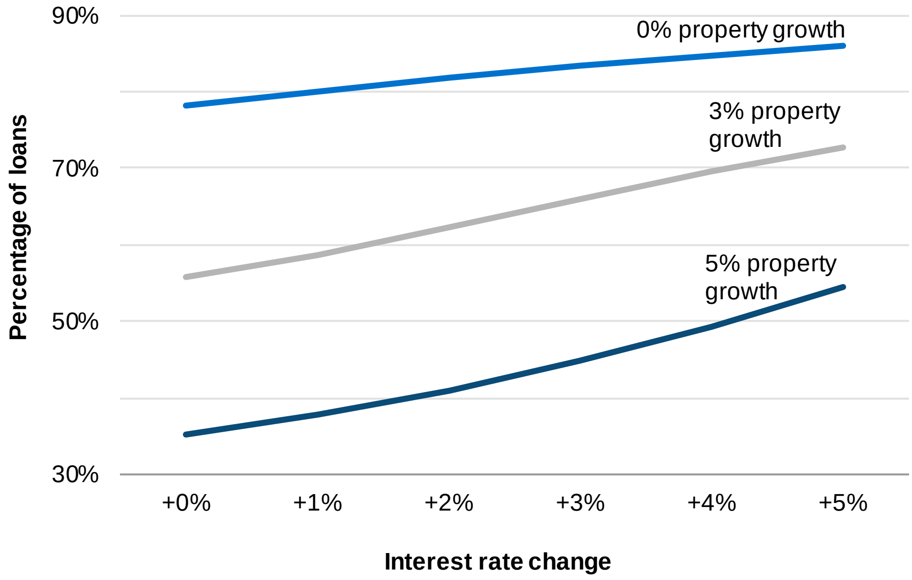
173 Residents going into aged care may need to pay the full amount upfront or a refundable accommodation deposit. We used $380,000 (at current values) as a benchmark to assess whether borrowers will be able to afford this deposit.

174 To assess whether borrowers will have enough, we estimated the amount of home equity that borrowers would have when they reach 84 years old, which is the average age of entering permanent residential aged care.

175 Although our data analysis indicates that no borrowers are likely to trigger the negative equity guarantee, many more borrowers are likely to have less

than $380,000 at age 84: see Figure 15. These borrowers may need to pay a combination of a deposit and a daily payment or apply for a government supported place.

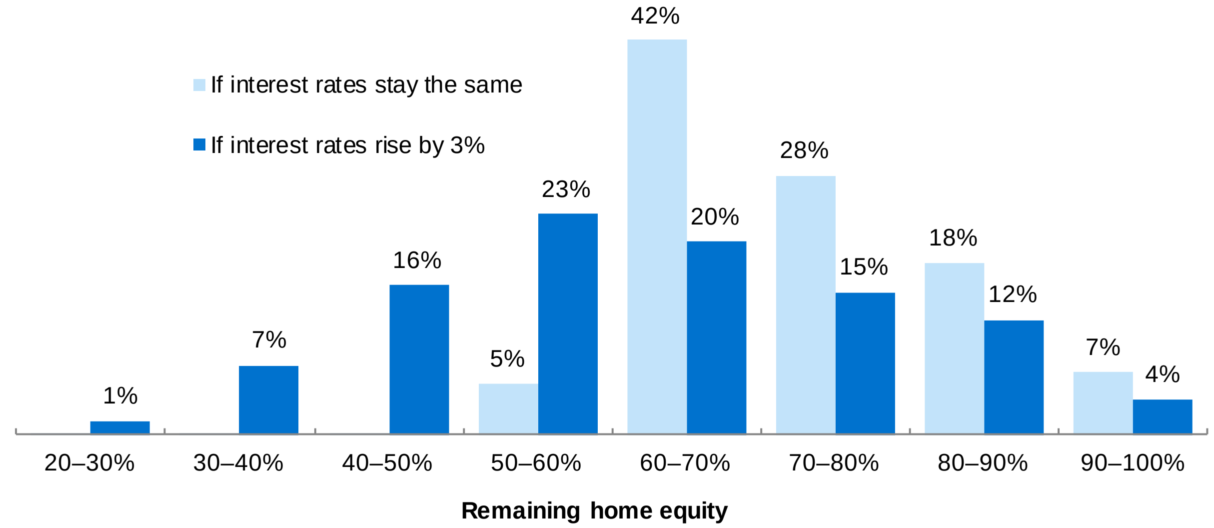
Figure 15: Percentage of loans with less than $380,000 equity at age 84



Note: See Table 31 in Appendix 3 for the underlying data shown in this figure (accessible version).

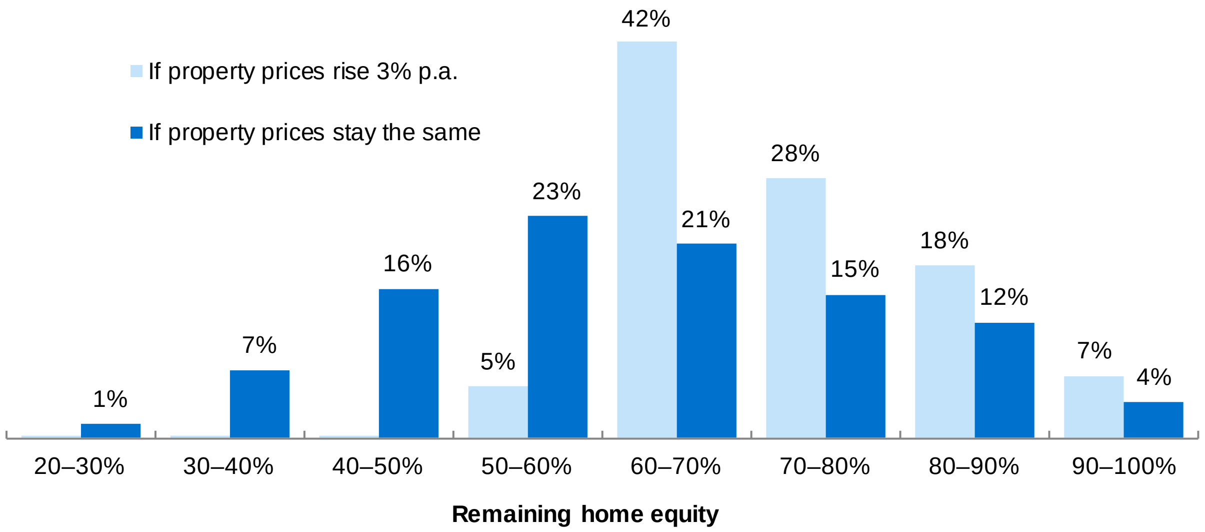
176 For example, Figure 16 illustrates how an increase in variable interest rates on loans could reduce the amount of home equity that is available to existing borrowers when they reach the average retirement age of 84. Figure 17 illustrates a scenario where property prices stay the same.

Figure 16: Percentage of borrowers with lower home equity at age 84, if interest rates rise by 3%



Note: See Table 32 in Appendix 3 for the underlying data shown in this figure (accessible version).

Figure 17: Percentage of borrowers with lower home equity at age 84, if property prices stay the same



Note: See Table 33 in Appendix 3 for the underlying data shown in this figure (accessible version).

Risk factors for equity erosion

177 We wanted to determine what characteristics of borrowers put them at high risk of equity erosion. To do this, we selected a group at high risk of erosion and then looked for differences between this group and the total borrower population. Equity erosion was more likely for younger borrowers with higher LVRs. Lower initial property values also appear to increase the risk of equity erosion.

178 We selected the high-risk group by assuming 3% per annum house price growth and by assuming that the interest rate will stay the same as at the date of application. Out the 17,053 loans in our analysis, only 57 loans would have negative equity at aged 84 (and therefore would rely on the negative equity guarantee) under those assumptions.

179 All 57 loans in the high-risk group have *both* age lower than average age at application of all reverse mortgage borrowers, and higher LVR than the average LVR at application.

180 In addition, of the 57 loans that have negative equity, 82% have a property value lower than the average property value of all reverse mortgage borrowers.

Interest rates and house prices

181 Future changes in house price growth (even if interest rates stay the same) will have an impact on the percentage of borrowers with greater than 90% of their original equity remaining at age 84.

182 With house price growth of 3% per annum, most borrowers will have 90% or greater equity remaining at age 84. If house prices are static, few borrowers (4%) will have 90% equity and 60% of borrowers will have between 40 and 70% of their equity remaining at age 84.

Loan duration

183 Lenders did not generally ask how long borrowers intended to remain in the loan. Without making inquiries into the borrower's anticipated exit strategy, lenders will not know if they are likely to be at risk of not having enough money left to pay for aged care.

184 The following two case studies from our loan file review are examples of loans where the lender did not ask about exit strategy; in one case, the borrower paid back the loan quickly and in the other the borrower appears to be at risk of equity erosion.

Note: For information on loan duration from our data analysis, see Section A.

Case study 16: No inquiries but voluntary repayments

Justine (aged 66) applied for a reverse mortgage for home improvements of $62,500. A lower than expected valuation of $210,000 meant she was only able to obtain $52,500 because of the lender's maximum LVR policy.

Her lender did not make any enquiries into Justine's exit strategy.

Justine immediately deposited some of the lump sum loan back into the account and made repayments equivalent to the interest charges. Justine repaid the full loan after less than 2 years by making a large repayment.

The relatively high LVR for her age and relatively low property value meant there was a risk of erosion. This was minimised by Justine's voluntary repayments.

Without making voluntary repayments, at age 84 Justine would have only $120,398 if her variable interest rate increased by 2% and the value of her house increased by 3% per annum.

Case study 17: Few inquiries and no exit plan

Kimberly, a 65-year old widowed pensioner, was seeking to re-finance her existing mortgage of approximately $22,000 and buy a car. Her home was valued at $200,000 and she borrowed $40,000 with a reverse mortgage.

Her lender did not ask about an exit plan for the loan. There was only a tick-a-box question about future aged care needs.

Kimberly made some voluntary repayments when she could, but the loan was still active after three and a half years and interest was accumulating on the balance.

If her variable interest rate increases by 2% and the value of her house increases by 3% per annum, Kimberly will have $158,774 at age 84. This may not be enough to pay for the aged care option of her choice.

185 Rarely lenders did enquire about exit strategy as in the following case study.

Case study 18: Erosion less likely with a short-term loan

Margaret and Ted (aged 66 and 68) took a line of credit for $200,000 over their property valued at $1,000,000.

Their lender recorded that they intended to sell another property and pay off the reverse mortgage.

They paid down the loan balance to zero with a substantial voluntary repayment after 18 months. While they paid interest and fees, they held onto their home.

Margaret and Ted would have faced different prospects if they had stayed in the loan indefinitely without making voluntary repayments. If the interest rate on their loan and their property value had remained unchanged, they would have ended up with only $377,130 by age 84.

E Finding 4: Market concentration and competition

Key points

The reverse mortgage market is highly concentrated with high barriers to entry for lenders and high switching costs for consumers, all of which are likely to affect competition and lead to poorer consumer outcomes.

186 Effective competition in the financial system should drive innovation in product offerings, improvements in product quality and variety, greater efficiency, and lower prices for the benefit of consumers.

Note: See Productivity Commission, *Competition in the Australian financial system—Draft report* (January 2018).

187 Concentration of market share is an indicator commonly used to assess the level of competition in a market.

Note: In its submission to the Productivity Commission Inquiry into Competition, the ACCC noted that it assesses the state of competition in a market based on a broad range of indicators, including: market shares and concentration; the height of barriers to entry and expansion; the rate of product and service innovation; symmetry in the pass through of cost reductions and cost increases; the ease with which customers can switch to substitute products and sources of supply; and the countervailing power of customers.

188 Concentrated markets can still deliver competitive outcomes as long as new providers can easily enter the market, existing smaller incumbents can expand, and consumers can easily and conveniently switch between alternative products or providers.

189 Our data analysis and consultations with stakeholders identified:

(a) high concentration in the reverse mortgage market;

(b) high barriers to entry and growth for lenders; and

(c) high switching costs for consumers due to the costs of taking out a reverse mortgage and financial constraints among many borrowers.

190 A market with these characteristics may affect competition and consumer outcomes, in the form of higher prices, poorer quality products, lower levels of investment and innovation, and reduced negotiating power for consumers, regardless of price or features.

Market concentration

191 The reverse mortgage market is highly concentrated, consisting of a small number of lenders. The largest two lenders accounted for 80% of the dollar value of new approved loans from 2013–17, while the largest four lenders accounted for 92% of new approved loans: see Table 10.

Table 10: Lenders in the reverse mortgage market, 2013–17

Lender	Percentage of dollar value of approved loans, 2013–17
Lender A	47%
Lender B (division of Lender A)	21%
Lender C	12%
Lender D	12%
Lender E	7%

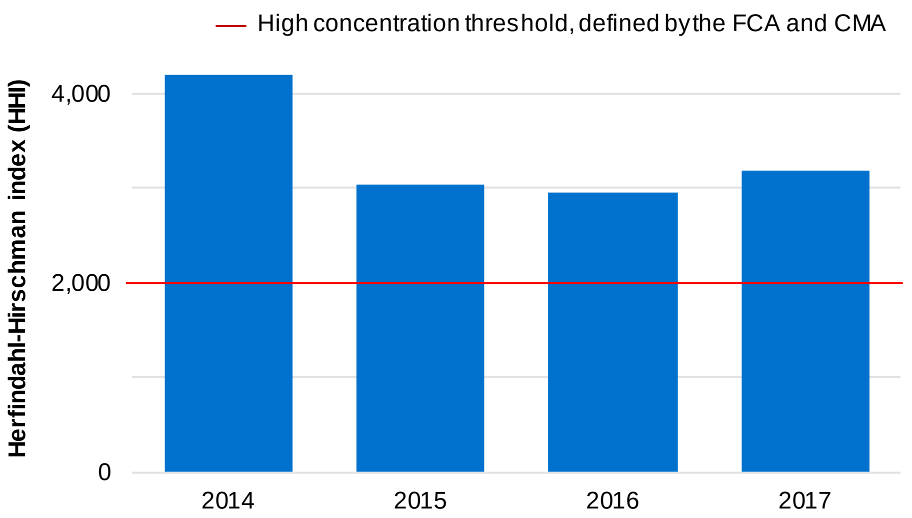
192 The Herfindahl-Hirschman Index (HHI) is a statistical measure of market concentration used widely in competition and market reviews. Several competition regulators consider that a HHI above 2,000 indicates that a market is highly concentrated.

Note: See ACCC, *Merger guidelines 2008* (updated 2017). In these guidelines, the ACCC notes they are less likely to identify competition concerns where a post-merger HHI is less than 2,000 or greater than 2,000 with a delta less than 100. The competition regulator in the United Kingdom, the Competition and Markets Authority, Merger Assessment Guidelines indicate a market with a HHI exceeding 2,000 may be regarded as highly concentrated. This threshold is used by the Financial Conduct Authority, and is in-line with the threshold used by the European Commission

193 The HHI in the reverse mortgage market in Australia was 3,195 in 2017, and has remained significantly above the 2,000 level threshold over the past three years.

194 From late 2017, the concentration in the reverse mortgage market increased further as two lenders ceased to originate new reverse mortgages. These exiting lenders together wrote nearly 20% of the amount lent from 2013 to mid-2017.

Figure 18: Market concentration for reverse mortgages



Note: See Table 34 in Appendix 3 for the underlying data shown in this figure (accessible version).

Barriers to entry

195 Our consultations with stakeholders identified factors that may discourage new or existing lenders from offering reverse mortgages: see Table 11.

Table 11: Potential barriers for lenders in offering reverse mortgages

Factor	Why it may be a barrier
Capital adequacy regulations	Industry participants have noted that APRA's capital adequacy regulations treated reverse mortgages in the same risk category as interest-only loans. This required lenders to hold more Tier 1 capital if they provide reverse mortgages. Industry participants cited this as a disincentive for lenders which can limit the supply of reverse mortgages. Note: See the Productivity Commission report, p. 159.
Wholesale funding	After the global financial crisis, non-bank authorised deposit taking institutions (ADIs) have faced greater difficulty accessing wholesale funding. This has led several lenders to exit the reverse mortgage industry, and may be impeding the entry of new non-ADIs.
Interest rates/ industry revenue	Because most reverse mortgages are tied to a variable interest rate, lenders have experienced declining revenue from reverse mortgages for the past five years due to lower interest rates.

Switching costs for consumers

196 Our loan file review suggests that many borrowers faced relatively high financial costs to switch reverse mortgage products due to comparatively high application fees (see Table 12) as well as costs to receive mandatory legal advice, get a property valuation, discharge any pre-existing encumbrances, register the mortgage, and pay stamp duty.

197 Some borrowers who sought to switch products may have also faced emotional costs associated with refinancing their home.

Table 12: Fees charged by lenders for reverse mortgages

Type of fee	Typical cost
Establishment fee	\$500–995
Ongoing administration fee	\$0–12
Loan discharge fee	\$300–400
Application to increase the credit limit	\$395–950
Application to lease, sub-divide or introduce an easement onto the property	\$0–500

F Finding 5: Reducing the risk of financial elder abuse

Key points

Lenders need to improve their procedures to address the risks of financial elder abuse. Our loan file review came across 15 instances where lenders had failed to identify and investigate indicators of possible abuse.

Adequate and robust frameworks across all product-based offerings for older consumers can help lenders and staff in detecting, combatting and escalating potential instances of financial elder abuse.

What is elder abuse?

198 The World Health Organisation (WHO) describes elder abuse as 'a single, or repeated act, or lack of appropriate action occurring within any relationship where there is an expectation of trust which causes harm or distress to an older person', or as 'the illegal or improper exploitation or use of funds or resources of the older person'.

Note: See WHO, *The Toronto declaration on the global prevention of elder abuse* (2002) and *World report on violence and health* (2002).

199 Industry awareness of financial elder abuse is improving. The Australian Law Reform Commission (ALRC) has highlighted that 'banks can play a valuable role in protecting their customers and encouraging them to consider carefully the risks of certain practices and transactions'.

200 The ALRC recommended that banks could:

(a) train staff to detect and appropriately respond to abuse;

(b) use software and other means to identify suspicious transactions; and

(c) report abuse to the relevant authorities when appropriate.

Note: See ALRC Report 131, *Elder abuse: A national legal response* (June 2017), p. 299. See also Financial Ombudsman Service (FOS), *The FOS approach to financial elder abuse* (October 2017).

201 Adequate and robust frameworks across all product-based offerings for older consumers can help lenders and staff in detecting, combatting and escalating potential instances of financial elder abuse. These frameworks not only play a role in deterring unwanted outcomes but also provide an additional layer of consumer protection.

202 Such frameworks usually include internal guidelines to assist staff when responding to 'red flags' or warning signs, ongoing training for staff, and escalation points, specifically referring consumers to external support agencies where appropriate.

Case study 19: Loan money given to family member

Daisy, an 85 year-old widowed pensioner, applied for a reverse mortgage of $315,000 in 2010. When she applied for the loan, Daisy was suffering from Alzheimer's disease. She also speaks very little English.

At the time of the application, Daisy's grandson was experiencing financial hardship.

Daisy went into her local bank branch with her grandson to seek a solution. Given her grandson's financial hardship, a personal loan could not be approved. Instead, Daisy stated that the branch manager persuaded her to take out a reverse mortgage.

The lender at the time required a legal advice certificate to be witnessed by a solicitor to ensure Daisy understood the terms of the reverse mortgage. Her grandson said that he also went to the solicitor's office with his grandmother.

Daisy proceeded with the reverse mortgage and provided the money to her grandson.

The need for adequate safeguards

203 Our review of the policies and procedures of lenders found that:

(a) three lenders lacked policies, procedures or guidelines to help lending staff to either detect instances of financial elder abuse or to respond to suspected instances of such abuse;

(b) two lenders did not provide staff with training on financial elder abuse or capacity while the other lenders touched on this topic through their responsible lending training to staff; and

(c) one lender introduced a policy in April 2017 which focused on vulnerable consumers generally and how to detect and escalate, through warning signs, suspected fraud or scams.

204 However, lenders did have some indirect safeguards in place to protect against financial elder abuse. These included:

(a) limiting the ability of a power of attorney to take up a reverse mortgage for a non-borrower benefit (by confirming the name of the loan account, or in one case requiring a letter of confirmation signed by a solicitor that the borrower was to receive benefit of the money); and

(b) only disbursing money into an account in the borrower's name.

205 Our loan file review came across 15 instances there was sufficient information in the loan documentation for the lender to identify a possible instance of financial elder abuse.

206 In each of these cases, the lender either did not make or did not document further inquiries into whether the consumer was being taken advantage of by a caregiver or family member.

207 Although our review identified potential indicators of financial elder abuse, our review of individual loan files identified no evidence of actual financial elder abuse.

208 Specifically, we found that lenders failed to recognise the following as potential indicators of financial elder abuse:

(a) repayment on a loan being made by an adult child;

(b) money transferred to a non-borrower;

(c) money provided to a child;

(d) involvement of children in the application;

(e) only non-borrowers receiving mandatory independent advice; and

(f) file notes indicating abuse by a sibling of the borrower.

209 Our review focused on the steps lenders took to identify and respond to warning signs of financial elder abuse. We did not examine what, if any, harm these practices caused to the borrowers in our review.

210 However, these findings illustrate that lenders may not have recognised potential instances of suspected financial elder abuse, which may have had repercussions for consumers taking out a reverse mortgage.

Note: See also Case study 4 in the executive summary of this report.

Case study 20: Query about loan purpose

Jennifer, an 82-year old retired widow on an age pension, applied for an $80,000 reverse mortgage in February 2013. She was approved by the lender for $60,950. The loan was used to repay an existing line of credit of approximately $30,000 and an additional $30,000 for alterations to her property. In determining the purpose of the loan, Jennifer's daughter was contacted about the amount borrowed by her mother.

G Finding 6: Protecting other residents in the home

Key points

A lack of tenancy protection can have serious consequences for non-borrower residents of the secured property.

The tenancy protection warning does not appear to be operating effectively to prompt borrowers to consider whether tenancy protection is required.

The tenancy protection provision we reviewed only allowed for limited protection, and restrictions like age limits meant it was not broadly applicable. Protection for a non-borrower spouse may be better achieved by adding them as a co-borrower if possible.

211 A reverse mortgage must be repaid either when the borrower vacates the property or passes away. If the borrower dies, other people living in the home may be forced to move out so it can be sold to repay the loan. This can have serious consequences for a surviving spouse or dependent adult child, and is a particular risk where one person in a relationship takes care of most or all of the financial decisions.

212 If the contract does not include tenancy protection, the lender must give the borrower a tenancy protection warning: see reg 74A and Form 7A of the National Credit Regulations.

213 The purpose of the tenancy protection warning is:

> to enable the consumer to make a fully informed decision about whether a particular reverse mortgage contract is suitable for their requirements in respect of the consequences for non-title holding residents (such as a partner whose name is not on the title of the property). If the borrower wants to protect this person, they would then be on notice and could choose to find a credit provider who offers reverse mortgages with the appropriate protections.
>
> Note: See the Explanatory Memorandum, Enhancements Bill, at [3.67].

214 We encourage all lenders to consider including options for broadly applicable tenancy protection in their contracts. This can help lenders avoid the risk of providing a loan that is unsuitable for the consumer's needs and objectives and help consumers 'find a credit provider who offers reverse mortgages with the appropriate protections'.

Limitations of the tenancy protection warning

215 Our consumer research suggested that the tenancy protection warning may not be operating effectively to ensure that lenders have adequately discussed this issue with borrowers or that borrowers have adequately considered whether they may require tenancy protection.

216 It is unclear whether this may be due to the form and timing of the warning, the bundling of the warning with other documents, a tendency for lenders to treat the warning as a formality and fail to draw sufficient attention to it, or a combination of these factors.

217 Our loan file review showed that lenders generally provided the tenancy protection warning to borrowers when required (87% compliance for lenders whose contracts do not contain a tenancy protection provision). For the remaining 13% of files, we could not determine whether the warning was:

(a) not provided at all (either due to non-compliance or because the contract contained a tenancy protection provision); or

(b) provided but a copy was not placed on file.

Note: One lender does not provide a tenancy protection warning because their contracts contain a tenancy protection provision.

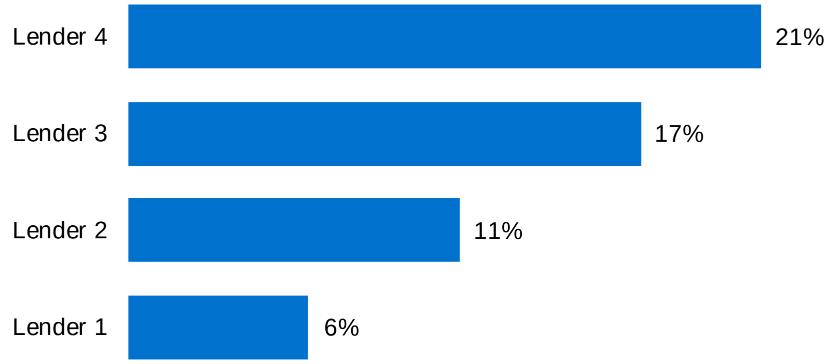
218 While most loan files had evidence that a tenancy protection warning was provided, most borrowers we interviewed did not recall a discussion about tenancy protection. This means that, even though most borrowers would have received this warning, they could not generally recall pre-contractual discussions about the implications of the loan for a non-borrower resident.

219 Borrowers did seem to intuitively understand that non-borrower residents would have to move out of the property if the borrower moved into aged care or died, but they did not appear to be concerned about this risk. Only one borrower reported discussing this issue in detail and taking significant action to ensure the house title was changed to include both partners.

The need for tenancy protection

220 Our loan file review showed that in about 11% of loans, the lender was aware that there was someone else living in the property: see Figure 19. For these loans, 42% did not include documented responses about the borrower's needs and objectives in this area.

Figure 19: Percentage of loans secured against properties with non-borrower residents



Note: See Table 35 in Appendix 3 for the underlying data shown in this figure (accessible version).

221 Of the five lenders in our review, only one lender's contract contained a tenancy protection provision which allows the borrower to nominate a non-borrower (subject to approval) for tenancy protection. Under this provision, the nominated person has a right stay in the property for a further year after the death of the last borrower. However, the provision gives the lender discretion to refuse an application seeking tenancy protection and is subject to limitation (the nominated non-borrower resident must be a relative of the borrower and over 70 years old). Therefore, this provision would not apply if the spouse or dependent child was under 70 years of age.

222 For the other four lenders in our review, borrowers could protect non-borrower residents only by adding their name to the loan contract, making them a co-borrower. Because reverse mortgages are subject to age restrictions, this approach has limitations. While it does have the advantage of giving the person the same rights as a borrower, this may not be desirable or appropriate depending on the nature of the relationship. One lender has a policy of actively inquiring about this issue if the borrower has a spouse who is not listed as a co-borrower.

223 The following case study from our loan file review highlights how non-borrower residents can be at risk of having to move out after the loan is paid off. It suggests that if a borrower's expressed wish to have tenancy protection is not accommodated, the borrower may still proceed with a loan, possibly because of a lack of product options, an imbalance in bargaining power, or because the future need to protect a non-borrower resident is not as important as the immediate need for the loan money.

Note: See also Case study 5 in the executive summary of this report.

Case study 21: Loan did not provide tenancy protection

Sandra applied for a reverse mortgage to help her buy a property after a divorce. She asked the lender to add her daughter to the title. The purpose of this request was not recorded. However, it is likely that she wished to give her daughter an interest in the property that would allow her to remain in the property if Sandra died or moved into aged care. The lender could not accommodate this request as all borrowers had to be over 65.

A tenancy protection warning was given to Sandra. As the lender's policy did not allow for tenancy protection, the reverse mortgage that Sandra took out probably did not meet her express needs and objectives in terms of providing for her daughter's security. At the time of our review, the loan was still active.

H Finding 7: Unfair contract terms

Key points

We identified potentially unfair terms in reverse mortgage contracts including:

- entire agreement clauses in three lenders' contracts (one of these lenders has removed these clauses, the second is considering removing them and the third no longer provides reverse mortgages);
- broadly drafted unilateral variation clauses; and
- clauses of non-monetary default that potentially allow lenders to take actions that are disproportionate to the nature of the breach.

Lenders have already made some changes in response to ASIC's concerns. Where they have not made changes, or we are not satisfied with the changes, we will require them to remove or modify unfair terms or, for existing contracts, to confirm that they will not rely on these terms.

Potentially unfair terms

224 The standard form terms and conditions for reverse mortgages are subject to laws which prohibit unfair contract terms. Some lenders include terms and conditions in their loan schedule which do not vary at all between contracts. These standard terms are also subject to the unfair contract terms law.

225 We reviewed the most recent version of each lender's standard terms and conditions provided under a notice to the lenders requesting policies and procedures and sample files. All five lenders' contracts contained terms that have the potential to be unfair. Table 13 summarises these terms and why we consider them to be potentially unfair.

226 Where a potentially unfair contract term was identified in our review, we gave each lender an opportunity to make submissions about the term.

227 Specifically, we asked for submissions about:

(a) whether the term would cause a significant imbalance in the parties' rights and obligations;

(b) why the term was necessary to protect a legitimate business;

(c) whether the term was likely to cause detriment to the consumer if relied on by the lender; and

(d) where relevant, what notice periods were given, whether an opportunity to rectify a default was provided and what the consumer can do if they are unhappy with a change made to the contract, including the right to terminate the contract and any applicable penalty for doing so.

228 Where a contract contains a clause that is potentially unfair, we will ensure it is removed or modified by the lender.

Table 13: Potentially unfair contract terms identified in our review

Type of clause/what it does	Why we are concerned	What we found
Entire agreement clauses This type of clause absolves the lender from responsibility for conduct, statements or representations that the lender makes to the borrower outside of the contract.	Entire agreement clauses or similar terms in reverse mortgage contracts may be unfair as they could absolve the lender from responsibility for conduct, statements or representations that the lender's staff may have made to the consumer about how the contract would operate (e.g. how the lender would exercise their discretions during or on review of the loan). The 'big four' banks have confirmed that their small business loan contracts now do not contain entire agreement clauses or similar terms (see Report 565 *Unfair contract terms and small business* (REP 565) at paragraphs 29–31).	Three lenders' contracts contained entire agreement clauses or similar terms. One lender has removed this term from its contracts. The second has agreed to review the term and consider removing it from its contracts. This lender had never relied on the term. The third lender is no longer providing reverse mortgages and had never actually relied on the term.
Broad indemnification clauses This type of clause makes the borrower liable to the lender for losses, costs, liabilities and expenses suffered or incurred by the lender, including those that may arise outside the control of the borrower.	Clauses that impose an obligation on a borrower to indemnify the lender for losses, costs, liabilities and expenses caused by fraud, negligence or wilful misconduct of the lender (including its staff, contractors and agents and appointed receivers) are likely to create an imbalance in rights and obligations of the parties which would cause detriment to the borrower and are not reasonably necessary to protect the legitimate interests of the lender.	One lender's contract contained a broad indemnification clause which made the borrower liable for any negligence of a receiver. This lender has agreed to remove this term from its contract and has never relied on the term.
Unilateral variation clauses This type of clause gives lenders (but not borrowers) a broad discretion to unilaterally vary terms and conditions of the contract, without the consent of the borrower.	Unilateral variation clauses are not necessarily unfair but are more likely to be so if they are broadly drafted. This is because broadly drafted clauses are more likely to cause a significant imbalance in the rights of the lender and borrower (in favour of the lender) and may not be reasonably necessary to protect the legitimate interests of the lender due to the breadth of the circumstances in which they can be relied on.	All lenders' standard form contractual terms and conditions contained some unilateral variation clauses that had the potential to be unfair contract terms. Some of these concerns were addressed by lenders' submissions. Three lenders' contracts contained broad variation clauses allowing them an unfettered discretion to vary any term or condition of the contract without borrower consent.

Type of clause/what it does	Why we are concerned	What we found
Unilateral variation clauses (cont.)	*Notice periods/Right to terminate the contract* Case law on unfair contract terms in consumer contracts suggests that the imbalance created by a unilateral variation clause can also be counterbalanced if the borrower has sufficient advance notice of the variation before it comes into effect to give them a real and reasonable opportunity to exit the contract without penalty rather than accept the variation. This reduces the likelihood of significant imbalance in rights and obligations and of detriment.	*Notice periods/Right to terminate the contract* All three lenders' contracts provided a period of 20–30 days' notice to be given in the event of changes under these clauses. The borrower can terminate the contract by paying the outstanding balance at any time without unreasonable fees being charged. However, practical difficulties for borrowers in terminating a reverse mortgage contract mean that they may be more likely to put up with the changes to the contract. For example, to pay the outstanding loan balance, most borrowers would need to either sell their home or refinance their loan. Because borrowers generally took out the reverse mortgage to stay in their home, they may be reluctant to sell and downsize or move to aged care. In addition, because the reverse mortgage market is highly concentrated, options to refinance are likely to be limited, particularly after some equity erosion has occurred. Some elderly borrowers may also be dealing with physical or mental decline, which may inhibit their ability to refinance. We will require lenders to remove or modify any unreasonably broad unilateral variation clauses.
Non-monetary default clauses This type of clause gives lenders a broad discretion about whether to treat a particular event or circumstance as an actual default.	Even if lenders do not rely on non-monetary default clauses to terminate a loan or impose a penalty, inclusion of these clauses means they can be used by lenders in an unfair way. For example, reverse mortgage contracts generally contain clauses that require the borrower to maintain the security property to a particular standard, limiting material changes to the property without consent. This protects the lender's legitimate interest in ensuring the value of the security property does not decline and is particularly important in light of the NNEG. However, these clauses should not be so broadly drafted that a lender could call an event of default for a relatively minor change to a security property. For example, a default clause that does not allow the borrower to make any changes to the property without consent would be clearly unfair (as was included by one lender).	All lenders' contracts contained examples of these clauses. Lenders submitted that in practice they do not rely on default provisions very often (or at all), or that in the event of default they will generally work with borrowers to remedy the default before acting. We consider that where the provisions do not reflect the lender's business practices in acting on defaults, they should be updated to reflect this for clarity. *Borrower misrepresentation* Four of the five lenders' contracts contained a clause of default relating to borrower misrepresentation, which had the potential to operate in an unfair manner. Although there is a legitimate business interest in a lender having protection from serious untrue or misleading representation and fraudulent statements, these clauses are generally worded broadly enough that they would also capture inadvertent minor untrue statements that would not materially alter the lender's credit risk. One lender has modified its clause to encompass only breaches that are material to its decision to provide or continue to provide credit.

Type of clause/what it does	Why we are concerned	What we found
Non-monetary default clauses (cont.)		*Broad catch-all default clauses* Three lenders' contracts contained broad default clauses for any breach of the contract, which encompassed a range of breaches with varying degrees of severity that did not always pose a material risk to the lender. We consider that lenders could: • provide a reasonable period for a borrower to remediate a breach of a specific event; and • adopt a 'material credit risk' threshold by applying a 'material credit risk' test so that a breach of a specific event must create a material risk to the lender of a monetary default or of the lender being unable to enforce its rights against any secured property. Note: This could be done by incorporating a credit risk-related materiality element into the definitions of the specific events, or applying a stand-alone material credit risk test. One lender will limit misrepresentations to those that materially impact its decision to provide credit. We will require lenders to remove or modify any unreasonably broad non-monetary default clauses.

I Other issues

Key points

Most borrowers had a basic but sometimes limited understanding of compound interest, how the size of their loan had been determined, and the cost of their loan.

Our review indicated that:

- while lenders placed the onus on borrowers to consider how their loan would affect their Centrelink payments, both lenders and borrowers paid little if any attention to this issue; and
- lenders had varied policies for supervising inquiries made by brokers, but there were failures to adequately inquire about the possible future needs of borrowers for both broker-originated and direct loans.

Borrowers also face significant barriers in finding and receiving independent professional guidance about a potential reverse mortgage.

Borrower understanding of the product

229 Most of the borrowers in our consumer research had a basic but sometimes limited understanding of how their reverse mortgage worked.

230 To evaluate the extent to which borrowers understood their loan, in the consumer interviews we asked borrowers to explain, unprompted and in their own words, their understanding of a reverse mortgage. We then asked follow-up questions to further examine the nature of their understanding.

231 In general, while all borrowers could articulate the basic elements of their loan, most could not explain specific details about these elements, including the impact of compound interest and loan size on the overall cost of the loan.

Table 14: Quality of borrower understanding

Aspect of loan	Quality of borrower understanding
Compound interest	All the borrowers we interviewed generally understood compound interest to mean 'interest upon interest', but when closely questioned many were uncertain about how compound interest is calculated. Despite this, most borrowers communicated a belief that compound interest carries risks.
Loan size	Most borrowers said that they had felt comfortable applying for whatever loan amount their lender or broker suggested. Most believed that this suggested amount was derived from a calculation of their age and property value, which was some kind of risk indicator for the lender, but said that they had not put much thought into how this was calculated. One borrower stated: 'The lender said they'd give us a percentage of the value of our home and we said we'd take the lot!'

Aspect of loan	Quality of borrower understanding
Loan cost	All borrowers told us that they believed that the interest rates for reverse mortgages were generally more expensive than comparable credit products and presumed this was because repayments were not required. Borrowers also communicated that their loan balance would increase over time, but many had a limited understanding of how this loan balance was related to their equity in the secured property.

232 The following case study illustrates how a misunderstanding of compound interest affected a particular borrower who made a complaint to their lender.

Case study 22: Misunderstanding of compound interest

James was 64 when he took out a reverse mortgage. He periodically withdrew money through the loan to pay for utility bills, groceries and other day-to-day expenses.

James incorrectly believed that he would be charged interest only on the amounts he withdrew. He did not know that interest also accrues on the interest itself.

After several years, James learned that monthly interest charges on his interest had been added to his loan balance. If he had known this sooner, James would have regularly deposited part of his pension into the loan account to offset the compounding of the interest.

233 Table 15 outlines the steps that lenders took to ensure that potential borrowers understood the terms and conditions of a reverse mortgage.

Table 15: What lenders did to ensure borrower understanding

What lenders did	How they did it
Explaining the product to the borrower	Of the five lenders in our review: • two lenders required their representatives to complete product-specific training for reverse mortgages, which included instructions on how the loan should be explained to consumers; • four lenders provided either product-specific training or instructions to brokers explaining how brokers should communicate with potential borrowers about the product; and • all lenders typically had some mandatory scripted questions which consumers had to be asked.
Requiring the borrower to receive independent 'financial advice'	Two lenders in our review required potential borrowers to produce a statutory declaration that they had received independent financial guidance before they applied for a loan. Declarations were to be signed by the guidance provider. The three other lenders only recommended that the borrower obtain this guidance. Note: For details of the financial guidance borrowers received, see paragraphs 268–273.

What lenders did	How they did it
Requiring the borrower to receive independent legal advice	All five lenders in our review required potential borrowers to receive independent legal advice before they applied for a loan. Note: For details of the legal advice borrowers received, see Section C.
Requiring the borrower to sign a declaration that they understood the product	Three of the five lenders required borrowers to sign a declaration. These declarations ranged from a simple ‘tick-box’ checklist stating that the borrower had considered their aged care needs to an exhaustive self-administered questionnaire about the borrower’s financial situation, alternative options and loan objectives.
Recommending that the borrower consult family members	Four of the five lenders recommended borrowers to consult a family member before taking out a reverse mortgage. Note: For details of recommendations to consult family members, see paragraphs 268–273.
Identifying borrowers who lacked capacity to enter into the transaction	Only one lender had a procedure on what steps lenders should take if they believed that the borrower may have lacked capacity to enter into the transaction.
Conducting a follow-up compliance call for broker originated loans	Two lenders conducted follow-up compliance calls. These calls checked whether the broker had explained the terms of the loan and had given disclosure documents to the potential borrower, and whether the borrower had considered the impact of the loan on their Centrelink payments.

234 The borrowers we interviewed stated that these measures had been rigorous, and sometimes exhausting. Most borrowers indicated that the measures had helped them feel confident about their decision.

> ‘I believe they were trying to ensure that I fully understood—I believe I do fully understand.’
>
> ‘They really did go on and on—between the paperwork they provided, the conversations we had, the solicitor being involved… it was endless!’

235 These measures placed an onus on borrowers to actively take their own steps to ensure their understanding of the product. When borrowers had already formed an opinion before speaking with the broker or lender that a reverse mortgage would be their ‘only option’, placing such an onus on the borrower is more likely to be ineffective.

> ‘Maybe I should have read it [the loan documents], and maybe I should have shopped around a bit more. But I was just happy to have found an option.’

236 Despite these measures, the borrowers we interviewed often did not specifically recall having any discussion with their lender or broker about aged care or future long-term needs in relation to the loan, and little to no understanding of the impact of the loan on their Centrelink payments.

Implications for income and financial capacity

Centrelink

237 Borrowers can access the money from a reverse mortgage in different ways. While some lenders only offer a line of credit, many lenders offer several options for borrowers, including an upfront lump sum.

Note: For a description of different types of loan structure, see Section B.

238 The advantages and disadvantages of each type of payment structure should be considered as part of the lender's assessment of the borrower's needs and objectives. For example, an upfront lump sum payment can disadvantage some consumers because:

(a) it may have an impact on their Centrelink payments based on the income and assets tests (see paragraphs 77–78); and

(b) interest will start to accrue and compound on the loan amount from when the lump sum is accessed, contributing to equity erosion (see paragraphs 79–80).

239 Considering the impact of a reverse mortgage on Centrelink payments is not a prescribed responsible lending requirement. However, lenders should take into account this issue, and the suitability of the loan payment structure more broadly, when considering whether a loan suits the borrower's needs and objectives.

240 Example 1 in RG 209 states that:

> because of the potential impact of a reverse mortgage on a consumer's eligibility for Centrelink payments, we consider that an inquiry into a consumer's eligibility to receive these payments is an essential component of this investigation and verification.

Potential reduction in Centrelink payments

241 As discussed in Section B, a reverse mortgage may affect a borrower's age pension or other Centrelink payments, particularly if it is taken out as a lump sum of over $40,000, is not used immediately, or is intended as a gift.

242 Our loan file review showed that well over half of borrowers (60%), were receiving Centrelink payments of some kind. However, the number of borrowers may be higher as 48% of all files did not record income inquiries. Therefore, a decrease in Centrelink payments was a possible adverse outcome for a large number of borrowers.

243 Our data analysis indicated that 2,209 loans were taken out as a lump sum payment where the approved amount was over $40,000. In our loan file review, 28% of loans had an upfront lump sum payment of $40,000 or greater.

Note: The number of borrowers affected could be higher than 28% as we did not take into account loans with a mixture of payment types (i.e. lump sum and a line of credit, redraw or income stream).

244 We could not access data on what borrowers actually used the loan for and whether they used the money within 90 days. For this reason, we could not determine the number of loans that may have caused a reduction in entitlements due to the income and assets tests and gifting provisions.

Lack of understanding by borrowers

245 Our consumer research highlighted that the impact of taking a lump sum on Centrelink entitlements was not explicitly considered by consumers. All except one of the borrowers we interviewed said they had not considered whether their loan could affect their pension or other Centrelink payments.

> ‘I’m not sure how negative money can impact your pension? It’s a debt—how can it affect your pension and why would I even think to tell Centrelink?’
>
> ‘They [Centrelink] only want people who do the wrong thing.’

246 Our consumer research showed that borrowers had a consistent lack of understanding of the possible impact of a reverse mortgage on entitlements. All borrowers we interviewed were either retired or about to retire and relied on a pension or other government benefits to cover day-to-day living expenses.

247 Almost all borrowers suggested that they had never discussed this with their financial adviser or lender. Further, many claimed that they ‘knew’ the reverse mortgage did not affect their pension, but they had not checked it directly with Centrelink themselves. Those that had considered the impact tended to have researched the issue themselves and/or asked Centrelink.

248 ASIC encourages borrowers who are considering a reverse mortgage to contact the Financial Information Service (a free service provided through Centrelink/Department of Human Services) for information and guidance on how their entitlements may be affected by a potential loan.

Limited consideration by lenders

249 Our loan file review showed that lenders did not document any consideration of what type of loan payment would be best for the borrower, including the impact of taking a lump sum on the borrower’s Centrelink payments.

250 While 80% of files reviewed contained an acknowledgement (either by the lender or consumer) that the impact on the pension or other entitlements had been considered by the borrower, there was no evidence that this was anything more than a mere formality. These acknowledgements were not supported by any evidence to show that the lender or consumer had actually considered this impact, or had done so in any detail.

251 The form of these acknowledgements placed the onus wholly on the consumer to make inquiries on this topic. Our consumer research indicated that, in many instances, these inquiries are not occurring.

Example: Impact of a loan on the age pension (hypothetical)

Beatrice, an age pensioner, has few assets besides her home. She takes out a reverse mortgage of $200,000 for renovations. Her renovations are delayed and the $200,000 sits in a bank account for 12 months. Because of this money, her regular age pension payments may be reduced.

Broker-initiated loans

252 Lenders had varying policies for monitoring and supervising the responsible lending inquiries made by brokers and compliance with the National Credit Act more broadly.

253 All lenders had policies on making a final assessment for broker-originated loans. These assessments generally seemed to involve checking through the application to ensure that the broker had complied with all their obligations under the National Credit Act and provided all mandatory disclosures.

254 Where lenders had both broker-originated and direct loans, they seemed to use the same process to assess and verify loan applications, generally by sending the application to a specialist or more senior person for approval.

255 Lenders appeared to rely primarily on inquiries made by the broker, often referring applications back to the broker if there was information missing from the application rather than making their own separate inquiries.

256 For example, one lender relied heavily on a checklist provided by the broker that had boxes for the broker to tick off to certify that the relevant inquiries and verification had been made. There was very little evidence on the lender's file to support the statements made by the broker in the checklist in relation to the responsible lending inquiries. Often this lender did not retain copies of supporting documentation or disclosure documents on the loan file.

257 The use of checklists, with little detail recorded of the underlying discussions or consideration, is not unique to broker-originated reverse mortgages. This issue was also observed in our loan file review of loans originated through direct sales.

258 Two of the three lenders with a higher percentage of broker-originated loans had policies requiring them to make an assessment or compliance telephone call to the consumer after the application was lodged. One stated that the purpose of this was to gauge consumer understanding of the loan application and loan features, to check whether the Centrelink impact was considered, and to ensure that key disclosures had been made.

259 These lenders made follow-up telephone calls in all cases for broker-originated loans in the files reviewed. For one lender, in most cases, the loan files only noted that these calls had been made and did not include enough detail to assess the nature of the discussions. For the other lender, the file contained a compliance call checklist for the person making the call, including aged care and other future costs, Centrelink impact, understanding of loan structure and features, key disclosure documents and loan terms and conditions such as maintenance and insurance.

260 To some extent, lenders can rely on the inquiries made by brokers. However, if they do so, we expect them to:

(a) have appropriate processes and procedures in place to review their representatives' compliance with the credit legislation, including the responsible lending obligations;

(b) ensure that representatives are appropriately trained and qualified;

(c) have adequate record-keeping and IT systems to allow them to provide consumers with a copy of the assessment, if requested to do so; and

(d) keep a record of all material that forms the basis of an assessment of whether a credit contract will be unsuitable.

Note: See Report 330 *Review of licensed credit assistance providers' monitoring and supervision of credit representatives* (REP 330).

Assessment of financial capacity

261 Four of the five lenders did not make any inquiries, or made very limited inquiries, about the consumer's financial situation and did not assess whether the consumer could meet their obligations under the contract without substantial hardship.

262 While reverse mortgages do not require ongoing repayments, the contract contains ongoing financial obligations. A typical reverse mortgage contains obligations to ensure that the property remains insured, to pay rates and to maintain the property. Most lenders made minimal or no inquiries about income and expenditure to assess the consumer's ability to meet these ongoing contractual financial obligations.

Note 1: In the United Kingdom, the Financial Conduct Authority (FCA) does not require the financial circumstances of consumers to be considered when applying for an equity release product.

Note 2: In the United States, since 2015 lenders are required to make a financial assessment as part of a reverse mortgage application to determine if consumers will be able to make ongoing payments such say taxes, insurance and other loan obligations. If the assessment indicates the consumer will not be able to meet these payments, the lender must require that a portion of the reverse mortgage funds be set aside for these payments.

263 Borrowers have certain obligations under their reverse mortgage, such as maintaining the security property and to continuing to pay insurance and rates. Borrowers may be in default if they fail to comply with these conditions, triggering a range of consequences. However, lenders generally do not rely on these clauses. During the period we reviewed, only one forced sale occurred. This was due to payment not being made within the required timeframe after the borrower's death.

264 Four of the lenders we reviewed did not have a requirement in their policies and procedures about making inquiries into a consumers' income. Two lenders required some inquiries into consumers' expenses and one required estimating the expenses associated with maintaining the property (e.g. rates, insurance and maintenance costs).

265 Just over half of the files we reviewed recorded responses about the consumer's income (including Centrelink) and 72 (65%) recorded responses about expenses.

266 Where lenders' policies did not require information about a consumer's financial circumstances to be collected, this information was generally not collected or verified in practice. Only one of the lenders consistently made inquiries and verified this information.

267 Overall, our review found no direct evidence of consumer harm arising from the absence of inquiries into the financial capacity of potential borrowers.

Finding help

268 Independent professional advice has the potential to aid borrower understanding. We spoke with lenders, brokers, consumer groups, financial advisers, accountants, legal practitioners, financial counsellors, and industry bodies that represent these advisers.

269 Overwhelmingly, these consultations indicated that there are significant barriers that prevent or deter borrowers from finding and receiving independent professional guidance about a potential reverse mortgage:

(a) *Cost*—In REP 224, we found that the estimated cost of providing comprehensive financial advice to a client was around $2,500–3,500. Because most potential borrowers are experiencing some degree of financial difficulty when they are considering a reverse mortgage, these types of costs may be perceived as too high.

(b) *Regulatory liability*—Financial advisers and accountants were reluctant to give guidance about reverse mortgages because they were anxious that recommending a reverse mortgage could amount to providing unlicensed credit assistance. To mitigate this risk, some industry bodies have advised their members to give only general information about reverse mortgages. In one instance, a lender offered reverse mortgages but also prohibited their financial advice arm from giving personalised guidance about reverse mortgages.

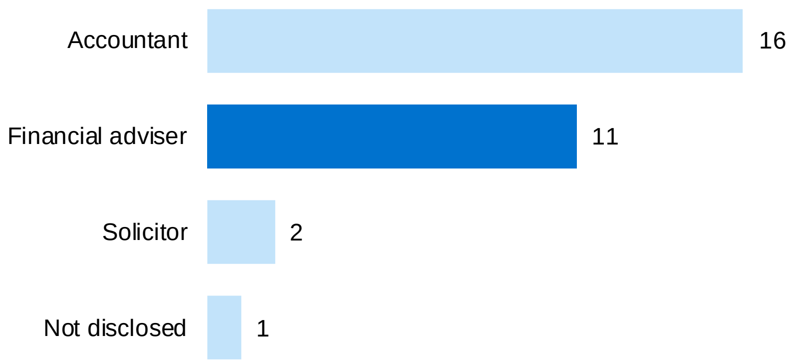
(c) *Stigma and awareness*—Stakeholders told us that many advisers are unwilling to provide guidance about a reverse mortgage because the product had a historically negative reputation as an exploitative product, or because the adviser was unfamiliar with the product.

270 Every lender we reviewed required prospective borrowers to receive legal advice and sometimes financial guidance about their potential reverse mortgage before entering the loan. But the difficulty of finding an adviser to provide financial guidance meant that some borrowers had to satisfy this requirement by 'shopping around' for someone who was willing to provide this guidance. Some borrowers resorted to an internet search engine to find a willing adviser.

271 These difficulties also meant that few borrowers had an opportunity to receive comprehensive guidance from a financial adviser about their overall financial needs and retirement position.

272 Rather, our review of financial guidance declarations made by borrowers indicated that most borrowers visited an accountant or solicitor to give them financial guidance, rather than a financial adviser: see Figure 20.

Figure 20: Entities that borrowers used to satisfy the financial guidance requirement for a reverse mortgage



Note: See Table 36 in Appendix 3 for the underlying data shown in this figure (accessible version).

273 Borrowers can receive free and independent general information about reverse mortgages by contacting the Financial Information Service or by accessing the 'My Aged Care' website, both of which are operated by the Australian Government. Seniors organisations such as National Seniors Australia also provide guidance to their members.

Appendix 1: Methodology

Scope of our review

274 Our review looked at reverse mortgage lending by the four most active credit providers that were originating loans for reverse mortgages as of January 2017. This included the Commonwealth Bank of Australia, Westpac Banking Corporation, Macquarie Bank Limited, and Australian Seniors Finance Pty Ltd (trading as Heartland Seniors Finance).

275 Our analysis of market concentration was based on loan originations by corporate groups and did not distinguish between loans offered by separate brands or divisions within the same corporate group.

276 For all other aspects of this review, we assessed the lending practices of the Retail Banking Services and Bankwest divisions of the Commonwealth Bank of Australia as separate lending entities as these divisions had independent processes for originating reverse mortgages.

277 We assessed the lending practices of three brands within the Westpac Banking Corporation as a single lending entity as these brands had similar processes for originating reverse mortgages. The brands were St George Bank, Bank of Melbourne and BankSA.

278 Our review focused on lending practices in place from 1 January 2013 to mid-July 2017. We selected January 2013 as a starting point to coincide with the commencement of the enhanced consumer protections for reverse mortgages that were introduced through the Credit Enhancements Act.

279 As part of our review, we:

(a) reviewed lending policies and procedures;

(b) examined records for 111 consumer loan files (loan file review);

(c) collected and analysed quantitative data on 17,349 loans;

(d) commissioned independent consumer research involving in-depth interviews with 30 randomly selected borrowers;

(e) reviewed consumer complaints made to ASIC, the lenders in our review, and an EDR scheme; and

(f) conducted closed consultations with industry and consumer groups.

280 We would like to thank the lenders who participated in our review and the other stakeholders we consulted for their help in each stage of this work.

What the review involved

Review of policies and procedures

281 We examined the policies and procedures that each lender had in force for providing credit for reverse mortgages. The primary purpose of this work was to better understand the formal procedures that lenders had in place to offer reverse mortgages.

Loan file review

282 We randomly selected and individually examined 111 consumer loan files to better understand the extent to which:

(a) consumers had received independent advice about their loan from a lawyer, accountant, financial counsellor, or other professional, and how lenders had documented a record of this advice;

(b) lenders made responsible lending inquiries into the needs and objectives and financial situation of consumers, and how credit assessments had been completed; and

(c) loans exhibited particular characteristics, such as non-borrower residents living in the security property.

283 We selected a total sample size of at least 105 loan files to provide an appropriate level of statistical confidence for our observations from this review. The number of loan files we examined from each lender was proportional to the total number of reverse mortgages they had originated during the loan file review period of 1 January 2013 to 30 December 2016.

284 Loan files were randomly selected from each lender within the review period by using a random number generator to identify specific loans based on the order in which they had been originated.

285 We did not collect or examine loan files from brokers to verify the quality of inquiries made by brokers for the preliminary assessment.

Quantitative data collection

286 We liaised extensively with lenders to develop an appropriate data collection framework for this review. Overall, we collected 53 separate data attributes (e.g. approved credit limit at origination, date the loan was approved) for each reverse mortgage originated by the lenders in our review between 1 January 2013 and 31 May 2017.

287 Broadly, our data collection framework included:

(a) loan and borrower identification;

(b) information about the security property;

(c) the loan application itself;

(d) details about the loan; and

(e) borrower details and demographics.

288 In constructing this framework, we gave each lender an opportunity to give feedback on a draft set of data definitions and a list of data attributes for potential collection. We then finalised this framework in consultation with lenders, taking into account the practical feasibility, forensic value and anticipated obstacles of collecting each data attribute.

289 This consultation process included a pilot stage, during which we gave each lender an opportunity within a fixed time period to supply voluntary pilot data to ASIC (consisting of either real or synthetic data). This process allowed lenders to verify the capabilities of their data systems and extraction processes, and to verify that the format of this data would comply with our expectations. Each lender participated in this pilot process before receiving the final copy of our data collection framework.

290 Each submission of data that we received from lenders was subjected to a structured process of profiling and validation. This allowed us to identify possible errors and issues of interpretation specific to the particular business practices and data reporting systems of each lender.

291 The steps in this process included the following:

(a) *Profiling*—We reviewed statistical summaries and distributions for possible errors and interpretational issues.

(b) *Individual variable validation routines*—We checked each data point to ensure it could be interpreted and that it met the data definitions set out in our final data request.

(c) *Individual variable recoding and standardisation routines*—We fixed common coding errors identified in previous data submissions to ensure that the data from each lender was coded on the same basis

(d) *Lender-specific record treatments*—We identified and fixed or removed specific individual attributes or loan records. For example, one lender had included data for a small number of records for loan applications that had been commenced but never completed. These corrections were applied manually to the processed data set.

Quantitative data analysis

292 Our data analysis was based on certain assumptions about:

(a) age, gender and marital status of borrowers;

(b) equity erosion; and

(c) market concentration.

Age, gender and marital status of borrowers

293 To calculate the age of the borrowers when they took out the loan, we used the age of the youngest borrower whenever there was more than one borrower for a loan.

Equity erosion

294 Data from the Australian Institute of Health and Welfare states the average age of entry to permanent residential aged care is 84 years and rising. We have used this age as a benchmark reference point for assessing a borrower's ability to afford aged care. We then used the actual age of each borrower to determine how long the loan would continue until they reached 84 years.

Note: See Australian Institute of Health and Welfare, National Aged Care Data Clearinghouse, *Admissions into aged care*.

295 There are some limitations to this approach:

(a) it excludes loans where the youngest borrower was 84 or older at the time of extraction (2,162 loans were excluded for this reason);

(b) not all borrowers will retain the reverse mortgage until they move to aged care, for example, they may downsize to a more affordable property before moving to aged care; and

(c) the number of years the borrower will be in the reverse mortgage will vary depending on age at entering the reverse mortgage; and

(d) the upfront payment for aged care will vary and is means tested.

296 Aged care providers advertise maximum upfront accommodation payments. Prospective residents and aged care providers may agree on a lower amount. The average agreed upfront accommodation payment from 1 July 2016 to 6 April 2017 was $380,000.

Note: See Aged Care Financing Authority (ACFA), *2017 Annual report on the funding and financing of the aged care industry* (July 2017).

297 We used this amount as a benchmark in our analysis for the upfront cost of independently paying for aged care. To take into account anticipated increases in accommodation costs, we inflated $380,000 by 3% per year for each borrower in the dataset to age 84 years.

298 Calculating the actual cost of aged care for a particular individual can be complex. If a borrower does not exceed certain income or asset tests, the Australian Government generally covers accommodation costs up to a specified amount.

299 Residents can also choose to pay an accommodation contribution or an accommodation payment through:

(a) a lump-sum ‘refundable accommodation contribution’ or ‘refundable accommodation deposit’ (we refer to this as an ‘upfront accommodation payment’);

(b) rental-style payments called a ‘daily accommodation contribution’ or ‘daily accommodation payment’ (we refer to this as a ‘daily accommodation payment’); or

(c) a combination of both.

300 A borrower who does not want to leave an inheritance may be comfortable with paying a lower upfront accommodation payment and paying a higher daily accommodation payment. Accommodation contributions are based on income and assets tests, so a borrower who receives less from the sale of their home due to equity erosion from a reverse mortgage may be required to pay a lower accommodation contribution.

301 In considering how equity erosion may affect borrowers, we also assumed that borrowers:

(a) did not make voluntary repayments; and

(b) may have withdrawn the full amount of the loan in a lump sum if they took a line of credit.

302 We made these assumptions because lenders:

(a) have authorised borrowers to do these things (so for these borrowers there is a possibility of erosion of equity); and

(b) do not ask borrowers how they anticipate drawing down on the loan beyond simple inquiries about purpose.

303 Of the 17,349 loans for which we obtained data, 152 loans were excluded from this analysis because missing property valuation data was not supplied, and 33 loans were excluded because the borrower was older than 84 years of age when they applied for the loan.

Market concentration

304 The Herfindahl-Hirschman Index (HHI) is calculated by squaring the market share of each firm competing in the market and then adding the resulting numbers. For example, for a market consisting of four firms with shares of 30%, 30%, 20%, and 20%, the HHI is 2,600, (302+302+202+202=2,600).

305 The HHI takes into account the number of firms in a market and their relative size distribution. It approaches zero when a market has a large number of firms of relatively equal size (more competitive) and reaches its maximum of 10,000 points when a market is controlled by a single firm (monopoly).

306 The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. The benefit of the HHI over other concentration measures is that it gives proportionately greater weight to the market shares of the larger firms, in accord with their relative importance in competitive interactions.

307 When assessing the HHI, we used the benchmarks from the Competition and Markets Authority (CMA) and the Financial Conduct Authority (FCA) in the United Kingdom—that is, if the HHI is:

(a) greater than 2,000, the market is considered highly concentrated;

(b) between 1,000 and 2,000, the market is considered moderately concentrated; or

(c) below 1,000, the market is considered to have low concentration.

308 We used a number of models to determine the HHI for the reverse mortgage market in Australia, including adjusting the result for our data having only captured close to 90% of the market and treating lenders who are divisions of other lender in the market separately or as one entity.

Consumer research

309 We commissioned Essence Communications to carry out qualitative research with consumers who had a reverse mortgage.

310 Essence Communications spoke with 30 borrowers, of whom 15 had taken out a reverse mortgage from 1 April 2017 to 30 June 2017 (recent borrowers) and 15 who had taken out the reverse mortgage between 1 July 2013 and 30 June 2015 (established borrowers). Interviews were conducted in metropolitan and regional locations around Australia.

311 To source participants for this research, we obtained contact lists from each of the lenders in our review using our compulsory information gathering powers. We wrote to these borrowers, inviting them to participate in this research. Borrowers who were interested then contacted us and gave permission for Essence Communications to contact them and carry out the research.

312 Because we received more interest in this study than the number of places that were available, we set quotas for the number of borrowers that would be interviewed from each lender, by State/Territory, by geographical area type (urban, rural) and by the amount borrowed, to collect a representative sample. The quota on the number of borrowers we interviewed from each lender was roughly consistent with the number of reverse mortgages that each lender had originated during the review period.

Table 16: Consumer research sample frame

Lender	Recent borrowers	Established borrowers	Total borrowers interviewed
Lender A	5	6	11
Lender B	1	3	4
Lender C	3	4	7
Lender D	4	1	5
Lender E	2	1	3
Total interviews	**15**	**15**	**30**

313 Essence Communications randomly selected the consumers who would participate in this research from each quota.

314 The research itself involved one-to-one qualitative interviews with consumers who had taken out the reverse mortgage. Interviews lasted approximately one hour and were conducted in the consumer's home or over the phone between 24 October and 14 November 2017.

315 The interviews explored:

(a) why consumers take out reverse mortgages;

(b) where and how they obtain information and advice during the purchase;

(c) how well they understand the product and its risks;

(d) the processes they go through to purchase; and

(e) how having a reverse mortgage has impacted their life-style and financial well-being.

316 There are limitations to this research. Our research was qualitative in nature. This provides in-depth understanding about the motivations, behaviour and knowledge of consumers. Due to the small sample sizes, qualitative research cannot be generalised to the wider population; it is used for illustrative purposes only.

317 As the consumers who participated in the research self-selected, there is a risk that we only spoke to those who were very engaged with their reverse mortgage product. They may be more knowledgeable about the product than reverse mortgage customers in general.

318 All interviews were carried out with consumers after the fact. This means there may be some post-rationalisation biases in the interviews as consumers justify their actions or they may have simply forgotten all the details of the process of taking out the reverse mortgage.

Stakeholder consultations

319 We had closed consultations with over 30 external stakeholders, including but not limited to:

(a) government departments and agencies;

(b) industry bodies which represent credit and financial services providers;

(c) industry bodies which represent lawyers, accountants and financial counsellors;

(d) consumer advocacy groups and legal centres;

(e) credit providers outside the scope of our review;

(f) academics;

(g) brokers; and

(h) international regulators.

320 Stakeholders consulted with us over phone or through written submissions. From this process, we sought to better understand perspectives about:

(a) the benefits, disadvantages, and risks of a reverse mortgage;

(b) factors affecting the market for reverse mortgages;

(c) the experience of consumers who took out a reverse mortgage, including their understanding of a reverse mortgage and how they received information about a potential loan; and

(d) the regulatory framework for reverse mortgages, including the responsible lending obligations.

Appendix 2: Regulation in other jurisdictions

Table 17: Overview of reverse mortgage lending in other jurisdictions

Country	Regulatory framework	Current market	Regulatory requirements
United States	Home equity conversion mortgages are provided by non-government lenders, but are insured by the Federal Housing Administration (FHA), part of the US Department of Housing and Urban Development. Nearly all reverse mortgages are home equity conversion mortgages. The Consumer Financial Protection Bureau (CFPB) provides oversight of the provision of reverse mortgages. State regulators also provide oversight. Note: See CFPB, *Reverse mortgages: Report to Congress*, 28 June 2012; Kimkiewicz, Melissa, 'State regulators have their eye on reverse mortgages' *National Mortgage News,* 26 July 2017.	Applications peaked in 2009 with around 115,000 approvals for these products, and has since stabilised to around 50,000 approvals. Home equity conversion mortgages are the only reverse mortgage insured by the FHA. As at 2017, the maximum loan limit is set at $636,150.	Reverse mortgages insured by the FHA have certain requirements, including: • borrowers must be 62 or older; • borrowers or their estates are not liable for loan balances that exceed the value of their home and lenders are guaranteed they will be repaid in full; • borrowers are guaranteed access to the full amount authorised, even if the lender experiences financial difficulty (where the borrower does not take the full amount at settlement); and • independent financial counselling is required for all borrowers; and • cross-selling of other financial products is prohibited.
United Kingdom	Reverse mortgages (known as lifetime mortgages) are regulated by the FCA. Home reversion products are also regulated under the same framework. Loans are provided by non-government lenders, frequently insurance companies. Note: See FCA, *Mortgages and home finance: Conduct of business sourcebook* (PDF, 1.5 MB), Consultation Paper 16/21, September 2016, (PDF 1 MB).	Applications peaked in 2008. In 2016, £2.15 billion of loans were written. As of August 2017, there were 78 different product options available from members of the Equity Release Council, compared to 24 product options a decade ago. The maximum LVR available in the market is 50%. Note: See Institute fur Finanzdienstleistungen e.V., *Study on equity release schemes in the EU,* Pt 1, 2007.	The FCA recently clarified the requirements for responsible lending inquiries for reverse mortgages to make it easier for providers to offer a type of lifetime mortgage that allows consumers to choose when to stop making interest payments. Affordability assessments are no longer required for these mortgages (bringing them into line with other types of reverse mortgages). Lenders must give consumers key facts illustrations. Voluntary repayments are not always possible and there may be charges.

Country	Regulatory framework	Current market	Regulatory requirements
New Zealand	In 2008 the Ministry of Social Development developed a code of standards for reverse mortgages. The code is voluntary and not legally binding. There are general protections under the Consumer Guarantees Act. Most lenders also comply with the NZ Government's Responsible Lending Code, although it is not legally binding. Note: See Deloitte report re NZ reverse mortgages and NZ Government's reverse mortgages website.	The total value of the NZ market is similar to the pre-global financial crisis period. However, the number of mortgages has been decreasing while the average loan size has increased. In December 2008 there were 6,878 reverse mortgages with an average loan size of $62,516 compared to 5,338 reverse mortgages with an average loan size of $83,229 in December 2013. There are two lenders in the market.	The voluntary Code of Standards provides for: • lifetime occupancy; • a no negative equity guarantee; • clear explanations of the conditions, charges, costs and responsibilities; • independent legal advice before taking out the loan; and • access to an independent complaints process.
Japan	There is a mix of government-backed and non-government-backed reverse mortgages. The Ministry of Health, Labour, and Welfare introduced a national government reverse mortgage program in 2002. Private banks also offer reverse mortgages (which account for nearly half of current loans). Note: See Kobayashi, Masahiro et al ' The reverse mortgage market in Japan and Its challenges', *Cityscape: A Journal of Policy Development and Research,*19 (2017) 1, 99, and Kojima,Toshiro, 'How to make reverse mortgages more common in Japan' Nomura Journal of Capital Markets 4 (Spring 2013) 4.	Reverse mortgages are not very popular in Japan; they generally require interest payments to be made during the course of the loan and do not guarantee lifetime tenure and therefore would not be called reverse mortgages in Australia.	Some of the loans from private banks are non-recourse in terms of the personal assets of borrowers, while others require heirs to be responsible for the remaining balance. In some cases, to protect borrowers and their heirs, special counselling is conducted before the conclusion of the contract. Alternatively, many lenders require prior consent by the reasonably presumed heirs to dispose of the property to avoid conflict at inheritance.
South Korea	The Korea Housing Finance Corporation (KHFC) Law was amended in 2007 to allow KHFC to guarantee reverse mortgage products provided by private financial institutions. KHFC is owned by the government and central bank of South Korea.	More than 20,000 people have applied for KHFC-sponsored reverse mortgages.	The main features of the reverse mortgage products sponsored by KHFC are as follows. • borrower age must be 60 years or older; • house price must be less than 900 million South Korean won ($US 800,000 equivalent); • 3-month certificate of deposit + 1.1% interest rate; and • KHFC-sponsored reverse mortgage products include an incentive to reduce property tax by 25%.

Appendix 3: Accessible versions of figures

321 This appendix is for people with visual or other impairments. It provides the underlying information for the figures presented in this report.

Table 18: Percentage of borrowers with at least $200,000 of remaining home equity by age 84, if economic conditions change

Scenario	Change to property prices	Change to interest rates	Percentage of borrowers
Scenario 1	Rise by 3% p.a.	No change	96%
Scenario 2	Rise by 3% p.a.	Rise by 3%	90%
Scenario 3	No change	No change	74%
Scenario 4	No change	Rise by 3%	53%

Note: This is the data contained in Figure 1.

Table 19: Percentage of borrowers with at least $380,000 of remaining home equity by age 84, if economic conditions change

Scenario	Change to property prices	Change to interest rates	Percentage of borrowers
Scenario 1	Rise by 3% p.a.	No change	67%
Scenario 2	Rise by 3% p.a.	Rise by 3%	53%
Scenario 3	No change	No change	34%
Scenario 4	No change	Rise by 3%	24%

Note: This is the data contained in Figure 2.

Table 20: Credit limit as a percentage of the maximum permitted loan size (by loan type)

Credit limit as a percentage of the maximum permitted LVR	Lump sum	Line of credit	Income stream	Combination
60%	4%	3%	5%	3%
65%	3%	3%	0%	3%
70%	3%	3%	7%	3%
75%	3%	3%	5%	2%
80%	4%	3%	11%	5%
85%	3%	3%	9%	2%
90%	4%	3%	7%	7%

Credit limit as a percentage of the maximum permitted LVR	Lump sum	Line of credit	Income stream	Combination
95%	3%	4%	5%	3%
100%	49%	49%	27%	47%
105%	2%	1%	5%	5%
110%	1%	0%	7%	2%

Note: This is the data contained in Figure 3.

Table 21: Effect of interest rate on total interest charges (year 3)

Year	10.3% interest rate	8.3% interest rate	6.3% interest rate
0	$118,627	$118,627	$118,627
5	$183,063	$172,482	$162,497
10	$305,861	$260,959	$222,590
15	$511,030	$394,820	$304,906
19	$770,521	$549,871	$392,189

Note: This is the data contained in Figure 4.

Table 22: Effect of house price growth on remaining equity

Year	0% growth	3% growth	5% growth
0	$513,971	$513,971	$513,971
5	$470,101	$570,858	$644,876
10	$410,008	$627,569	$807,846
15	$327,692	$680,661	$1,010,220
19	$240,409	$717,076	$1,206,355

Note: This is the data contained in Figure 5.

Table 23: Effect of loan duration on total interest charges

Year	Interest
0	$0
5	$43,870
10	$103,963
15	$186,279

Note: This is the data contained in Figure 6.

Table 24: Effect of LVR on remaining equity

Year	Higher LVR	Lower LVR
0	$400,000	$375,000
5	$441,355	$406,785
10	$480,740	$432,935
15	$514,564	$448,459
19	$534,059	$448,386

Note: This is the data contained in Figure 7.

Table 25: Distribution channels for reverse mortgages

Lender	Direct	Broker
Lender 1	95%	5%
Lender 2	88%	12%
Lender 3	45%	55%
Lender 4	41%	59%
Lender 5	0%	100%

Note: This is the data contained in Figure 9.

Table 26: Percentage of borrowers at origination (by age and gender)

Age	Females	Males
60–64	3.1%	1.2%
56–69	17.1%	9.9%
70–74	16.9%	13.4%
75–79	10.5%	10.3%
80–84	5.4%	5.5%
85–89	2.6%	2.1%
90+	1.3%	0.7%

Note: This is the data contained in Figure 10.

Table 27: Distribution of the market value of the secured properties

Market value of secured property	Percentage of loans
$100,000–200,000	2.69%
$200,000–300,000	12.75%
$300,000–400,000	19.86%
$400,000–500,000	16.28%
$500,000–600,000	12.27%
$600,000–700,000	8.51%
$700,000–800,000	6.03%
$800,000–900,000	4.96%
$900,000–1 million	3.64%
$1–1.1 million	2.28%
$1.1–1.2 million	2.09%
$1.2–1.3 million	1.81%
$1.3–1.4 million	1.29%
$1.4 million+	5.44%

Note: This is the data contained in Figure 11.

Table 28: Percentage of loans with no remaining equity at age 84

Change in interest rates	-3% property growth	0% property growth	3% property growth
+0%	8%	0%	0%
+1%	15%	0%	0%
+2%	23%	2%	0%
+3%	30%	6%	0%
+4%	37%	15%	0%
+5%	44%	23%	2%

Note: This is the data contained in Figure 12.

Table 29: Percentage of loans with no remaining equity after 10 years

Interest rate change	-3% property growth	0% property growth
+0%	2%	0%
+1%	3%	0%
+2%	6%	0%
+3%	10%	2%
+4%	14%	3%
+5%	34%	5%

Note: This is the data contained in Figure 13.

Table 30: Percentage of loans where borrowers applied for a top-up shortly after taking out the loan

Lender	Percentage of loans
Lender 1	26%
Lender 2	13%
Lender 3	4%

Note: This is the data contained in Figure 14.

Table 31: Percentage of loans with less than $380,000 equity at age 84

Interest rate change	0% property growth	3% property growth	5% property growth
+0%	78.3%	55.7%	35.1%
+1%	80.1%	58.7%	37.9%
+2%	81.9%	62.3%	41.0%
+3%	83.4%	65.8%	44.9%
+4%	84.7%	69.6%	49.3%
+5%	85.9%	72.8%	54.4%

Note: This is the data contained in Figure 15.

Table 32: Percentage of borrowers with lower home equity at age 84, if interest rates rise by 3%

Remaining home equity (%)	Percentage of borrowers if interest rates stay the same	Percentage of borrowers if interest rates rise by 3%
20–30%	0.0%	1.4%
30–40%	0.0%	7.4%
40–50%	0.1%	15.9%
50–60%	5.4%	23.4%
60–70%	42.1%	20.5%
70–80%	27.5%	15.1%
80–90%	18.3%	12.2%
90–100%	6.6%	3.7%

Note: This is the data contained in Figure 16.

Table 33: Percentage of borrowers with lower home equity at age 84, if property prices stay the same

Remaining home equity	Percentage of borrowers if property prices rise 3% p.a.	Percentage of borrowers if property prices stay the same
20–30%	0.0%	1.4%
30–40%	0.0%	7.1%
40–50%	0.1%	15.8%
50–60%	5.4%	23.5%
60–70%	42.1%	20.5%
70–80%	27.5%	15.2%
80–90%	18.3%	12.3%
90–100%	6.6%	3.8%

Note: This is the data contained in Figure 17.

Table 34: Market concentration for reverse mortgages

Year	Herfindahl-Hirschman index (HHI)
2014	4,189
2015	3,039
2016	2,954
2017	3,195

Note: This is the data contained in Figure 18.

Table 35: Percentage of loans secured against properties with non-borrower residents

Lender	Percentage of loans
Lender 1	6%
Lender 2	11%
Lender 3	17%
Lender 4	21%

Note: This is the data contained in Figure 19.

Table 36: Entities that borrowers used to satisfy the financial guidance requirement for a reverse mortgage

Entity	Number of loans
Accountant	16
Financial adviser	11
Solicitor	2
Not disclosed	1

Note: This is the data contained in Figure 20.

Key terms

Term	Meaning in this document
ABA	Australian Bankers' Association
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACFA	Aged Care Financing Authority
ADI	Authorised deposit taking institution
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act
age pension	As defined under s23 of the Social Security Act
ALRC	Australian Law Reform Commission
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
borrower	A person that has taken out a reverse mortgage
broker	Generally, a member of the sector of the credit industry that provides independent home loan credit assistance (i.e. reverse mortgage credit assistance where the credit assistance is secured by real property and neither the licensee nor its representatives will be the credit provider)
CMA	Competition and Markets Authority
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of the Act
CPI	The Consumer Price Index is an indicator of the inflation rate run by the ABS. It measures the changing price of a fixed basket of goods and services purchased by the average household in eight capital cities around Australia
credit	Credit to which the National Credit Code applies Note: See s3 and 5–6 of the National Credit Code

Term	Meaning in this document
credit assistance	Has the meaning given in s8 of the National Credit Act
credit contract	Has the meaning in s4 of the National Credit Code
Credit Enhancements Act	*Consumer Credit Legislation (Enhancements) Act 2012*
Credit Enhancements Bill	*Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*
credit licensee	A person who hold an Australian credit licence. Note: See s5 of the National Credit Act
daily accommodation payment	Securing aged care accommodation through rental-style payments (e.g. a 'daily accommodation contribution' or 'daily accommodation payment')
Deloitte report	A report by Deloitte Australia, *Deloitte Australian mortgage report 2018*
EDR	External dispute resolution
equity projection	Projections which illustrate the effect a reverse mortgage may have on the equity in your home over time and show the potential impact of interest rates and house price
equity release products	Products which enable borrowers to obtain money in exchange for an interest in real property
Explanatory Memorandum	The Explanatory Memorandum to the Credit Enhancements Bill
FCA	Financial Conduct Authority (UK)
financial adviser	A natural person providing personal advice to retail clients on behalf of an AFS licensee who is either: • an authorised representative of an AFS licensee; • or an employee representative of an AFS licensee
financial elder abuse	The illegal or improper exploitation or use of funds or resources of an older person
FOS	Financial Ombudsman Service
guidance provider	An accountant, financial adviser or lawyer
HHI	Herfindahl-Hirschman Index
IDR	Internal dispute resolution
lender (or product provider)	A credit provider
LVR	Loan-to-valuation ratio
National Credit Act	*National Consumer Credit Protection Act 2009*

Term	Meaning in this document
National Credit Code	National Credit Code at Sch 1 of the National Credit Act
National Credit regulations	*National Consumer Credit Protection Regulations 2010*
non-borrower resident	A person living in the home (e.g. spouse, partner or other family member) who is not listed on the house title or in the mortgage contract
Productivity Commission report	A report by the Productivity Commission, *Housing decisions of older Australians* (December 2015)
REP 109 (for example)	An ASIC report (in this example numbered 109)
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
residential property	Has the meaning given in s204 of the National Credit Code
responsible lending obligations	The legal obligations set out in Ch 3 of the National Credit Act
reverse mortgage	Has the meaning as in s13A of the National Credit Code
reverse mortgage calculator	The reverse mortgage calculator on ASIC's MoneySmart website
reverse mortgage information statement	Has the meaning as in s5 of the National Credit Act
Social Security Act	*Social Security Act 1991*
tenancy protection provision	A provision which allows a person other than the borrower (i.e. a non-borrower resident) to have a right against the credit provider to occupy the security property when an event that would result in the loan ending occurs Note: See s18B of the National Credit Code
tenancy protection warning	A warning that the reverse mortgage contract does not include a tenancy protection provision Note: See reg 74A and Form 7A of the National Credit Regulations
upfront accommodation payment	Securing aged care accommodation through an upfront lump-sum payment (e.g. a 'refundable accommodation contribution' or 'refundable accommodation deposit')

Related information

Headnotes

Aged care needs, Centrelink payments, consumer credit, elder abuse, financial elder abuse, equity erosion, lenders, loans, LVR, mortgage brokers, responsible lending obligations, reverse mortgages, tenancy protection

Regulatory guides

RG 209 *Credit licencing: Responsible lending conduct*

Legislation

ASIC Act, Subdiv BA

Corporations Act, Ch 7, s761A, 913B

Credit Enhancements Act

National Credit Act, Ch 3, s5, 8, 35, 133D, 133DB

National Credit Code, s4, 5–6, 13A, 18B, 88, 93, 204, Pt 5 Subdiv 1-A

National Credit Regulations, Form 7A, reg 28LC, 74A

National Consumer Credit Protection Amendment Regulation 2013 (No. 2)

Social Security Act, s8(1), (4)–(5), 23, 1118(1)(a)–(b), 1073

Reports

REP 59 *Equity release products*

REP 109 *'All we have is this house': Consumer experiences with reverse mortgages*

REP 224 *Access to financial advice in Australia*

REP 330 *Review of licensed credit assistance providers' monitoring and supervision of credit representatives*

REP 516 *Review of mortgage broker remuneration*

REP 537 *Building seniors' financial capability report 2017*

REP 550 *ASIC's work for older Australians*

REP 565 *Unfair contract terms and small business loans*

Information sheets

INFO 185 *Using ASIC's reverse mortgage calculator*

Other references

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