



Determination

29 March 2018

- **Reverse Mortgage**
 - Lender
 - Agency
- **Unsuitable product**
 - Non-disclosure
- **Misleading conduct**

DETERMINATION

Consumers: Consumer A and Consumer B

Financial Services Provider (FSP): FSP

Date: 29 March 2018

Summary

1. I find that the consumers' complaints about representations made to them by a bank have already been the subject of determination by the Financial Ombudsman Service Ltd (**FOS**).
2. I find that the bank was not the agent of the FSP for the purposes of the relevant representations and that the FSP is not liable for those representations.
3. I find that the FSP did not fail to disclose the:
 - (a) amount or scale of the relevant fixed interest rate break charge (**the break charge**), and
 - (b) risks associated with reverse mortgages, including the exposure to variable rates and currency risks from the agreement between the FSP and its wholesale lender.
4. I find that, in the circumstances, the reverse mortgage loans between the consumers and the FSP were not unsuitable, unjust or unconscionable.
5. I find that the break charges imposed by the FSP are not unconscionable or excessive and are in accordance with the law, good industry practice and the contract between the consumers and the FSP.
5. This Determination affirms the position set out in our Review letter dated 17 January 2017 (**the Review**). I do not propose to restate that analysis but instead adopt it for the purposes of this Determination. A copy of the Review is attached.
6. The complaint is not upheld.

Background to the complaint

7. In or about May 2007, the consumers approached an employee at a bank, who assisted them to complete and submit an application, as referrer, for a reverse mortgage with the FSP. The consumers allege that the bank employee told them that the break charge on the fixed interest rate portion on the reverse mortgage loan would be between \$3,000 and \$5,000.
8. On 24 May 2007, the consumers entered into a reverse mortgage loan with the FSP for \$30,000, which was split into two parts:
 - (a) \$15,000 in a loan with a fixed interest rate of 8.59%, and
 - (b) \$15,000 in a variable rate account with a variable interest rate of 8.99% per annum.

9. The loan was secured by a first registered mortgage over the consumers' residential property.
10. On 12 November 2007, the consumers requested the FSP change the variable rate account facility interest rate from a variable rate to a fixed rate at 8.59% per annum.
11. On 31 January 2008, the consumers were given a further advance of \$29,000 at the same fixed interest rate of 8.59% per annum. The further advance increased the loan balance to \$59,877.42 inclusive of interest.
12. On 17 July 2012, the FSP told the consumers that the likely break charge, if they paid out the balance of the loan, would be a further \$52,450. In 2012, the consumers lodged a complaint about the bank with FOS.
13. On 28 August 2015, FOS issued its final Determination which found that the bank had no involvement in the consumers' decision to fix the interest rate of their loan, and was not liable for any loss incurred by the consumers as a result of being charged a break fee.
14. On 26 August 2015, the consumers discharged the reverse mortgage for an amount which included a break charge of \$48,250.
15. On 31 December 2015, the consumers lodged their complaint with the Credit and Investments Ombudsman Ltd (**CIO**) against the FSP.

Key issues

16. The key issues to be decided in this Determination are whether:
 - (a) I can make any further determination in relation to the representations which the consumers allege were made by the bank,
 - (b) the FSP is responsible for those representations if they were made,
 - (c) the FSP failed to disclose to the consumers the:
 - (i) amount or scale of the relevant fixed rate break charge (**the break charge**), and
 - (ii) risks associated with reverse mortgages, including the exposure to variable rates and currency risks from the agreement between the FSP and its wholesale lender.
 - (d) the reverse mortgage loan agreement was unsuitable, unjust or unconscionable; and
 - (e) the break charge is excessive and not in accordance with the law, good industry practice or the agreement between the FSP and the consumers.

Relevant considerations

17. In making a Determination, I am required to have regard to:
 - (a) relevant legal requirements or rights provided by law to the consumers in relation to the subject matter of the complaint,
 - (b) applicable codes of practice,
 - (c) good practice in the financial services industry, and

(d) fairness in all the circumstances.¹

18. Both the consumers and the FSP have been given the opportunity to provide information in support of their respective positions. I am satisfied that all information provided by the parties has been exchanged between the parties, and that each party is aware of the issues raised in this complaint.

Findings and reasons for decision

19. CIO Rule 10.1(m) states that I cannot deal with a complaint if:

...the complaint has been dealt with by a court, tribunal, arbitrator, OAIC or another EDR scheme...

20. The consumers' complaints about the representations made to them by the bank have already been dealt with by another EDR Scheme, FOS, and I cannot deal with them further.
21. The FSP will only be liable for the representations of the bank, in this case, if the bank was the agent of the FSP when making those representations.
22. The bank was not the actual agent of the FSP as explained in the Review paragraphs 25 - 30. However, the FSP may still be liable for representations by the bank if the FSP "held it out" to be so or if the bank acted as the ostensible or apparent agent of the FSP.
23. The consumers signed a Finance Referral Contract (and authority to disclose personal information) on 22 January 2008, in which they expressly acknowledged that the bank was not acting as the agent of the FSP. There was, therefore, no ostensible or apparent authority for the bank as agent of the FSP.
24. There is no evidence of any further "holding out" by the FSP of the bank as its agent.
25. I find, therefore, that the FSP is not liable for any representations alleged by the consumers to have been made by the bank about the break charge under the reverse mortgage.
26. The consumers allege that FSP did not properly disclose the extent of the possible break charge and the risks of an early redemption of a reverse mortgage with a fixed interest rate.
27. On or about 1 May 2007, the consumers received a booklet entitled "Practical Guide to Reverse Mortgages in Australia" which states among other things:
- (a) if the consumers were to repay all or part of the reverse mortgage early, a break fee may be payable,
 - (b) the advantage of a variable rate is that early repayments do not attract significant break charges,
 - (c) if the consumers were planning to repay a reverse mortgage in a short time frame a variable interest rate may be more suitable than fixed, and
 - (d) consumers are encouraged to obtain financial advice and must obtain independent legal advice.

¹ CIO Rule 12.1 – 9th Edition. All references to CIO Rules in this Determination are references to the 9th Edition Rules.

28. On 2 May 2007, the consumers signed a product disclosure certificate (**PDC**) as part of their application, which acknowledges that key features of the loan had been discussed with the consumers including that the break charge may be payable if the loan was repaid early and that the break charge may be significant.
29. I find that FSP has properly disclosed the likely imposition of a break charge in the event of an early repayment of a fixed interest rate reverse mortgage and that such a charge may be significant.
30. The consumers have also alleged that a fixed interest rate reverse mortgage product was unsuitable for them and that it was unjust or unconscionable for the FSP to enter into such a contract with them.
31. As set out in the Review, the responsible lending obligations under the *National Consumer Credit Protection Act 2009* (Cth) do not apply to the consumers' loan contract and therefore the FSP did not have a positive regulatory obligation to inquire whether a fixed interest rate loan product was suitable to the consumers' needs and objectives and financial position.
32. Protections against unjust contracts or unjust transactions do potentially apply either under the *National Credit Code* (**the NCC**) or the *Contracts Review Act 1980* (NSW). As set out in the Review at paragraphs 60 – 68, there are several factors that mitigate against a finding that the contract in question was unjust:
 - (a) there is no evidence that the consumers had any special disadvantage such as their literacy, language or a disability,
 - (b) the consumers had the benefit of independent legal advice,
 - (c) the disclosure discussed at paragraph 27 above specifically addressed the consumers' complaints in relation to converting a variable interest rate to a fixed rate,
 - (d) there is no evidence that the consumers told the FSP that they intended to pay out the loan early,
 - (e) there is no evidence of any undue influence, pressure or unfair tactics by the FSP to induce the consumers to fix the interest rate on any part of their reverse mortgage either initially or at the later times during the term of the loan when they requested fixed interest rates,
 - (f) it appears the consumers elected to fix the interest rate on their reverse mortgage after making their own inquiries.
33. I do not find that the relevant reverse mortgage is an unjust contract.
34. The FSP must not, according to section 12CA the *Australian Securities and Investments Commission Act 2001* (Cth) (**the ASIC Act**) engage in unconscionable conduct in the provision of financial services. As well as the factors discussed at paragraph 32 above, which largely address the non-exhaustive list of factors in section 12CB of the ASIC Act and to which a court must have regard when considering a claim of unconscionability, it is central to such a claim that the FSP acted against "good conscience" or "business morality."
35. As discussed above, there is no evidence that the FSP:

- (a) was informed by the consumers that they intended to pay out the reverse mortgage early,
 - (b) ignored any such expression of intention, or
 - (c) pressured, persuaded or influenced the consumers to fix the interest rate on their reverse mortgage.
36. I find that the FSP did not engage in unconscionable conduct in relation to the consumers' reverse mortgage.
37. Under section 78(2) of the NCC, fees and charges may removed or adjusted if they are excessive or unconscionable. This would be the case if such a fee did not reflect the real cost of a particular event or exigency to the FSP and if its imposition on the consumer amounted to an attempt to derive an unconscionable profit or benefit.
38. A fixed interest rate loan product provides the FSP which supplies it with a predictable profit which is based on the term of the loan. This then influences how the FSP raises its own capital. In the case of a reverse mortgage, this term is uncertain but may be estimated based on actuarial analysis of the average life expectancy of the borrower. If interest rates fall during the term of the loan, an early payout will result in a loss of profit for the FSP as it will only be able to lend the repaid funds at the new lower rates but will have raised that capital based on higher expected earnings.
39. In relation to the amount of break charge in this case, as set out in the Review at paragraphs 89-100, and as is standard industry practice, the FSP entered into a so-called "hedge" agreement with a third party provider to manage the risk occasioned by fixed interest rate loans when interest rates vary. The FSP has disclosed to CIO, with evidence from its third party provider, the actual cost it incurred by the early payout of the consumers' fixed interest rate reverse mortgage.
40. It appears that this cost was passed on to the consumers in the break charge without any substantial addition.
41. The reverse mortgage agreement between the consumers and the FSP provides for the imposition of the break charge based on the cost of the early payout of the reverse mortgage to the FSP.
42. I find, therefore, that the imposition and amount of the break fee was not excessive or unconscionable in the circumstances.

Determination

43. The complaint is not upheld.



Raj Venga
Ombudsman



Review

17 January 2017

- **Reverse Mortgage**
 - Lender
 - Agency
- **Unsuitable product**
 - Non-disclosure
- **Misleading conduct**

17 January 2017

REVIEW

1. This Review provides the parties with our assessment of the claims made by the consumers.

Summary

2. The consumers' complaint relates to a reverse mortgage they entered into with the financial services provider (**the FSP**) in May 2007. In particular, the fixed rate break cost (**FRBC**) associated with early repayment of the loan.
3. We find that:
 - (a) ABC Bank (**ABC**) was not an agent of the FSP,
 - (b) the consumers were not misled in relation to the FRBC by the FSP,
 - (c) the reverse mortgage was not unsuitable for the consumer's needs, and
 - (d) the FSP disclosed adequate information about the true nature and cost of the FRBC payable for early discharge of the loan. In particular, the FSP is entitled to charge the FRBC as it was disclosed in the loan contracts and we are not aware of any laws it is in breach of.¹
4. Consequently, we are unable to consider the consumers' complaint further.²

Background to complaint

5. In or about May 2007, the consumers approached Ms X, an employee at ABC, who assisted them to complete and submit an application, as referrer, for a reverse mortgage with the FSP.³
6. On 24 May 2007, the consumers entered into a reverse mortgage⁴ loan with the FSP for \$30,000, which was split into two parts:
 - (a) \$15,000 in an Equitytap Fixed for Life loan with a fixed interest rate of 8.59%, and
 - (b) \$15,000 in a Ready Access Variable Rate account with a variable interest rate of 8.99% per annum.

¹ CIO Rule 10.1(d) – Ninth Edition. Any reference to the CIO Rules in this Review is a reference to the ninth edition of our rules.

² CIO Rule 36.1(d).

³ Equitytap Application Kit executed by the consumers on 2 May 2007.

⁴ Equitytap Split Loan Agreement dated 24 May 2007 (**loan agreement**).

7. The loan was secured by a first registered mortgage over the consumers' residential property (**the consumers' home**).
8. On 12 November 2007, the consumers requested the FSP change the Ready Access Variable Rate account facility interest rate from a variable rate to a fixed rate at 8.59% per annum.⁵
9. On 31 January 2008, the consumers were given a further advance of \$29,000 at the same fixed interest rate of 8.59% per annum. The further advance increased the loan balance to \$59,877.42 (inclusive of interest). The loan remained secured by the consumers' home.⁶
10. On or about 20 August 2010, the consumers first contacted the FSP to request the likely FRBC which the FSP noted could be significant due to current market conditions.⁷
11. During the loan, the consumers requested indicative payout figures from the FSP which included a FRBC of:⁸
 - (a) \$36,153 on 31 January 2012,
 - (b) \$52,450 on 17 July 2012,
 - (c) \$29,925 on 29 January 2013,
 - (d) \$13,950 on 3 February 2014,
 - (e) \$29,325 on 8 October 2014,
 - (f) \$39,550 on 7 July 2015,
 - (g) \$38,450 on 20 August 2015, and
 - (h) \$48,250 on 26 August 2015.
12. On 26 August 2015, the consumer discharged the reverse mortgage which included FRBC of \$48,250.⁹

FOS complaint

13. In 2012, the consumers lodged a complaint about ABC with the Financial Ombudsman Service Ltd (**FOS**).
14. On 28 August 2015, FOS issued its final Determination in favour of ABC.¹⁰
15. In the final Determination, FOS found that ABC had no involvement on the consumers' decision to fix the interest rate of their loan which was requested by the consumers' solicitor. Accordingly, ABC was not responsible for any loss by the consumers because:

⁵ Ready Access Option – Interest Rate Switch – Declaration dated 12 November 2007.

⁶ Change by agreement – Increase in principal sum signed by the consumers on 31 January 2008.

⁷ FSP's file notes.

⁸ FSP's indicative discharge quotes addressed to the consumers.

⁹ Statement of Account for loan number– fixed rate.

¹⁰ Determination of Financial Ombudsman – Banking & Finance dated 28 August 2015.

- (a) a loan with a variable rate was not unsuitable for them and met the consumers' overall requirements and objectives,
 - (b) ABC did not mislead the consumers as to break costs since the consumers applied for a variable rate loan,
 - (c) ABC met its disclosure obligations and was not obliged to warn the consumers about break costs for a fixed rate loan since the consumers applied for a variable rate loan, and
 - (d) the break costs on the loan were significant because the consumers changed the interest rate to fixed and that decision did not involve ABC but was made by the consumers through their solicitor.
16. On 31 December 2015, the consumers lodged their complaint with the Credit and Investment Ombudsman Ltd (**CIO**) against the FSP.¹¹

Consumers' claims

17. The consumers claim that:¹²
- (a) they were misled in relation to the amount of the FRBC fee. Ms X, as agent for the FSP, informed them that the FRBC fee would be between \$3,000 and \$5,000,
 - (b) the reverse mortgage was unsuitable for their needs as they required a short term loan that could be repaid early (i.e. within two to three years) without penalty and at a fixed interest rate, and
 - (c) the FSP failed to properly disclose:
 - (i) the amount or scale of the FRBC,
 - (ii) the risks associated with reverse mortgages including, the exposure to variable rates and currency risks from the agreement between the FSP, and its wholesale lender, and
 - (iii) to ABC what constituted a 'substantial amount' for the FRBC.
18. In resolution of the complaint the consumers would like compensation of:
- (a) \$66,000, which they say represents the amount they have been over-charged,¹³ or alternatively
 - (b) \$98,749 representing a refund of the total interest, break fees, administration costs and legal fees incurred should it be determined that the consumers are to be returned to the position they were in before they applied for the loan.¹⁴

¹¹ Complaint form.

¹² Complaint form; Letters from the consumers to CIO dated 15 July 2016, 21 September 2016 and 16 October 2016.

¹³ Letter from the consumers to CIO dated 15 July 2016.

¹⁴ Letter from the consumers to CIO dated 21 September 2016.

FSP's response

19. The FSP says that:¹⁵

- (a) it was unaware the consumers wanted to repay the loan in three years,
- (b) it was not a party to any conversations between ABC and the consumers,
- (c) it was ABC and not the FSP that provided an indicative range for the FRBC of \$3,000 to \$5,000 to the consumers,
- (d) the FRBC on fixed-for-life loans is currently extremely expensive due to the depressed nature of local and global economies with interest rates generally very low,
- (e) to fund the consumers' fixed rate loan the FSP borrowed money on the wholesale market at a fixed rate and it has no option to repay that loan early,
- (f) the FSP is entitled to charge the FRBC as it reflects a third party cost and there is no profit element retained by the FSP. As such, the FSP cannot negotiate the amount of the FRBC charged,
- (g) the reverse mortgage is a fixed-for-life loan which is not meant to be repaid until six months after the borrower has passed away or moved into a long term aged care facility,
- (h) the loan application, loan offer (where independent legal advice was mandatory) and the pre settlement compliance call all refer to significant break costs applying if the loan is repaid early, and
- (i) the consumers initialled the product disclosure certificate acknowledging the key features of the loan including possible significant break costs and an increasing loan balance.

Considerations CIO is required to have regard to

20. In dealing with this complaint, CIO has observed procedural fairness and has had regard to:

- (a) relevant legal requirements and rights provided by law,
- (b) applicable codes of practice,
- (c) good industry practice in the financial services industry, and
- (d) fairness in all the circumstances.¹⁶

21. Both the consumer and the FSP have been given the opportunity to provide information in support of their respective positions.

22. We are satisfied that with the exception of any information considered to be confidential and/or commercially sensitive,¹⁷ all information relevant to this

¹⁵ FSP's letter to the consumer dated 6 May 2013; FSP's email to the consumers on 21 October 2015; Emails from the FSP to CIO dated 8 and 27 September 2016.

¹⁶ CIO Rule 12.1.

complaint received from the FSP and the consumer has been exchanged between the parties.

Was there a relationship of agency between the FSP and ABC?

Relevant considerations

Agency

23. We consider that the FSP will only be responsible for the allegations made against Ms X, if ABC can be considered to be an agent of the FSP.
24. If ABC is found to be an agent of the FSP, then the knowledge obtained by ABC, while acting as agent, may be attributed to the FSP. In the absence of an agency relationship, any knowledge or conduct of ABC cannot be attributed to the FSP.
25. The existence of an agency relationship depends on the particular facts of the case.¹⁸
26. At law, a referrer (such as ABC) is normally considered to be an agent of a borrower, not the lender,¹⁹ and this is notwithstanding the fact that a referrer may receive a fee or commission from the lender.²⁰

Referral Agreement

27. The courts have indicated that:²¹

Agency is to be determined by an analysis of the consensual legal relations between the parties, it is not merely a conclusion drawn from the performance by A of a function, even necessary, to the operation or functioning of the business enterprise of P in question.

28. The FSP has provided a copy of the Referral Agreement (**the Referral Agreement**) which was entered into between the FSP and ABC. The Referral Agreement is effective from 1 July 2006.
29. Among other things, the Referral Agreement provides that the relationship between the FSP and ABC is that of a commercial contractual relationship which does not create a partnership, joint venture or other form of association in which either party may be liable for the acts or omissions of the other.²²
30. The Referral Agreement also provides that:
 - (a) in all its dealings with applicants, ABC acts on its own behalf and not on behalf of the FSP or the applicants,²³

¹⁷ With the exception of the provision of the file notes, swap profiles, the emails from the FSP's wholesale lender, and the Referral Agreement between the FSP and ABC which the FSP considers to be confidential and commercially sensitive. We have summarised or quoted verbatim any information that was said to be commercially sensitive, which we have considered in this Review.

¹⁸ *Branwhite v Worcester Works Finance Ltd* [1969] 1 AC 552 at pp 573, 587; *Custom Credit Corporation v Lynch* [1993] VicRp [1993] 2 VR 469 at 486.

¹⁹ *Custom Credit v Lynch* [1993] VicRp 86 [1993] 2 VR 469 at 486; *Morlend Finance Corp (Vic) Pty Ltd v Westendorp* [1993] 2 VR 284 at 308; *Micarone v Perpetual Trustees* [1999] SASC 265 at 632.

²⁰ *Custom Credit v Lynch* [1993] VicRp 86 [1993] 2 VR 469 at 486 to 487; *Octapon Pty Ltd v Esanda Finance Corp* (unreported, Supreme Court NSW, 3/02/89).

²¹ *Tonto Home Loans Pty Ltd v Taveres & Ors* [2011] NSWCA 389 at 194.

²² Referral Agreement clause 16.3.

²³ Referral Agreement clause 4.1.

- (b) ABC is responsible for the conduct and statements of its staff who make referrals or provide promotional material to applicants,²⁴
- (c) where ABC provide services under the Referral Agreement through its staff, ABC must ensure those persons are suitably qualified,²⁵
- (d) if an application is accepted the applicant is entering into a direct contractual relationship with the FSP,²⁶
- (e) the FSP pays ABC a fee for each successful application,²⁷ and
- (f) ABC has no obligations to the FSP in its capacity as the business introducing party except as expressly stated in the agreement.²⁸

Disclosure

- 31. At law, if a contract is signed by a person, he or she is generally taken to have accepted, and will be bound by, the terms of the contract whether or not they have read it.²⁹
- 32. We also note that on or about 22 January 2008, the consumers acknowledged that ABC was acting as an independent contractor and was not acting as either the agent of the consumers or the FSP.³⁰

Our findings

- 33. Based on the above, we do not consider that a relationship of agency exists between the FSP and ABC.
- 34. Accordingly, we are unable to consider this aspect of the consumers' complaint further.³¹

Did the FSP mislead the consumer about the FRBC?

Relevant Considerations

- 35. Misleading or deceptive conduct is prohibited under section 12DA(1) of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**). The obligation not to mislead or deceive is also consistent with good industry practice.³²
- 36. The FSP's conduct will only be misleading if it causes a mistaken belief as to the true position.³³
- 37. To consider the consumers' claims, it is necessary to establish, among other things:

²⁴ Referral Agreement clause 6.1.

²⁵ Referral Agreement clause 6.2.

²⁶ Referral Agreement clause 7.6.

²⁷ Referral Agreement clause 8.1.

²⁸ Referral Agreement clause 13.4.

²⁹ See *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165.

³⁰ Finance Referral Contract (and authority to disclose personal information) signed by the consumers dated 22 January 2008.

³¹ CIO Rule 36.1(d).

³² Such as: clause 4.7(c) of the Mortgage and Finance Association of Australia Code of Practice, and Key Promise 1 of the Customer Owned Banking Code of Practice.

³³ *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* [1982] HCA 44.

- (a) what representation was made to them, and
- (b) whether the representation was misleading in the circumstances.

What representation was made to the consumers?

38. The representations allegedly made to the consumers were that:
- (a) the reverse mortgage product was suitable as a short term loan,
 - (b) the FRBC would be in the vicinity of \$3,000 to \$5,000, and
 - (c) the interest rate should be fixed.
39. We note that the consumers have stated that the representations were made by:
- (a) ABC, and/or
 - (b) ABC as the FSP's agent.
40. A referrer such as ABC is generally considered to represent the borrower, not the lender.³⁴
41. As noted above, the Referrer Agreement confirms the relationship is contractual in nature such that ABC does not act as the FSP's agent.
42. Consequently, the FSP is not responsible for ABC's conduct.³⁵
43. As there is no agency, we have only considered the FSP's conduct towards the consumer.

Did the FSP make the representation?

44. Relevantly, the consumers have stated that the only persons involved in assisting them at the time of the initial application were:³⁶
- (a) Ms X of ABC, and
 - (b) their solicitor, Mr Z.
45. The FSP has indicated that the first direct contact with the consumers was a compliance call conducted with consumer B on 21 May 2007.³⁷
46. The information available therefore does not support the consumers' claims that the FSP represented that:
- (a) the reverse mortgage product was suitable as a short term loan,
 - (b) the FRBC would be in the vicinity of \$3,000 to \$5,000, and
 - (c) the interest rate be fixed.

³⁴ *Custom Credit Corporation Ltd v Lynch* [1993] 2 VR 469 at 486.

³⁵ CIO Rule 10.1(e).

³⁶ Letter from the consumers to CIO dated 15 July 2016.

³⁷ FSPs filenotes. FSP's Initial Review response dated 27 September 2016.

47. Consequently, we cannot conclude that any such representations were made by the FSP.

Our finding

48. We find that the FSP did not mislead the consumer into believing the alleged representations because it does not appear that the FSP had any contact with the consumer during the loan application process.
49. Therefore, we cannot consider this claim any further.³⁸

Was the loan unsuitable for the consumer?

Relevant Considerations

Responsible lending obligations

50. At the time that the consumers applied for the loan in May 2007 which was varied in January 2008, the law did not impose a positive obligation on a credit provider (such as the FSP) to assess whether the loan was unsuitable.
51. Following the introduction of the *National Consumer Credit Protection Act 2009 (National Credit Act)* on 1 July 2010, credit providers are now required by law to assess whether the financial product being applied for is not unsuitable for the borrower.³⁹
52. However, because the consumer's loan was entered into before the introduction of the responsible lending obligations, we are unable to have regard to them because they do not operate retrospectively.
53. Given the above, we will next turn to the consideration of whether the consumer's loan was otherwise an unjust transaction.

Unjustness

54. If a credit contract is not regulated by the NCC, it cannot be found to be unjust under the NCC.⁴⁰
55. Despite the above, a consumer may still claim relief from an unjust contract, if the credit contract is reviewable under the *Contracts Review Act 1980* (NSW) (**CRA**) such as when the loan is secured by property located in New South Wales.
56. Section 7 of the CRA gives the Court the power to reopen or vary credit contracts that are found to be unjust. When dealing with a claim of this type, the Court

³⁸ CIO Rule 36.1(d).

³⁹ Chapter 3 of the NCA sets out the responsible lending obligations of credit providers in relation to credit contracts regulated by the National Credit Code (**NCC**) (**responsible lending obligations**) and entered into after 1 July 2010, sections 128-131.

⁴⁰ *National Consumer Credit Protection Act 2009* (Cth) Schedule 1. We note that from 1 July 2010, the Uniform Consumer Credit Code (**UCCC**), enacted under the *Consumer Credit (Victoria) Act 1995* (Vic), was replaced by the National Credit Code, Schedule 1 to the *National Consumer Credit Protection Act 2009* (Cth) (**NCCPA**). If regulated by the UCCC, this loan would be considered to be a carried over instrument for the purposes of the Code: *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009* (Cth). However, the replacement provisions relating to the National Credit Code's application and presumptions (sections 5 and 13), do not apply to carried over instruments. Accordingly, the corresponding UCCC sections must be utilized (sections 6 and 11 of the UCCC).

must consider a number of factors and all of the circumstances relating to the contract at the time that it was made.⁴¹

57. Case law has demonstrated that certain elements may contribute to the consideration of whether a particular contract was unjust at the time it was made, and these include:
- (a) the purpose for which the loan was obtained,⁴²
 - (b) a lender being willing to lend on the value of security alone and being indifferent to the purpose of the loan,⁴³
 - (c) whether a financier was “*innocent*” of the cause of the unjustness;⁴⁴
 - (d) indifference to the ability of a borrower to service a loan,⁴⁵
 - (e) borrowers having poor educational backgrounds, or being completely uneducated or illiterate,⁴⁶
 - (f) borrowers being commercially inexperienced,⁴⁷ and
 - (g) a failure to obtain independent advice, or for a lender to recommend the obtaining of independent advice.⁴⁸
58. A bad bargain alone is not enough to establish unjustness and “something more” is required to establish that a loan was unjust at the time it was made, such as a borrower being unable to reasonably protect his or her interests⁴⁹ due to factors such as a poor education, language difficulties or little understanding of basic business affairs.

Unconscionable Conduct

59. The *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) contains two sets of provisions dealing with unconscionable conduct.
60. Firstly, there is the general law notion⁵⁰ of unconscionability which requires that the consumer demonstrate that he or she was suffering from a special disadvantage,⁵¹ such as, being illiterate or intellectually disabled.
61. Secondly, there is statutory unconscionability,⁵² which has a wider application than common law unconscionability, as it does not necessarily require the consumer to

⁴¹ UCC section 70(2); and CRA, sections 7 and 9.

⁴² *Perpetual Trustee Co Ltd v Khoshaba* [2006] NSWCA 41 at 42 (**Khoshaba**) at 70 and 104, cited with approval in *Provident Capital v Naumovski* [2013] NSWSC 40 at 207(a) (**Naumovski**).

⁴³ *Khoshaba* at 82 and 104; *Elkofairi v Permanent Trustee Co Ltd* [2002] NSWCA 413 (**Elkofairi**), cited with approval in **Naumovski** at 207(b).

⁴⁴ *Khoshaba* at 96, cited with approval in *Naumovski* at 207(c).

⁴⁵ *Spina v Permanent Custodians Ltd* [2009] NSWCA 206 at 89-90, cited with approval in *Naumovski* at 207(d).

⁴⁶ *Elkofairi* at 53; *Fast Loans Pty Ltd v Samardzic* [2011] NSWSC 19 at 91 (**Fast Fix**); *Riz & 1 or v Perpetual Trustee Australia Ltd & 4 ors* [2007] NSWSC 1153 (**Riz**) at 2, cited with approval in *Naumovski* at 207(f).

⁴⁷ *Fast Fix* at 91; *Khoshaba* 129-130, cited with approval in *Naumovski* at 207(g).

⁴⁸ *Fast Fix* at 95; *Khoshaba* at 75, cited with approval in *Naumovski* at 207(h).

⁴⁹ *Khoshaba* at 128.

⁵⁰ ASIC Act in force as at 4 April 2007, section 12CA.

⁵¹ *Perpetual Trustee Company Ltd v Burniston [No 2]* [2012] WASC 383 at 298 to 300.

⁵² Section 12CB of the ASIC Act contains a non-exhaustive list of factors that a court may have regard to in determining if the supplier of a financial service has engaged in unconscionable conduct.

demonstrate any special disadvantage.⁵³ In this case, a consumer must establish that the conduct complained was highly unethical.

62. Section 12CB(2)⁵⁴ of the ASIC Act provides a non-exhaustive list of factors a court may have regard to when considering a claim of statutory unconscionable conduct.

Our finding

63. The consumers claim that the loan was not suitable for their needs as they required a loan which would be paid off within two to three years.

64. On the information available to us, we note that the consumers:

(a) received the FSP's booklet titled "Practical Guide to Reverse Mortgages in Australia" (**FSP Booklet**) on about 1 May 2007, which provides that:

- (i) to repay all or part of the reverse mortgage early, FRBC may be charged,⁵⁵
- (ii) the advantage of a variable rate is that early repayments do not attract FRBC,⁵⁶
- (iii) if planning to repay a reverse mortgage in a short time frame a variable interest rate may be more suitable than fixed,⁵⁷ and
- (iv) consumers are encouraged to obtain financial advice and must obtain independent legal advice.⁵⁸

(b) obtained independent legal advice from their solicitor, Mr Z.⁵⁹

65. We consider that the FSP Booklet indicates that a variable interest rate would be the suitable option if a consumer would like to repay a reverse mortgage early, such as within two to three years of the loan commencement.

66. We also note that the consumers obtained independent advice from their solicitor who was aware of the consumers purpose for the loan and did not consider the loan to be unsuitable for their needs.⁶⁰

67. Despite the FSP Booklet and after obtaining independent legal advice, the consumers signed the loan agreement splitting half the loan to a fixed interest rate and the other half to a variable interest rate which the consumers converted to a fixed interest rate on 12 November 2007.⁶¹

68. Therefore, we consider that at the time of the loan:

(a) there was no obligation on the FSP to consider suitability,

⁵³ *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell* [2011] NSWCA 389 (21 December 2011) at 291.

⁵⁴ ASIC Act in force as at 4 April 2007.

⁵⁵ FSP Booklet page 14.

⁵⁶ FSP Booklet page 15.

⁵⁷ FSP Booklet page 16.

⁵⁸ FSP Booklet pages 20 and 21.

⁵⁹ Letter from the consumers to CIO dated 15 July 2016.

⁶⁰ Letter from the consumers to CIO dated 15 July 2016.

⁶¹ Loan agreement and FSP "Ready Access Option – Interest Rate Switch – Declaration" dated 12 November 2007 signed by the consumers.

- (b) the consumers relied on their own enquiries in assessing whether the reverse mortgage was suitable, and
- (c) the consumers elected to fix the interest rate despite the information obtained in the FSP Booklet as to the benefits of variable rates over fixed rates.

Unconscionable conduct or unjust loan

69. As noted above, we can consider whether:

- (a) the loan was unjust under the CRA, and
- (b) by providing the loan, the FSP engaged in unconscionable conduct.

70. Upon review of the considerations specified in the ASIC Act, we note that:⁶²

- (a) there was a material inequality in bargaining power between the FSP and the consumer, however, that inequality did not affect the bargain struck,
- (b) the provisions of the loan were of a standard type that would be characterised as being reasonably necessary for the protection of the FSP's legitimate interests, which includes protecting the FSP against the effect of market fluctuations on wholesale funding costs,
- (c) the terms of the loan agreement do not appear to have been unusual, burdensome, or wrongful (see next section for our consideration on this aspect),
- (d) no undue influence or pressure appears to have been exerted on the consumers,
- (e) the consumers appear to have been well educated and commercially experienced with consumer A being a qualified accountant and lecturer in financial services law,⁶³ and
- (f) the consumers obtained independent legal advice.⁶⁴

71. On the information made available to us, the consumers do not appear to have been at any disadvantage or any special disadvantage when obtaining the loan.

72. Therefore, the loan does not appear to be unconscionable or unjust for the purposes of the ASIC Act or CRA.

73. Accordingly, for the reasons stated above we consider that the consumers' claim that the loan is unsuitable, unconscionable or unjust has not been made out.⁶⁵

Has the FRBC been adequately disclosed?

⁶² ASIC Act in force as at 4 April 2007, section 12CB.

⁶³ FSP's filenotes on 20 August 2010 recording information supplied by Consumer A.

⁶⁴ Declaration by the borrower signed by the consumers dated 1 June 2007.

⁶⁵ CIO Rule 36.1(d).

74. As we understand it, the consumers claim that the FSP failed to properly disclose at the time of the loan that:
- (a) the amount or scale of the FRBC at the time of discharge,
 - (b) the risks associated with reverse mortgages such as the exposure to variable rates and currency risks from the agreement between the FSP, Perpetual and the wholesale funder, and
 - (c) to ABC what constituted a 'substantial amount' for the FRBC.
75. We have set out below our general approach to complaints of this nature, as well as the considerations we will have regard to where a loan is discharged and the consumers incur a break cost.

Our findings

76. We are unable to consider a complaint that relates to a fee that has been properly disclosed in the loan agreement and does not appear to be otherwise in breach of the law or unconscionable.⁶⁶

Disclosure

77. As noted above, if a contract is signed by a person, he or she is generally taken to have accepted and will be bound by, the terms of the contract whether or not they have read it.
78. A lender (such as, the FSP) is required to disclose the amount of a fee or its method of calculation, *if it is ascertainable*⁶⁷. As such, if the amount of a fee or its method of calculation is not ascertainable, a lender is not in breach of the NCC if it does not disclose the amount of the fee or its method of calculation.
79. While no method of calculation was provided, there appears to be extensive disclosure about what factors could be taken into account in calculating the FRBC. The disclosures also warn that the FRBC could be substantial.
80. On or about 1 May 2007, the consumers received the FSP Booklet which states that the early repayment of all or part of a reverse mortgage subject to a fixed interest rate may attract a FRBC.⁶⁸
81. On 2 May 2007, the consumers signed a product disclosure certificate (**PDC**) as part of the application kit which acknowledges key features of the loan had been discussed with the consumers including that FRBC may be payable if the loan was repaid early and that the FRBC may be significant.
82. As well, the FRBC was disclosed on pages 2 and 3 of the loan agreement and at clause 5.5 of the Equitytap General Terms and Conditions dated January 2007 (**T&Cs**). Both documents indicate that the FRBC and the method of calculating the FRBC are not known at the time of entering into the loan agreement.

⁶⁶ CIO 10.1(d).

⁶⁷ UCCC section 15(G).

⁶⁸ FSP Booklet page 14.

83. The loan agreement also notes on page 3 that the term of the loan can potentially be quite long and the FRBC quite large if interest rates fall significantly which has been the case since the consumers' loan was entered into.
84. The T&Cs also explained that FRBCs are charged in order to recover the losses that the FSP would incur if the borrower repaid a fixed rate loan early. Clause 5.5 provides an example situation only.
85. We also note that the consumers signed an Equitytap borrower warranty (**the warranty**) with the loan agreement on 1 June 2007. The warranty includes a number of matters discussed with the consumers during the application process. By signing the warranty, the consumers acknowledged that:
 - (a) they understood the features of the loan,
 - (b) they were obliged to obtain independent legal advice, and
 - (c) they understood that if the loan was repaid early, break costs and deferred establishment fees may apply and that these fees may be significant.

Loan Term

86. One of the key factors that would appear to contribute to the size of the FRBC is the term of the loan. As the interest rate was fixed, a break cost became payable on the discharge of the loan prior to the Fixed Repayment Date, which is six months after a borrower either dies or moves to long-term aged care.
87. However, because there is no way of knowing for certain at the time the loan is entered into when a borrower will die or move to long term care, the actuarial life expectancy of the borrower is used to calculate the fixed rate loan term. It is necessary to know the fixed rate term in order to calculate the break cost if the loan is repaid before the Fixed Repayment Date.
88. This potentially means the term of the fixed rate loan term could be up to 25 years, depending on the age of the borrower at the time the loan is entered into.

Excessive fee

89. A fee may nonetheless be unconscionable if it is not equal to the lender's reasonable costs arising from the early termination or prepayment of the loan, including the lender's reasonable administration costs in respect of the termination or prepayment.⁶⁹
90. Generally speaking, when a lender enters into an agreement with a borrower to fix the interest rate on a loan, it will at the same time also enter into an agreement with a wholesale lender to manage its risk exposure to movements in interest rates. In investment terms, this is known as a "hedge".
91. When a borrower wishes to discharge their loan before the expiry of the fixed interest rate period, the lender will in turn have to terminate its agreement with the wholesale lender. The cost to the lender of doing so is generally passed onto the borrower under the loan agreement. The cost can vary as it is dependent on the inter-bank lending rates known as "wholesale market swap rates" that can change throughout the course of a day.

⁶⁹ UCCC section 72(2).

92. The FSP has provided us with emails from their wholesale lender, ZZZ, showing the break cost quotes provided in both the indicative payout figures and the final payout figure provided to the consumers.
93. Based on our review of the emails provided by the FSP, we are satisfied that the FRBC quoted to the consumer reflect the exact costs that would be incurred by the FSP from ZZZ as a result of the consumer terminating the loan contract early.

Method of calculation

94. As part of our investigation, we also checked to see if the calculation of the break cost under the loan contract was correct.
95. The emails from ZZZ confirm that the break cost is a third party cost to the FSP and one which becomes payable on the early discharge of the loan. It is our understanding that ZZZ calculates the break cost, not the FSP.
96. In addition to the market swap rates, the break cost is also dependent on the fixed rate loan term. This will vary depending on the age of a borrower at the time the loan is discharged. This is because an actuarial life expectancy varies depending on the age of the individual or joint borrower at the time the loan was entered into.
97. The FSP has provided us with information showing that for each reverse mortgage loan entered into, it creates a profile for the borrower to calculate the loan term.
98. This profile takes into account the gender and current age of the borrower and how the loan balance is projected to change each year that the loan balance increases and the age of the borrower changes. These calculations also take into account the changes to the actuarial life expectancy of the borrower (single or joint profile) each year.
99. The profile is provided to ZZZ when the loan is first fixed. If the loan is later discharged and a break cost is payable under the loan contract, ZZZ uses the profile calculations to calculate the break cost based on the market swap rates.
100. Based on the information that has been provided to us, we are satisfied that the break cost has been correctly disclosed in the loan agreement and is a reasonable estimate of a cost that would be incurred by the FSP. We do not consider that the break cost is unconscionable in the circumstances or otherwise in breach of the law.⁷⁰
101. On the information made available to us, we find that the information about the true nature and cost of the FRBC payable for early discharge of their loan was disclosed was adequate.
102. Accordingly, we are unable to consider this aspect of the complaint further.⁷¹

Responding to our Review

103. For the reasons set out above, we are unable to deal with this complaint further.

⁷⁰ CIO Rule 10.1(d).

⁷¹ CIO Rule 36.1(d).

104. If the consumer disagrees with our Review and has further information to indicate that the complaint should remain open, we ask that this be provided to us by no later than **31 January 2017**.
105. If the consumer provides us with new information, we will assess whether this changes the findings set out in this Review. If so, we will notify the parties and continue to deal with the complaint.
106. The consumer can also ask for a Determination. A Determination is made by the Ombudsman and is a final decision about the complaint.
107. If we do not receive a response from the consumer, the Review will become our final decision and the complaint will be closed. We will notify the parties of this.

The consumer must respond by **31 January 2017**. If more time is needed, a request for an extension should be made as soon as possible and, at the very latest, before **31 January 2017**.

Case Manager