

The FOS Approach to Financial difficulty series: Dealing with common financial difficulty issues

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We have created a series of FOS Approach documents, such as this one, to help consumers and financial services providers better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and dispute types that we see at FOS. However, it is important to understand that each dispute that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no FOS Approach document can cover everything you might want to know about key issues.

1 At a glance

1.1 Scope

When a consumer (an individual or small business owner) experiences financial difficulty, they will often ask their financial services provider to help them with a repayment arrangement. Many successful arrangements are entered into regularly, but sometimes the consumer and financial services provider are not able to agree on an arrangement that suits them both. That's where FOS can help.

1.2 Summary

Who should read this document?

Financial services providers (FSPs) that deal with credit products, consumer representatives and consumers (individuals and small business owners), who are experiencing financial difficulty.

Anyone who wants to understand some common issues we see in financial difficulty disputes including:

- Loans held in joint names.
- Where there are guarantors, caveators or a second mortgagee.
- Where the debt has arisen under a guarantor liability.
- Where the debtor is bankrupt.
- Where a consumer requires further assistance.
- Where there is a shortfall after the sale of a property.

Summary of the FOS Approach

Financial difficulty occurs when a consumer is unexpectedly unable to meet their repayment obligations. This can be as a result of a variety of causes including accident, separation, death of a family member, unexpected medical or funeral expenses, reduction of work hours, redundancy, or a downturn in business.

Our experience has shown that disputes between consumers in financial difficulty and their FSPs occur most commonly in circumstances where one or both of the parties fail to:

- identify the financial difficulty and provide sufficient information to understand it
- propose a solution that is robust and relevant to the circumstances
- take appropriate action when the financial difficulty is not able to be overcome, and
- ensure that any resolution agreements reached bring finality to the issue.

Where a loan is held in joint names, an FSP may agree to a short-term arrangement to vary a contract as requested by one joint borrower, even if the co-borrower may not

be willing to agree to any variation. This may happen, for example, where there has been a marriage breakdown. This would allow the borrowers time to finalise their affairs and resolve any disagreement – for example, in the Family Court. We would not, however, expect an FSP to wait for an indefinite period without payments.

An FSP should not insist on getting the consent of guarantors, caveators or second mortgagees as a condition of granting a contract variation. An FSP should also not delay in assessing a hardship request, or consider itself limited in the types of assistance it can offer, just because there are guarantors, caveators or second mortgagees involved in the contract. If, however, there is a Deed of Priority in place with a second mortgagee, it may be appropriate to obtain their prior consent if required by the Deed.

Bankruptcy alone is not sufficient reason for an FSP to decline hardship assistance for a secured debt. However, the individual needs to show they would be able to repay the debt if a contract variation was granted.

We consider that where an unforeseen new event of financial difficulty has occurred, the FSP should review any new request for assistance with fresh eyes, independently of any previous agreements. While this may occur after a period of financial difficulty assistance has come to an end, it can also happen during this time.

It is important that the FSP forms its own view on any repayment proposal. Although a lender may consult with its Lenders Mortgage Insurer (LMI), it is our view that the FSP should come to its own decision about the consumer's ability to repay the loan or it may fail to give real and genuine consideration to a hardship variation.

2 In detail

2.1 The FOS Approach

Understanding why a consumer is experiencing financial difficulty is important to be able to identify an appropriate solution. However, in most cases, finding out why should not be a barrier to considering a request.

A consumer might identify that they are, or soon will be, in financial difficulty, even though their account is not in arrears. In these circumstances we consider that a consumer should contact their FSP sooner rather than later, and the FSP should try to work with the consumer to work out a suitable repayment arrangement to overcome the financial difficulty.

FSPs are increasingly willing to identify customers who may be experiencing financial difficulty. This can be done in many ways, such as supporting internal training, identifying high-risk accounts, and being willing to understand the reasons why accounts may be unpaid or paid late.

It is better for all parties if an FSP provides financial difficulty assistance promptly and early, when it will have the greatest impact. We encourage the early identification of customers who may be experiencing financial difficulty.

2.2 Loans held in joint names

In some cases, a contract variation may be requested by one joint borrower, and the co-borrower may not be willing to agree to any variation. This may happen, for example, where there has been a marriage breakdown.

Under the National Credit Code (NCC), Code of Banking Practice and Mutual Banking Code of Practice, a request for financial difficulty assistance does not need to be a joint request from all borrowers to a loan. For example, the NCC refers to 'a debtor' being able to apply for a change. 'A debtor' is defined as a person (other than a guarantor) who is liable to pay for (or to repay) credit, and includes a prospective debtor. As each borrower is both jointly and severally liable to their obligations under a loan, each borrower is individually entitled to make a financial difficulty request to their FSP.

We expect FSPs to work with an individual borrower who is requesting assistance, and to discuss options for resolving their financial difficulty. If one joint borrower can demonstrate that they would be able to meet ongoing repayments if assistance was provided, then the options should be fully explored even if the co-borrower is not involved.

If one joint borrower would not be able to meet repayments to a joint facility without the support of the co-borrower, an appropriate resolution may be for the FSP to agree to a short-term arrangement with one borrower only. This would allow the borrowers time to finalise their affairs and resolve any disagreement between themselves – for

example, in the Family Court. We would not, however, expect an FSP to wait for an indefinite period without payments while a Family Court matter was resolved.

2.3 Disputes involving guarantors, caveators or a second mortgagee

In some cases, FSPs have refused to consider a variation without first obtaining the consent of any guarantor, caveator or second mortgagee. This is despite most guarantee contracts allowing a variation to be covered by the guarantee, even without the prior consent of the guarantor, and a first mortgagee taking priority over caveats or second mortgagees.

It is our view that in most cases the FSP should not insist on getting the consent of guarantors, caveators or second mortgagees as a condition of granting a contract variation. An exception may be where the borrower's liability under a regulated contract is increased and the FSP wishes to hold the guarantor liable for the increase above the existing guarantee limit. An FSP should also not delay in assessing a hardship request, or consider itself limited in the types of assistance it can offer, just because there are guarantors, caveators or second mortgagees involved in the contract. If, however, there is a Deed of Priority in place with a second mortgagee, it may be appropriate to obtain their prior consent if required by the Deed.

2.4 Where the debt has arisen under a guarantor liability

We consider that it is good industry practice to give genuine consideration to a guarantor's financial difficulty; however, the options available to a guarantor will be different to those of a borrower.

The options available may include a short-term repayment arrangement or a reasonable time for the guarantor to either refinance the debt with a third party or undertake the sale of assets.

2.5 Where the individual is bankrupt

Bankruptcy alone is not sufficient reason for an FSP to decline hardship assistance for a secured debt. We would still expect the FSP to seek information about the individual's current financial circumstances, and to offer appropriate assistance based on an assessment of that information. The individual needs to be able to demonstrate that they would be able to repay the debt if a contract variation was granted.

In disputes where an individual is bankrupt, we require the consent of their Trustee in Bankruptcy to consider any dispute. If a dispute involves a secured asset that has vested in the Trustee (that is, a Trustee has been given the power and authority to deal with the asset), such as the individual's home, then we will invite the Trustee to attend any telephone conciliation conference we hold. If the Trustee decides not to attend, any outcome may be subject to the Trustee's consent.

2.6 When a consumer requires further assistance

We commonly see cases where a repayment arrangement has been made as a result of a request for assistance and then at the end of that arrangement, the consumer seeks further assistance. This may happen because the original assistance was not realistic or robust enough for the circumstances, or it may be that an anticipated change in circumstances has not eventuated. For example, the consumer may have expected to secure a new job, but this has not happened. It could also be that an entirely new cause of financial difficulty has arisen.

We consider that where an unforeseen new event of financial difficulty has occurred, the FSP should review any new request for assistance with fresh eyes, independently of any previous agreements. While this may occur after a period of financial difficulty assistance has come to an end, it can also happen during a period of financial difficulty assistance if the new event could not have been reasonably foreseen at the time the period of assistance commenced.

If a reasonable alternative is available that will help the consumer overcome their financial difficulty, it should not be overlooked purely because the consumer was previously unable to maintain an agreement.

When we consider disputes of this type, we take this approach:

- If there is a demonstrated, material improvement in the consumer's circumstances, but some further support is still required, we expect the FSP to reassess the circumstances. This is because a further measure of assistance may be enough to help the consumer overcome their financial difficulty entirely.
- If there is deterioration in the consumer's circumstances then the FSP should consider whether there is an alternative arrangement that will help overcome the situation. If this is not possible then there may be little that the FSP can do to further assist.

If there is no unforeseen new event and the consumer's financial difficulty is ongoing despite a period of assistance, the FSP should consider whether the earlier offer of assistance was appropriate to the consumer's situation. If it was appropriate, and a reasonable alternative arrangement is not possible, there may be little that the FSP can do to further assist.

We commonly receive disputes involving requests to reconsider a financial difficulty arrangement where the original arrangement has already been the subject of a FOS dispute. The decision of whether FOS will reconsider a financial difficulty dispute depends on the individual circumstances of each dispute and how the earlier dispute was resolved.

2.7 Financial difficulty and the impact of responsible lending obligations

The national credit reforms introduced by the National Consumer Credit Protection Act (NCCP) include “responsible lending” obligations which apply to new loans or increases in existing loans.

Under these obligations, a credit provider must make reasonable enquiries and take reasonable steps to verify information in order to assess whether the regulated credit contract will be “not unsuitable” – this includes the requirement that it must be affordable. These obligations will generally not apply to variations of an existing regulated credit contract on the basis of financial difficulty unless additional lending is provided. However, any repayments under a contract variation should still be affordable to the individual.

ASIC’s Information Sheet 105, released in December 2010, explains this in more detail.

2.8 When there is a shortfall

Sometimes the sale of the security property will result in a shortfall debt owed by the consumer. When a consumer is seeking to repay a shortfall, but is unable to do so immediately, the FSP has an obligation under the Code of Banking Practice, the Mutual Banking Code of Practice and good industry practice to work with the consumer. The FSP may wish to do this in consultation with their Lenders’ Mortgage Insurer (LMI).

It is important the FSP forms its own view on any repayment proposal. Although a lender may consult with its LMI, the FSP should come to its own decision about the consumer’s ability to repay the loan or it may fail to give real and genuine consideration to an appropriate variation.

It is in the interests of all parties to resolve these matters as soon as possible. Where a shortfall debt is unsecured, it is our view that any repayment arrangement should aim to see the debt repaid within the short- to medium-term; for example, within five years.

3 Context

3.1 Repeat requests for assistance

Case 1: Choose relevant case studies that deal with important issues

A dispute was brought to us by a husband and wife – Jim and Angela – who held an investment loan with the FSP. Jim suffered a heart attack and was unable to make repayments for several months. When he returned to work his income was reduced as his role had changed. Jim was not able to pay the arrears and sought assistance from the FSP. The arrears were capitalised and the couple were able to continue to make ongoing repayments.

A year later, Angela was in a car accident and they had to rely on just the husband's income. When they fell behind in payments again, the FSP commenced recovery action even though the couple had advised it of the wife's accident.

In the telephone conciliation conference FOS noted that the second request for assistance arose out of a new and unforeseen event and therefore the FSP should consider Jim and Angela's request for assistance with new eyes. The FSP agreed to provide three months for the couple to finalise an insurance claim and determine whether the change in their combined circumstances would enable them to recommence repayments to the loan in the future. If, after a period of time, the couple felt that they would be able to recommence payments to the loan, the FSP agreed to explore how the arrears could be repaid, either by varying the loan or some other means.

If Jim and Angela considered that their circumstances would not enable repayments to recommence to the loan, the FSP also agreed to offer a reasonable period of time for them to sell the investment property.

Case 2: Shortfall

Julia had purchased a number of investment properties. Her financial position changed and she experienced difficulty paying the difference between the rental incomes received and the repayments required on the loans. This caused the loans to fall into arrears. Julia considered that as this was a long-term change to her financial position, the investment properties would need to be sold to reduce the debt owed to the FSP.

While trying to sell the properties, Julia learnt that the local property market had changed and the properties could not be sold for anywhere near their original purchase price. It was clear to her and the FSP that the sales would result in a shortfall.

FOS conducted a telephone conciliation conference and the parties reached an agreement on a timeframe for sale and a repayment amount that Julia could sustain both prior to and after the sale of the investment properties. The FSP also agreed to

restructure the residual shortfall debt from the sale of the investment properties so that it could be repaid at the rate the parties agreed Julia could afford. By working together, Julia and FSP were able to overcome a highly uncertain situation, and the outcome was an agreement that worked for both parties.

3.2 References

Definitions

Term	Definition
Borrower	A borrower is a consumer who receives an amount of money from a lender, and is obligated to pay back or repay an equal amount of money to the lender.
CBP	Code of Banking Practice
Consumer	An individual or small business owner who uses the services provided by a financial services provider.
Credit contract	A credit facility provided to an individual or small business which may include a consumer credit contract
Financial Difficulty	A consumer may experience financial difficulty if they are unexpectedly unable to meet the repayment obligations on a credit contract
FSP	Financial services provider (a business that has chosen FOS as their external dispute resolution scheme)
LMI	Lender's Mortgage Insurer
MBCP	Mutual Banking Code of Practice
NCC	National Credit Code
Regulated credit contract	A contract regulated by UCCC or NCC
SOFP	Statement of financial position is used to provide current and accurate details of all aspects of a consumer's financial position

Useful links

This document is one of a series we have produced about financial difficulty. We have also created documents which cover:

- How FOS approaches financial difficulty, taking into consideration legal principles, industry codes and good industry practice
- Our power to vary regulated credit contracts
- Working together to find solutions

All four documents can be found on the [FOS website](http://www.fos.org.au/approach) (www.fos.org.au/approach).

The following sites provide useful information to help people experiencing financial difficulty:

- Australian Securities and Investments Commission's [MoneySmart](http://www.moneysmart.gov.au) website.
www.moneysmart.gov.au
- Australian Bankers' Association '[Doing it tough](http://www.doingittough.info)' website.
www.doingittough.info
- [Financial Counselling Australia](http://www.financialcounsellingaustralia.org.au) website
www.financialcounsellingaustralia.org.au

The following Codes of Practice were referred to in this approach document:

- The [Code of Banking Practice](http://bit.ly/291ZkqN)
http://bit.ly/291ZkqN
- The [Mutual Banking Code of Practice](http://bit.ly/28Zy6i1)
http://bit.ly/28Zy6i1
- The National Credit Code (NCC) is included as Schedule 1 to the [National Consumer Credit Protection Act 2009](http://bit.ly/28ZokuH) (Cth) (NCCP) which can be viewed here:
http://bit.ly/28ZokuH
- [ASIC information sheet 105](http://bit.ly/293TB4Q)
http://bit.ly/293TB4Q