27 February 2009

Dr Ken Henry
AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Henry

Re: EQUITY RELEASE SUBMISSION FOR RETIREMENT INCOME SYSTEM REVIEW

The National Information Centre on Retirement Investments Inc (NICRI) is funded by the Federal Government through the Department of Families, Housing, Community Service and Indigenous Affairs (FaHCSIA). NICRI provides free, independent information on all forms of investment products and practices. NICRI was established in 1990 and since then has spoken directly to approximately 80,000 consumers, and forwarded over 4.5 million publications on topics ranging from the safety of investment products to the intricacies of superannuation. In 2006, NICRI established an on-line DIY financial planning tool, 'moneymap'.

Due to the escalation of interest in reverse mortgage/equity release products over the past two years, NICRI obtained additional funding through FaHCSIA to establish a 6 month pilot program to provide information to older Australians on accessing the equity in their home. The service commenced on 2 February this year, and is referred to as the Equity Release/Reverse Mortgage Information Service (ERRMIS).

While acknowledging that the purchase of a reverse mortgage product does not impact directly on the income tax system's level of adequacy or inadequacy, there are some concerns relating to the safety of consumers in terms of fairness in ensuring a relatively worry free retirement.

We are therefore taking the opportunity to comment on this aspect of Australia's Future Tax System Retirement Income Consultation paper.

Equity Release in Australia

At present there are two streams of equity release products available in Australia:

- Reverse mortgage, and
- Home reversion scheme.

There are currently 13 active providers of *reverse mortgage* products in Australia, and one provider of a *home reversion* scheme.

a. Reverse mortgage

The most common equity release product is a reverse mortgage. These products are generally on offer to homeowners over the age of 60 and require no repayment until death, sale of home, serious default or moving to aged care. Equity can be released as a lump sum, draw down (income stream) or combination of the two. Figures supplied by SEQUAL (Reverse Mortgage Industry body) shows that in June 2008, 36,600 Australians had a reverse mortgage with around $2.3 billion outstanding. The growth rate in the industry for the 2007/08 financial year was 27% in terms of funds outstanding.

b. Home Reversion Scheme

Home reversion schemes enable a financial institution to purchase a percentage of your property for a set figure. In return, the company keeps the percentage when the house is sold. Homesafe Solutions, sold through Bendigo Bank, is the only current provider of this product in Australia. It has restricted loans to selected Sydney and Melbourne areas.

Future of Equity Release in Australia

ERRMIS believes that the equity release market will increase over time, based on calls through to our service since our launch on 2 Feb, discussions with the industry, and feedback from retirees. In particular, we have identified the following as contributing factors:

- Society is more accepting of the notion of leaving less for dependents to inherit
- Perception of Reverse Mortgages as a mainstream product
- Insufficient age pension leading people to supplement income from other sources
- Low interest rates make the product 'cheaper' (short term factor)
- Appeal of product – no ongoing repayments, guaranteed income, still keep the house.

While ERRMIS agrees that equity release products are an appropriate option for some people, they are not suitable for all. It is evident that they are becoming part of Australia's retirement income landscape. With this in mind, we would like to ensure that safeguards are put in place to protect Australia's retired homeowners. They are a vulnerable group open to exploitation, and they are contributing to the economy by spending the equity in their home. It is essential that they are protected by Government legislation.

While there currently appears to be no major problems with industry practice, we are suggesting some reforms to ensure that retirees are protected into the future…

Recommendations identified are:

1. Break Fee examples to be written into contracts

With the unprecedented drop in interest rates recently, consumers have wanted to escape from higher fixed-rate contracts they entered into over the last few years. Unfortunately, break fees have, in some cases been quite high. We have heard of cases where the break fee is almost the same as the initial loan amount. Break fees will continue to increase as rates decrease further.

While we understand the provider's need to include break fees, we are not sure all clients understand the extent of such fees. Looking at the contracts on reverse mortgages, the true cost of break fees are not made clear. There is a warning that penalties could be high, but how much is high?

Recommendation: *Providers should include examples of break fees on fixed-term contracts. Our suggestion is for providers to include a scenario that shows individuals their break fee 1, 3 and 5 years into the term. Assumptions should include that no repayments are made during the term, and the standard variable rate falls 4% below the relevant fixed-term rate.*

2. Mandatory No Negative Equity Guarantee

The No Negative Equity Guarantee (NNEG) is an agreement with consumers that they will never owe more than the value of the security property at the time repayment is required, except in certain circumstances such as wilful damage, fraud, or sale of the house without consent of the provider. At present this guarantee is offered by SEQUAL members as part of their voluntary code of conduct. Several non-SEQUAL members also offer this guarantee. We are concerned that not all contracts are clear on how the NNEG may be considered void. Some state that a default can lead to voidance of the NNEG, but don't clearly show what type of default. In most cases, default can be remedied through financial restitution. For example, default of a maintenance provision (e.g. not repairing a hot water cylinder) can be remedied by the provider and the cost added on to the reverse mortgage debt. Resort to cancelling the NNEG would be unnecessary in this case.

Recommendation: *The NNEG guarantee should be mandatory for all reverse mortgage or equity release providers. Voidance of the NNEG should be restricted to cases where fraud, wilful damage or sale without consent have resulted in the property value realised being less than the reverse mortgage balance outstanding. In these circumstances, the additional amount payable shall reflect the extent to which the fraud, damage or sale has contributed to the loss. If the contract allows for a protected equity amount, this shall always be protected.*

3. Past Providers

We have identified some issues which could impact clients of equity release products in the future if providers exit the market. These issues include maintaining competitive interest rates, maintaining customer service levels, and ensuring clients can still borrow money up to their *loan to valuation ratio* (LVR). We would like to see these recommendations added in to all new equity release contracts.

Recommendations:

a. ***Guarantee from providers that they will continue to lend to existing clients, or waive any break fee clause.*** – Not all past providers of reverse mortgages allow existing members to borrow more. At present this is due to lack of funding in the current global financial markets. In addition to not being able to borrow more, break fees still apply, making it too expensive for a borrower to unlock further equity via another provider.

   This clearly causes ongoing hardship for some customers. One elderly caller required funds to do some badly needed renovations to her home. Her provider informed her it was not providing reverse mortgage extensions to existing customers. She wanted to refinance with another company, but the break fee imposed would have meant she owed more than her LVR and would not have been able to obtain a reverse mortgage elsewhere. Besides her house, she had no additional assets, and is unable to do the renovation.

b. ***Guarantee that the interest rate will remain within the industry average.*** While past providers are reasonably in line with the market standard variable rate (one was almost 2 percentage points higher, but possibly due to product differentiation), there is nothing to prevent past providers inflating rates in the future. We would like to see contractual provisions capping rates within an agreed range of the ongoing standard variable rate.

c. ***Guarantee ongoing product and client service.*** We experienced a considerable lack of product knowledge from some providers. As they are not providing new reverse mortgage advances, there may be a tendency to become complacent, fail to train new staff on the product, and let service standards slip. Questions concerning a reverse mortgage will be around for the life of the loan and, as the customer ages, it is important that there are experienced people available to assist with their queries.

4. Legal advice

Legal advice appears to be a mandatory requirement of all reverse mortgage providers we have encountered to date. While we agree that this is vital, feedback from the industry and callers suggests that many lawyers will not advise on equity release products. Three key reasons have emerged:

a. Bad publicity from overseas (UK experience), and past failure of some providers in Australia such as *Money for Living* have made lawyers weary when advising on an equity release product.

b. Contracts may be too complex. We highlight the Homesafe Solutions product. While the contract reads well, it also contains complex formulae that require considerable mathematical knowledge to understand.

c. Some lawyers have never encountered a reverse mortgage contract before and are reluctant to charge a client for all the time necessary to read through and research the contract. As a result they decline to provide the client the legal advice required to receive the loan.

These factors have resulted in people being told not to take out a reverse mortgage, people being refused advice, or in some cases, huge legal fees paid for the lawyer to come up to speed on the product before they can check the contract. Fees are often added on to the cost of the reverse mortgage, and also compound over time. We heard one rumour of a legal bill being over $7000 – this would amount to $23,148 over a 15 year period at 8% interest.

We note that the Legal Practitioners Liability Committee has provided practice notes on equity release products, but in general we feel that the legal professions' knowledge of the market could improve.

Recommendation: *The Government funds an independent education program to educate the legal profession on equity release products.* Further, w*e would like to ensure that independent legal advice is mandatory for all equity release contracts, with an onus of proof on the provider to show that advice was obtained*.

5. Ensure homeownership remains with the retiree

Several years ago, *Money For Living* entered the equity release market and purchased houses in exchange for lifetime rental and monthly income. This particular equity release is referred to as a 'Sale and Lease' scheme. The company on-sold the properties and then became insolvent, leaving some customers without their promised income and without ownership of their home. With reverse mortgages (and the Homesafe Solutions product), ownership of the property does not change hands – the mortgagee just holds an interest in the property.

We believe that consumers should be protected from future Sale and Lease schemes.

Recommendation: *To ensure that the Money for Living scenario does not happen again we would like to see a requirement that equity release providers are prevented from taking ownership of the property prior to the loan being funded or investment payment being made.*

6. Victorian Department of Human Services model

The Department of Human Service, Victoria, offers a low-cost home renovation loan (Home Renovation Service). This is available to homeowners on concession cards wanting to do maintenance on their home, up to $10,000. Repayments are as little as $20/week over 15 years. One caller recently was about to sign up to an equity release product and borrow $30,000 – a considerable amount more than required. If she proceeded with this loan she would owe around $67,000 in 10 years time, assuming current interest rates. We suggested it may be in her interest to investigate the Home Renovation Service as an alternative option. She was able to borrow a sufficient amount to cover renovations, meet the repayments, and would still have equity left over for an aged care bond or bequest. Victoria is the only state we are aware of that offers this product.

Recommendation: *That the Commonwealth assists States and Territories to establish Home Renovation Service products across Australia to enable retirees to undertake essential repairs to their homes. Along with the Pension Loan Scheme, such a service would enhance the range of equity release products available to retirees, and provide a low cost way of obtaining small amounts of finance to improve living conditions.*

Conclusion

While these 6 recommendations have been developed over the 4 weeks the service has been running we believe that they will protect consumer rights as equity release products increase in popularity as part of the retirement income landscape in Australia.

ERRMIS expects more issues to be identified as the service progresses over the coming months. We look forward to working with Government on safeguarding the rights of consumers of equity release products, and wish the committee all the best in your research into Australia's retirement income system.

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Director

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