

The AFCA Approach to financial difficulty: our power to vary credit contracts

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

These documents explain the way we approach some common issues and complaint types that we see at AFCA. However, it is important to understand that each complaint 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 AFCA Approach document can cover everything you might want to know about key issues.

1 At a glance

1.1 Scope

This document sets out our approach to financial difficulty complaints. The approach has been adopted from AFCA's predecessor scheme, the Financial Ombudsman Service.

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

1.2 Summary

Who should read this document?

Anyone who wants to understand our ability to vary credit contracts (as set out in our Rules), and wants to know how and when AFCA applies this remedy to financial difficulty complaints.

Summary of the AFCA Approach

Financial difficulty occurs when a consumer is unexpectedly unable to meet their repayment obligations. This can be due to a number 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.

Under AFCA's Rules we have the ability to vary credit contracts, but we will only do this in circumstances where a variation will see the repayment of the loan in a reasonable period.

The main thing we look at when considering varying a credit contract is whether the consumer can demonstrate an ability to service the loan in the future.

2 In detail

2.1 The AFCA Approach

If a financial firm does not agree to a reasonable request to vary a credit facility's terms, AFCA can review that decision and may, in some instances, require the financial firm to vary the credit contract.

We will firstly encourage parties to negotiate a realistic solution, and we will only consider using our ability to vary a credit contract as a last resort, where negotiations have failed to resolve the complaint.

We will only require a financial firm to vary a credit contract if we are satisfied that:

- the consumer can demonstrate an ability to repay the debt in full if the contract is varied, even if this is over a longer period, and
- assistance would be appropriate – taking into account the consumer’s current financial position.

Demonstrating capacity to repay a debt can be achieved in a number of ways, including:

- regularly making repayments at a level to show that the debt can be repaid in a reasonable time if it was varied
- a consumer providing information about their financial position to show how their circumstances have or will change, to enable future repayments to be met
- a combination of the above.

While all options should be considered by a financial firm, AFCA will only vary a credit contract if the consumer has provided information about their situation.

If the debt is secured, the value of the security is not necessarily relevant to the decision to vary a credit contract if the consumer has demonstrated they have the ability to repay the debt. This is because a variation will provide an opportunity for the debt to be repaid without the need for the security to be sold.

The decision of whether to vary a credit contract depends on the consumer’s specific circumstances. This means that we need the consumer to give us all the relevant information and supporting documents that we ask for.

If a loan is secured over an asset (for example a home loan or vehicle loan) and the consumer has not demonstrated that they will be able to meet their contractual repayments in the long term, the most appropriate resolution may be to sell the asset. If this is the case, we will encourage parties to discuss this option. We may also arrange a telephone conciliation conference to discuss a timeframe for the consumer to sell the asset voluntarily.

3 Context

3.1 Case studies

The case studies below are based on determinations by AFCA’s predecessor scheme, the Financial Ombudsman Service (FOS). While previous determinations by its predecessor scheme is not binding precedents, where relevant they will inform AFCA’s approach to an issue.

Case 1: Car loan

Nick requested assistance when he was unable to make full repayments on his car loan, which had three years remaining. He provided the financial firm with a Statement of Financial Position (SOFP) that showed that he could afford repayments of \$120 per month if the loan term was extended by a further year.

The financial firm declined to vary the loan term and sought additional information from Nick, including a statement from his non-English speaking partner regarding the payment of household expenses. Nick lodged a complaint with Financial Ombudsman Service (FOS). FOS contacted the financial firm and noted that the proposal put forward appeared to be reasonable based on the information held by the financial firm. This was because the SOFP showed that:

- Nick could afford repayments of \$120 per month
- he had been making repayments of this amount for several months, and
- the extension of the loan term by one year would see the remaining debt repaid.

FOS considered that Nick had demonstrated an ability to repay the debt if the contract was varied. Therefore, it was appropriate for the ombudsman to vary the credit contract if a resolution was not reached between the parties. The financial firm reconsidered its position and accepted Nick's proposal without the need for further information. The resolution was formalised in a settlement agreement.

Case 2: Reduced repayment arrangements provided with time to sell the security

Amanda and her ex-partner were joint borrowers of a personal loan with the financial firm. The personal loan was secured by a motor bike. Amanda also had a credit card in her name only with the financial firm.

Amanda was a victim of family violence perpetrated by her ex-partner. She said her ex-partner had damaged the motorbike and financially abused her by threatening her with bankruptcy. Her ex-partner had subsequently left Australia and was not contributing towards the personal loan.

Amanda lodged a complaint with FOS, seeking financial difficulty assistance and for her ex-partner to be removed from the personal loan. She also raised issues about the financial firm not responding appropriately to her previous requests for assistance.

FOS investigated the complaint and said it could not require the financial firm to remove her ex-partner from the personal loan, as this was a commercial decision for the financial firm to make which was outside its jurisdiction.

FOS found that the financial firm failed to demonstrate on a number of occasions that it gave genuine consideration to Amanda's previous requests for financial assistance. FOS said the financial firm should compensate Amanda \$3,000 in non-financial loss

compensation for the stress and inconvenience she suffered as a result of its inappropriate responses.

FOS gave Amanda two months to sell the motorbike, and apply the sale proceeds to reduce the balance of the personal loan. It also varied the personal loan and credit card accounts by endorsing the FSP's offer of reduced repayment arrangements for six months to give Amanda some breathing space to reduce her other debts.

FOS also said that if Amanda was still experiencing financial difficulty at the end of the reduced repayment arrangements, the financial firm should engage with her and enter into an affordable long-term repayment arrangement for both the credit card and the personal loan.

3.2 References

Definitions

Term	Definition
Consumer	An individual or small business owner who uses the services of a financial firm
Credit contract	A credit facility provided to an individual or small business which may include a consumer credit contract
Financial difficulty	A consumer (individual or small business owner) may experience financial difficulty if they are unexpectedly unable to meet the repayment obligations on a credit contract
Financial firm	A bank or credit provider who is a Member of AFCA
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 AFCA approaches financial difficulty, taking into consideration legal principles, industry codes and good industry practice
- working together to find solutions
- dealing with common issues
- early release of superannuation.

All five documents can be found on [our website](#)¹.

¹ www.afca.org.au/approach

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

Document	Title / Link
MoneySmart	Australian Securities and Investments Commission's MoneySmart website www.moneysmart.gov.au
Doing it tough	Australian Bankers' Association 'Doing it tough' website www.doingittough.info
Financial Counselling Australia	www.financialcounsellingaustralia.org.au
Code of Banking Practice	http://bit.ly/291ZkqN/