

# INDUSTRY SUBMISSION

An Australian Consumer Law  
Fair Markets - Confident Consumers

March, 2009

**Disclaimer:**

This submission was developed by the Author and is based on discussions with a range of market practitioners and research provided by various parties.

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# Background

## Senior Australian's Equity Release Association of Lenders (SEQUAL)

SEQUAL is comprised of the major financial institutions offering Reverse Mortgages. Since its inception as the peak industry body for the Australian Equity Release market, SEQUAL has worked in the interest of the community by imposing high standards of professionalism on those who design and distribute Equity Release products for Senior Australians.

**SEQUAL's main objectives can be found at [www.sequal.com.au](http://www.sequal.com.au)**

In addition to their regulatory and legal obligations, SEQUAL Members must comply with the **SEQUAL Code of Conduct and Guidelines for Application of the Code**. The Code and Guidelines cover members' dealings with borrowers, borrowers' families and borrowers' advisers. Failure to comply with the SEQUAL Code of Conduct could result in a lender being expelled from SEQUAL membership.

SEQUAL has also established an Industry Accreditation protocol in order to raise the professional standards of the Brokers, Planners, Accountants and Lawyers that assist consumers to make informed decisions about Reverse Mortgages. Market practitioners that achieve Industry Accreditation through SEQUAL gain the designation of **Reverse Mortgage Consultant ("RMC")**. The RMC designation forms an important part of SEQUAL's commitment to assisting consumers to easily identify properly-trained market practitioners.

SEQUAL is committed to the development of an ethical and efficient Seniors Equity Release market in Australia.

## Funding Retirement -Equity Release Strategies

There is good reason to explore the options provided through equity release and the family home is now an intrinsic part of the planning process.

The strategies for Equity release through the use of Reverse Mortgages are diverse. For some retirees they are an effective means to supplement income or to provide access to capital. For others, they can be a tool to help manage market volatility. For frail retirees with poor health, it can provide them with choices for accessing the care they need and provides the ability to pay the aged care fees.

When used effectively, Reverse Mortgages can help a retiree to access the significant wealth they have accumulated in an illiquid asset in order to more effectively live the life that they choose.

The availability of Reverse Mortgages is a critical factor for many Senior Australians now approaching retirement with the expectation of living longer than any generation before them and the intention of living well.

## **The Australian Reverse Mortgage Market**

The most recent Deloitte SEQUAL Reverse Mortgage Study found that the Australian Reverse Mortgage market, as at 30 June 2008, consisted of more than 36,600 reverse mortgage loans with total outstanding lending of \$2.3 billion. This represents almost 14% growth over the six months to June 2008 and 27% growth over the 12 months from 30 June 2007.

Whilst demand for Reverse Mortgages is likely to continue to grow due to a number of compelling factors including demographic shift, the supply of Reverse Mortgages has been adversely impacted by the current global financial crisis. This market disruption has constrained the ability of some Reverse Mortgage providers to access funding with the effect that a number of SEQUAL Members have either withdrawn from the market or have significantly scaled-back their participation.

Given the vital public interest issues associated with the existence of a viable Seniors Equity Release market, Government clearly has an important role to perform in encouraging the efficient operation of Australia's financial markets and in particular, ensuring robust competition in the Reverse Mortgage market.

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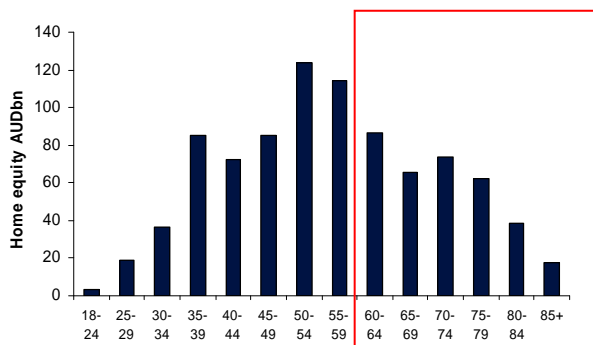
# 1. Property Ownership and the Wealth of Senior Australians

Many retirees have left the workforce poorly prepared via superannuation and other investments to fund their lifestyle until the end of their life. “Australia has a low household savings rate which results in our gross national savings rate rank of 17<sup>th</sup> out of the 28 OECD countries”.<sup>1</sup>

In addition, more recent retirees, part of the so-called Baby Boomer generation, have increased expectations of their quality of life in retirement without significant liquid funds to enable this to be achieved.

*“History, some might say, has been kind to the baby boomers. They have enjoyed affordable housing, access to free education, often generous welfare benefits and frequently favourable employment markets. Now the baby boomers – those people aged between about 45 and 65 years – will have to respond in a very real way to the challenges of an aging population, where the consequences of their actions now and throughout their lives will have ramifications for the generations to follow”.*<sup>2</sup>

The good news is that the majority of Baby Boomers have achieved the “Great Australian Dream” of owning their own home. Total Home Equity (Owner Occupied) was \$887 billion, at the end of 2005. The Over 60s accounted for \$345bn (39%).



Source: Datamonitor

However, the absence of significant levels of savings (superannuation) and a concentration of wealth in an indivisible/illiquid asset (owner-occupied property), has made many Senior Australians “Asset-Rich but Cash-Poor”.

In the past, any retiree in this difficult position, had two choices; significantly reduce their living standards or sell the family home - often having to then move away from an established network of family and friends and in many cases reducing their age pension entitlements.

With the emergence of the Australian equity release market, retirees now have another option – tap into the stored wealth of their home.

<sup>1</sup> IFSA Submission to Australia’s Future Tax System Review. October, 2008

<sup>2</sup> AMP.NATSEM Income and Wealth Report. Issue No. 16. March 2007

## 2. The Seniors Equity Release Market

The dominant Seniors Equity Release product in Australia is the Reverse Mortgage.

Product design in Australia's Reverse Mortgage market is arguably "world-class" on the basis that the local market has benefitted from the lessons learned overseas, the competitive environment created by the involvement of both specialist lenders and major banks and the early establishment of SEQUAL as a peak body directing market practices.

### *How does a Reverse Mortgage work?*

- It is a loan advanced as a lump sum or regular payment to a home-owning senior enabling them to access the equity in their own home.
- No repayments are made during the life of the loan, with the total outstanding payable on death, on sale of the property or on moving out of the home permanently.
- The No Negative Equity Guarantee limits the exposure of the borrower to the value of the property
- The Security is provided in the form of a conventional Mortgage Charge

### *The Size of the Reverse Mortgage Market*

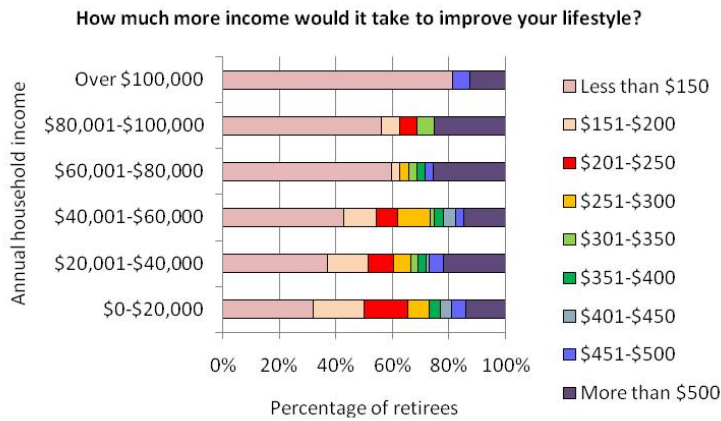
The SEQUAL/Trowbridge Deloitte Reverse Mortgage Study in December 2007 found that:

- There are 33,700 reverse mortgages
- The total outstanding value is \$2.02b
- The average loan size is \$60,000
- \$466m in new loans were drawn down in 2007, (75% of the Loan Facility Amount of \$627m)
- 18% of borrowers made additional draw downs from their loan account
- 10% of loans were taken as a regular income
- 10% of loans were paid back in full in 2007 and 6% were partially paid back, the vast majority being through voluntary repayment
- 30% of reverse mortgages were made outside the capital cities
- 44% of loans are to couples, 40% to single females and 16% to single males
- The average age of borrowers is 74 years, with 29% of loans made to those in their 60s, 50% to those in their 70s and 21% to those in their 80s

### 3. How Can Reverse Mortgages Assist Seniors?

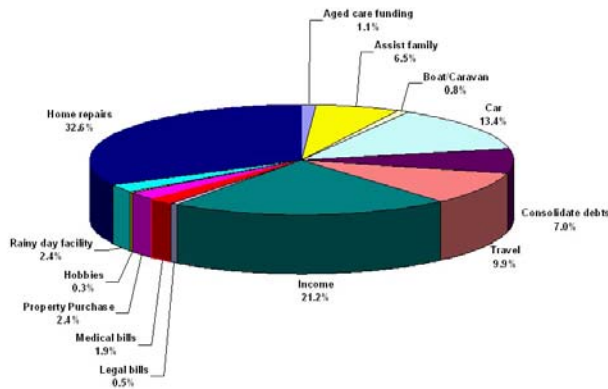
Even a modest draw down under a Reverse Mortgage can provide the opportunity for senior Australians to significantly improve their standard of living in retirement.

The 'It's on the House' SEQUAL-RFI Reverse Mortgage Study<sup>3</sup> was conducted in October 2007 with phone interviews of 1000 Australians over the age of 60. This Study found that a modest increase to their income would significantly improve the lives of most retirees, with 50% of those surveyed indicating that as little as \$300 a month would be sufficient.



The Study also showed that a third of retirees (31%) expected to rely on their home as a source of retirement funding and revealed that baby boomers are not optimistic about their ability to fund their retirement, with a third fearing their funds would last only five to 10 years.

#### Reverse Mortgages are used for a variety of reasons by Senior Australians:



Source: ABN Amro Portfolio Analysis

Contrary to popular opinion, it is very rare that the proceeds are used for frivolous reasons. Some use them to supplement their retirement income, while others use them to replace their car or to renovate or upgrade their home, in many cases to help them cope with a disability. Other primary uses include for emergency medical treatment or to assist family members.

<sup>3</sup> Report available for Download at: [http://www.sequal.com.au/images/stories/sequal\\_rfi\\_study.pdf](http://www.sequal.com.au/images/stories/sequal_rfi_study.pdf)

Senior Australians cannot be classified as a single homogenous group. For pension policy purposes, it may be appropriate to consider the distribution of Government assistance based on home ownership. This distinction is currently applied in the assessment of the Assets Test and in other benefits entitlement (e.g. Rent Assistance).

Home ownership is an important foundation for the retirement plans of many Senior Australians, and it is important to ensure that any method of drawing an income from the wealth stored in the home is soundly based so that Seniors understand the options available to them in order that they can make fully-informed decisions.

### ***Consumer Education is Crucial***

SEQUAL has worked with ASIC recently to develop a general education booklet for Australian Seniors. However, much more needs to be done to educate Senior Australians about their retirement funding options. It should be a priority for Government to ensure that Senior Australians are not deprived of a better understanding of the role that Equity Release can play in meeting their needs and preferences in retirement.

Government funding of balanced financial literacy programs and counselling services is crucial. SEQUAL acknowledges the valuable contribution made by Centrelink's Financial Information Service ("FIS"), and other agencies such as ASIC and NICRI. In particular, SEQUAL welcomes the recent launch Equity Release/Reverse Mortgage Information Centre operated by NICRI.<sup>4</sup>

*NICRI CEO, Wendy Schilg says, "the new service, funded by the Commonwealth Department of Families, Housing, Community Services and Indigenous Affairs, has been made "essential" as adverse investment conditions force more older consumers to consider using their home equity to live on.*

*"For the past 12 months many retirees have watched the value of their investments fall substantially and rather than being forced to sell investments at a loss they are considering reverse mortgages as a way to bolster their income levels," Ms Schilg says.*

*"Older investors in managed funds with suspended redemptions or those who fail to qualify for Centrelink help may see a reverse mortgage as their only option".*

*The service covers a range of topics including:*

- Compound interest*
- Drawdown, lump sum or line of credit*
- No negative equity guarantees*
- Contract default clauses*
- Social security consequences*
- Provider details*

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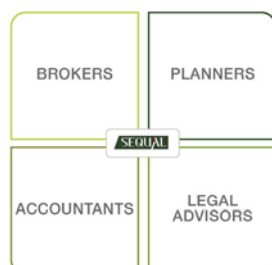
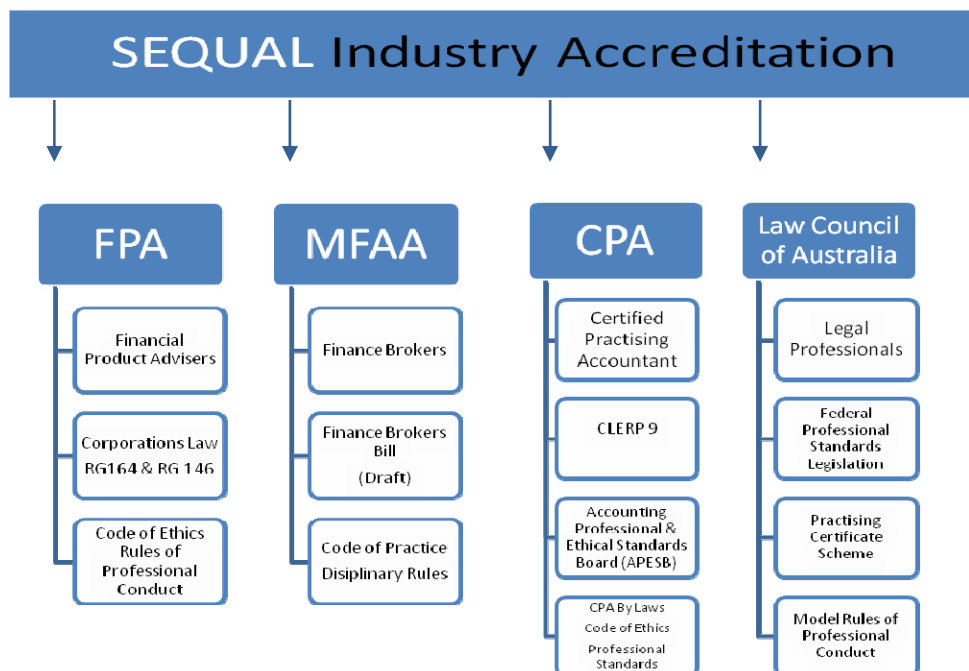
<sup>4</sup> More Information can be found at: <http://reversemortgage.nicri.org.au>

## 4. How is SEQUAL ensuring the Emergence of an Ethical and Efficient Reverse Mortgage Market?

### Industry Accreditation

SEQUAL has established an Industry Accreditation protocol in order to raise Professional Standards above the Minimum Education Requirements imposed by legislation and Industry Association Membership.

SEQUAL works closely with Industry Sector Associations to ensure that their Members are properly trained to assist their clients to make informed decisions about Equity Release.



To give effect to this protocol, SEQUAL has developed the educational standards required for market practitioners to achieve the designation of **Reverse Mortgage Consultant ("RMC")**.

The RMC designation forms an important part of SEQUAL's commitment to assisting consumers to identify properly-trained market practitioners.

### Ensuring Quality Advice for Seniors

*"In the relatively brief period before many baby boomers must begin to make concrete decisions about*

*their retirement, most will have a series of choices to make about how they can maximise their retirement nest eggs.*

*It is those boomers that take full advantage of the range of options available to them who are likely to be better off. Invariably, to get this right, people will need to access good financial advice”.<sup>5</sup>*

It is crucial that market practitioners are willing and able to provide reliable advice to Senior Australians. Over 1,500 professionals (Brokers, Planners, Accountants and Lawyers have successfully graduated as SEQUAL-accredited Reverse Mortgage Consultants (“RMCs”).

The RMC designation forms an important part of SEQUAL’s commitment to assisting consumers to easily identify and access properly-trained market practitioners who have gained Industry Accreditation.

### ***SEQUAL Code of Conduct and Guidelines***

SEQUAL Members are expected to comply with the SEQUAL Code of Conduct and critical Guidelines<sup>6</sup> (see Attachments) which are issue from time to time.

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<sup>5</sup> “Boomers Doing It For Themselves”, AMP.NATSEM Income and Wealth Report Issue 16. March 2007

<sup>6</sup> Download SEQUAL Code of Conduct and Policy Guidelines from: <http://www.sequal.com.au/content/view/21/38/>

## 5. SEQUAL's View on "An Australian Consumer Law"

### *Regulation of Reverse Mortgages*

SEQUAL supports considered regulation that encourages the development of an ethical and efficient equity release market in Australia. However, it is important that Government have proper regard for the standards of industry practice that have been achieved by SEQUAL in consultation with Regulatory Bodies, Consumer Advocacy Agencies and Government itself, over an extended period of time.

*'ASIC welcomes industry moves to address consumers concerns about these products including the development of a code of practice by reverse mortgage providers industry group SEQUAL and the efforts of individual product providers to develop innovative provisions that mitigate some of the risks for consumers.'*<sup>7</sup>

SEQUAL is well-placed to influence the design and distribution of appropriate Reverse Mortgage products and the principles of the SEQUAL Code of Conduct should be preserved for the benefit of borrowers.

SEQUAL Guidelines have introduced important consumer protection measures such as the preservation of the benefit of No Negative Equity Guarantees, and access to good quality independent financial and legal advice.

SEQUAL supports the Government's National Consumer Credit Reform<sup>8</sup> initiative and expects to actively participate in Phase Two of the Action Plan as a Member of the Consumer and Industry Consultative Group.

Regulators have acknowledged the contribution being made by industry and they have delivered on their undertaking to *"work with industry to promote best practice and identify and appropriately deal with risks for consumers."*<sup>9</sup>

The Australian Investments and Securities Commission (ASIC) provides a clear consumer guide at

[www.fido.asic.gov.au/equityrelease](http://www.fido.asic.gov.au/equityrelease) where it is stated that:

"The best way to address some of these risks and ensure you get the product that is most appropriate for your needs is to get **independent legal and financial advice**. Make sure you get a lawyer to read the terms and conditions and explain exactly what you're signing up for.

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<sup>7</sup> Mr. Greg Tanzer -ASIC Executive Director of Consumer Protection, November 2005

<sup>8</sup> Download the Action Plan: [http://www.treasury.gov.au/documents/1381/PDF/NCC\\_Brochure\\_02102008.pdf](http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf)

<sup>9</sup> ASIC Report 59 Equity Release Products –November, 2005. Download at: [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Equity\\_release\\_report.pdf/\\$file/Equity\\_release\\_report.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Equity_release_report.pdf/$file/Equity_release_report.pdf)

1. On the financial side talk to someone who understands financial matters, knows your personal needs and will put your interest ahead of anything else. Always check how your adviser is being paid for the advice they give you.
2. **If you are using a mortgage broker, look for one who has received industry accreditation<sup>10</sup>.**
3. Consult the Centrelink Financial Information Service or the Department of Veterans Affairs to see if it may impact on your pension entitlements.
4. Talk it over with your family.

In Australia advice about loans is fairly loosely regulated so be fussy about the people who advise you”.

### ***The Application of Unfair Contract Terms to Reverse Mortgages***

SEQUAL has previously responded to a Consultation Paper<sup>11</sup> provided by Consumer Affairs Victoria (“CAV”) and our concerns regarding the proposed reforms remain centred on the proposals submitted by CAV (“The Proposals”) in relation to the Application of Unfair Contract Terms to Reverse Mortgages.

It is important that the proposed reforms recognise the contribution to proper process in the design and delivery of Reverse Mortgages established by SEQUAL, across the various industry sectors.

In general, it is our view that consumers would be better protected by the adoption of the SEQUAL guidelines, rather than identifying specific provisions and categorising them as unfair.

The SEQUAL guidelines ensure complying loan agreements are clearly stated so that consumers can make informed decisions and are open to further change as required by market forces and following discussions with regulators and consumer advocacy groups to deal with any specific issues raised.

### ***Are the Proposals Necessary?***

Common law allows consumers to challenge unconscionable bargains, and in NSW the *Contracts Review Act* allows consumers to challenge unjust contracts.

While the UCCC allows credit contracts to be re-opened if unconscionable, it is difficult for consumers to bring these actions, and the scope of the review under the UCCC is unclear.

Under the proposals we have had the opportunity to review, unfair terms appear to be automatically void and an offence is committed if unfair terms are included in a credit contract. The proposals focus on the terms of the contract – i.e. whether a term is by its very nature unjust – without needing to consider the particular circumstances of the bargain. While unfair terms are clearly undesirable, the remedy proposed may create more problems than it solves.

All states and territories have Fair Trading Acts which are substantially the same. From a lender's perspective, the Acts do little to add to the restrictions already imposed by the *ASIC Act* (which mirrors provisions of the *Trade Practices Act* for credit providers). The principal requirements are not to act in a misleading or deceptive fashion or act unconscionably.

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<sup>10</sup> SEQUAL Industry Accreditation (Refer Section 4, Page 11 of this submission).

<sup>11</sup> “The Application of Unfair Contract Terms to Consumer Credit Contracts -Reverse Mortgages”, November, 2007

## ***Are the Proposals Appropriate?***

Over the last 40 years the legal and commercial climate has changed so that parties are no longer free to insert unfair provisions in contracts. In any event, most commentators and businesses support the general proposition that unfair terms should not be included in contracts, at least in contracts with consumers.

It is essential that these Proposals are national for the smooth operation of business, and the proper enforcement of the law. Against that background, the following aspects of the Proposals cause concern:

- The possibility of offences being committed and penalties imposed may create unnecessary consequences, when varying or voiding the provision is sufficient remedy. These possibilities could impact on the high ratings afforded to Australian mortgage backed securities.
- The current confusion and expense caused by WA's unique regulation of finance brokers clearly demonstrates problems businesses can encounter when there is inconsistent legislation.
- The fact that the only remedy would be to make the provision void is inappropriate. The court should be able to vary or annul the provision or make such other orders as it considers fit. This is to avoid a deadlock situation where the clause is necessary but is demonstrably unfair, but if excluded altogether would result in significant loss to the supplier/lender.
- There are already sufficient remedies for consumers under common law, the *Trade Practices Act*, *Fair Trading Act*, and through ASIC approved dispute resolution schemes.
- The appropriate approach may be to amend the UCCC to make it clear that all terms of a credit contract can be reopened. Although this is arguably already the case, there are some commentators who express doubts. Another initiative is to require all lenders to be members of an ASIC approved dispute resolution scheme so that consumers have an accessible avenue of complaint for the whole of their relationship with lenders, rather than focussing just on unfair terms in contracts.
- In considering legislation, governments are required to consider any problems or issues which give rise to the need for action, and assess that against the impact on consumers and businesses. While there is strong support for legislative action that ensures consumers have ready redress for unfair terms, the cost to industry of these Proposals is likely to exceed the benefit to consumers and the community. Clearly, there is no demonstrable market failure.

## ***Appendix 1 -SEQUAL Code of Conduct***

SEQUAL's Code of Conduct encourages the responsible use of Equity Release in the community.

The Code of Conduct requires SEQUAL members to:

1. Treat all Borrowers with respect and dignity;
2. Participate in an ASIC approved External Dispute Resolution Scheme;
3. Ensure that all products carry a clear and transparent 'no negative equity' or 'non-recourse' guarantee. That is, the Borrower(s) will never owe more than the net realisable value of their property, provided the terms and conditions of the loan have been met;
4. Strongly encourage Borrower(s) to discuss the transaction with family members and to seek independent financial advice from a qualified financial adviser;
5. Strongly encourage Borrower(s) if entitled to Centrelink benefits, to discuss the transaction with Centrelink to ensure they fully understand the impact;
6. Ensure that the Borrower(s) obtains independent legal advice performed by the solicitor of their choice. Prior to the completion of the transaction, the Borrower(s) or their solicitor will be provided with full details of the benefits the Borrower(s) will receive, and the obligations they are entering into;
7. Clearly and accurately identify all costs to the Borrower(s) that are associated with the transaction;
8. Not assert or imply to a Borrower(s) that the Borrower(s) is obligated to purchase any other product or service offered by the Member or any other company in order to enter into an equity release product;
9. Provide in writing, a fair and complete package of equity release documents, covering the benefits and obligations of the product. This will include making available to the Borrower(s) and their advisers a tool illustrating the potential effect of future house values, interest rates and the capitalisation of interest on the loan; and
10. Ensure that all loans are written under the Uniform Consumer Credit Code (UCCC), irrespective of the use of proceeds from the loan. All Members will comply with the Privacy Act, Trade Practices Act any other relevant Code or Regulation at law.

## ***Appendix 2 - SEQUAL Guideline***

### **No Negative Equity Guarantee and Default Conditions August 2007**

#### **Background**

The SEQUAL Code of Conduct requires all SEQUAL Members to offer a No Negative Equity Guarantee (NNEG). The NNEG provides that the borrower shall never owe more than the value of the property provided they comply with the terms of the contract

Following the CHOICE reports in 2006 and 2007, and the inevitable and continued focus on the terms and conditions in Reverse Mortgage lenders contracts, it is necessary that the SEQUAL Code of Conduct be enhanced such that a No Negative Equity Guarantee must be in force without reference to whether the customer is in default. This issue is considered threshold to the credibility of SEQUAL. It is also necessary to limit the effect of default clauses on consumers by ensuring proper process is followed.

In addition, there has been some comment on the ability of lenders to apply penalties or require repayment if the borrower is in default of the conditions of the loan. For this reason, a minimum process needs to be specified.

This Guideline sets out the general conditions which must be contained in contracts as a minimum as well as the minimum process required in the instance of defaults.

This Guideline is considered mandatory for all SEQUAL Members as part of their compliance with the SEQUAL Code of Conduct, and is deemed for this purpose to be part of that Code of Conduct.

#### **Minimum Contract Requirements – No Negative Equity Guarantee**

It is required that the terms of the contract with the borrower must be in the following general terms:

- The NNEG must apply in any situations where a repayment trigger event occurs under the contract
- The NNEG must guarantee that the lender will not have recourse to recover amounts in excess of the net sales proceeds of the property (ie after reasonable sales costs including any government taxes) from the borrower or their estate or any other person in any circumstance other than those specified below
- When the repayment trigger is a sale of the property, it is acceptable that the contract specifies that it must be sold at arms-length and only following express permission of the lender prior to the sale, and that non-compliance with this requirement will invalidate the NNEG
- The only other situations in which the NNEG can be invalidated where it would otherwise apply is where there has been fraud by the borrower or willful damage to the security property by the borrower which has resulted in the shortfall.
- If the borrower is in default under the loan for any other reason, the lender cannot use this as a reason to invalidate the NNEG.

## **Minimum Procedural Requirements on Default**

- Where there are default conditions in the loan contract, these must be fair and reasonable.
- Where there is a serious default under the contract, it is permissible that the lender can require the loan to be repayable immediately or apply a default rate of interest.
- Except in a situation where there is an immediate threat to the value of the underlying security, the lender must act in accordance with the Uniform Consumer Credit Code as regards notice and follow the process outlined below prior to moving to require the loan to be repaid or applying a default rate of interest:
  - Send the borrower a written notice of default specifying a period for rectification of the default (such period being reasonable taking into account the particular circumstances of the default).
  - The Lender (or their representative) must personally contact (or make a reasonable attempt to contact) the borrower (or their legal personal representative) prior to the expiry date of the notice to ensure that they have received the notice and understand the consequences of not rectifying the default
  - If the borrower remains in default after the period of notice has expired, the lender may commence action for the loan to be repaid in full at that point. Alternatively, it is permitted that the lender can, in these circumstances, choose to charge a higher default rate of interest until the default is rectified, as long as the default rate is reasonable in the circumstances having regard to the nature or cost of the default to the lender.

## **Date of Operation**

This Guideline came into operation on the 1 January 2008 and applies to all contracts issued on or after that date or the date of amendment of the standard contract to comply with this Guideline, whichever is the earliest.

All contracts were reviewed by SEQUAL by the 1 January 2008, and whenever they are amended, and at least annually to ensure compliance with this requirement. SEQUAL will keep a list of complying members, which will be available to interested parties as required.