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THE FINANCIERS ASSOCIATION OF AUSTRALIA LIMITED NEWSLETTER

Welcome to the Autumn 2006 edition of The Financiers Association of Australia Limited newsletter.

As usual we try to keep up with any legislative changes in the credit code as well as inserting any interesting general business pieces gleaned from various sources.

A welcome is also extended to new members at this time.

The rise of the reverse mortgage in Australia

The past year has seen marked changes in the financial services market. Not least of which is the rise in the marketing of 'new' products to Australian consumers. The Reverse Mortgage, a form of 'equity release' product, has fast become one of the most talked about products on the Australian market.

The Reverse Mortgage is not a new concept. It was developed in the 1980s in Britain and the United States but market conditions and the complexity of the product have meant that it has met with varying success in these markets.

2005 saw the rise of the marketing of the Reverse Mortgage product to Australian consumers.

A Reverse Mortgage involves a consumer borrowing money from a lender against the equity in their home. The borrower grants the lender a mortgage over the property and receives a lump-sum payment from the lender or a number of payments over time (similar to a pension), or both. Usually, no principal or interest is paid by the borrower during the term of the loan. When the borrower dies or voluntarily sells their home, the loan becomes payable to the lender.

Given the nature of the product, it is being widely marketed to older Australians as a means of 'unlocking' the equity in their home and providing a steady and reliable income stream in retirement. It is becoming increasingly popular as the current generation of retirees become less concerned with leaving an inheritance for their children and more concerned with their lifestyle after their working lives are at an end.

The Australian Investment and Securities Commission (ASIC), in their November 2005 Report on Equity Release Products, revealed that in the year to March 2005 the reverse mortgage sector grew from $468 million to $770 million. There are now at least 15 providers of this product in the Australian market. The *Australian Financial Review* reports that it is expected that loans advanced for reverse mortgage will balloon to $3 billion by 2010.

Whilst the growth of this product is obvious it creates challenges for regulators of consumer credit. There is no doubt that the product is complex and that it is vital that Australian consumers be given all the facts before deciding whether such a product is suitable for their situation. The Uniform Consumer Credit Code, the legislation which regulates consumer credit, does not currently deal with products of this kind adequately. Industry regulators are aware of this.

The mortgage broking industry should be aware that ASIC are considering the regulation of equity release products, carefully following their report delivered in November 2005. ASIC's current view is that consumers are not being assessed carefully enough as to their suitability for the product and it is becoming increasingly concerned at the dangers of misleading and deceptive conduct in the marketing and advertising of reverse mortgage products.

The finance industry should expect to see ASIC and the government looking into this product further in the coming year. However, the number of Australians taking up this product seems set to continue to rise.

extract from the Finance Broker February 2006

LAST RESORT LOANS

Many people fail to understand the real cost of providing a small-sum, short-term loan, Whitelaw argues. If a company loaned $100 dollars over five days and charged a mere $1,the annual rate would still be 107 per cent, he says. Such a conversion is unfair, he says, much like asking a hotel to advertise the cost of a room for a year rather than just one night. "Technically, what they're doing is providing the loan interest rate at 60 percent, but then on top of that are fees and costs to provide that product and cover their costs," he says. This is in conflict with the Criminal Code he concedes, because the law makes no distinction between fees and interest. "That's where we're calling on government to amend that federal law," says Whitelaw.

One of the group's biggest concessions was to outlaw "rollovers": interest and charges added to unpaid loans, effectively creating a snowballing loan difficult to pay off. Terlinski says such restrictions don't go far enough. "They say they don't do rollovers because that's against their industry ethics, but they'll loan you the money to pay off your first loan."

Traditional banks, meanwhile, have been criticized for neglecting the segment of the population that uses payday companies, by closing branches in low-income areas and not offering viable alternatives. Dollar Financial Corp., for example, describes itself as a company "serving underbanked consumers." "This product generally isn't available from credit unions and banks, but consumers from time to time do need this service," says Whitelaw. Some users can't get credit from banks, some don't have the financial literacy to understand the alternatives. Others enjoy the convenient hours and customer service.

Ironically, those who use payday companies have bank accounts – they're needed to get a loan, along with a pay stub. Studies also show that payday stores are increasingly locating close to banks, a further sign they're offering something banks do not. Canada's banks say they do provide services like overdraft protection and credit cards, which serve the same purpose as payday loans. But they can't explain why 1 .5 million Canadians use payday loan companies each year. "If you have the answer we would hire you right away," Jacques Hébert, a director of the Canadian Bankers Association, told a Senate hearing looking into payday loan companies last year.

Given the risky nature of unsecured loans, it is no surprise that banks, and even most credit unions, are reluctant to offer them. "Banks have a responsibility to their customers (and to their depositors and shareholders) to lend responsibly," the CBA wrote in a submission to the Senate. Still, banks play an arm's-length role by providing credit to large payday companies. In some cases, all the money a payday company lends comes from banks and other blue-chip financial institutions, something the industry calls the "broker model."

If legislation like Manitoba's is successful, or if Ottawa eventually steps in and introduces its own, banks and credit unions might be more inclined to enter the payday fray, argues Young. The industry lobby, on the other hand, hopes legislation will help an already viable industry prosper. Either way, the two groups have been strangely united in their belief that Ottawa has let the industry go unregulated for too long.

Business or consumer loan?

Rous v Australian Finance Direct Ltd (Commercial) [2006] NSWCTTT 2 (10 January 2006)

Ms Rous and her husband set up a company called RC Property Group Pty Ltd.
They were the sole directors and shareholders of the company. The company was involved in the

furnishing and then reselling of properties.

They took out a loan from Australian Finance Direct to finance the cost of a business related course run by the National Investment Institute Pty Ltd. The course cost them $55,000. In order to partly finance the cost of the course, Ms Rous filled out an application for a loan from AFD of $20,345. The loan was approved by AFD on 11 November 2002.

When they filled in the enrolment forms they wrote that they wanted the invoice for the course to go to RC Property Group Pty Ltd. Loan repayments for the course were made from their business cheque account of the same name.

After establishing the business and entering into the credit contract with AFD Ms Rous left her job as a teacher. While she took the course, the company entered into various property transactions.

On 25 November 2003 NII, the training provider, was placed into administration and was subsequently wound up.

Ms Rous then sought to be relieved of any liabilities she had under the credit contract with Australian Finance Direct Ltd (AFD). She made this claim in reliance on the Consumer Credit Code.

The Code allows in certain situations that a credit provider be made liable if the debtor suffers loss or damage as a result of a misrepresentation in relation to a contract with a supplier. Under the code, proceedings should be brought against the supplier and the credit provider. (Here, due to their liquidation, it was not possible to bring an action against NII.)

The Code doesn't apply to all types of credit. It only applies if the credit is provided for personal/domestic/household purposes. If the credit is provided for a business purpose then the tribunal looking at the application has no jurisdiction to decide on the matter.

The judge said that the "knowledge gained by Ms Rous through the NII course was to be used by the company ... with a view to making profits... I am satisfied that the overall purpose was predominantly a business one." As the credit was related to a business purpose then the tribunal lacked jurisdiction to deal with the matter and so the application was dismissed.

An incorrectly filled out statutory demand can prove costly

Condor Asset Management Ltd v Excelsior Eastern Ltd [2005] NSWSC 1139

Condor Asset Management Ltd was the "assignee of the GDK Financial Solutions Trust" and the responsible entity of the Peridon Village Trust. The company owed $15,768.50 to Excelsior Eastern Ltd. Excelsior made a statutory demand on Condor.

Condor opposed the statutory demand on four grounds. Of the four grounds only one was accepted by the judge. Condor argued that there was a defect in the demand as it refers to debts but didn't outline these individually, rather a total was given.

The judge looked closely at the prescribed form a demand must be in. The statute clearly said that each individual debt must be noted as well as a total at the bottom of the demand. Condor told the judge that there were in fact several debts owed to them by Excelsior, however only a total had been recorded on the demand.

The judge also referred to previous case law on the matter and said that "Clearly, a statutory demand relating to two or more debts must give a 'description' of the individual debts and state their amounts as well as state the total of those amounts."

The judge said that the non-compliance with the statute was equal to a defect. The judge went on to consider whether the defect was then equal to a substantial injustice so as to make the demand ineffective.

The judge said that the most common and fruitful way of opposing a demand is to argue that there is a genuine dispute about "the existence or amount of a debt to which the demand relates". The judge said that due to the demand not making it clear as to what the debt relates to this would make it very difficult for Condor to make an arguable case. "Failure to provide the means of such identification means that the company is denied the ability even to begin to consider whether...

[the Act]...provides a ground for challenge." The demand was therefore defective and was set

The judgment debtor dies. Then what?

All names and all other identifiable exact details have been changed for various reasons but the case is factual

Lend *Finance ltd v Alpha & Beta*

Angeline gave a guarantee in 1997 in relation to a financing agreement between Finance Ltd (FAL) and A. Pty Ltd for vehicles and various items of office and farm equipment.

On June 2002 FAL sued her under this guarantee and got judgment for $13,886.77 plus expenses and interest. In November 2002 the NSW sheriff made an attempt to seize goods from her to sell to pay the debt but said that "the debtor owns no goods on the premises upon which to make a seizure." Angeline died in December 2002. No executor was appointed to her estate so in December 2004 FAL took the matter to court. They sought an order that the estate be administered in bankruptcy. FAL asked the court who the bankruptcy petition should be served on. On 11 January 2005 a registrar ordered that the petition be served on Angeline's" next of kin, Mr AR, Mrs ER and Mr RR.

On 15 February 2005 a grant of probate was made in the Supreme Court of NSW to a Ms Dean describing her as executrix, trustee and sole beneficiary. On 8 March 2005 th R's opposed the petition on the grounds that the deceased's estate was not bankrupt. Shortly after this, Ms Dean (Mr Rs' partner) discovered she was the sole beneficiary under the will and she too filed a notice of objection.

They argued that the deceased's estate was in fact solvent. Ms Dean also claimed that she would be best to administer the estate rather than an independent trustee.

The judge pointed out that there is no requirement that the court address the solvency of the estate when looking at an application like this. He was "far from satisfied" that the estate was solvent.

He said that the court should give a legal personal representative an opportunity to be appointed, look into the affairs of the deceased, and carry out the necessary jobs before the estate creditors should be paid. However, in this case, "over two years have passed since the deceased's death without any step being taken other than the recent obtaining of a grant of probate." He was also concerned at suggestions that the R's and Ms Dean "have sought in the past to conduct themselves in relation to property of the deceased with the object of preventing the petitioning creditor from ever being paid." He decided that it would be in the best interests of the unsecured creditors of the estate for it to be administered by an independent trustee.

If you come across or would like to contribute any article that may be of interest for the newsletter please fax on (02) 9299 1433 or post to the Association c/- GPO Box 3463 Sydney NSW 1043.

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