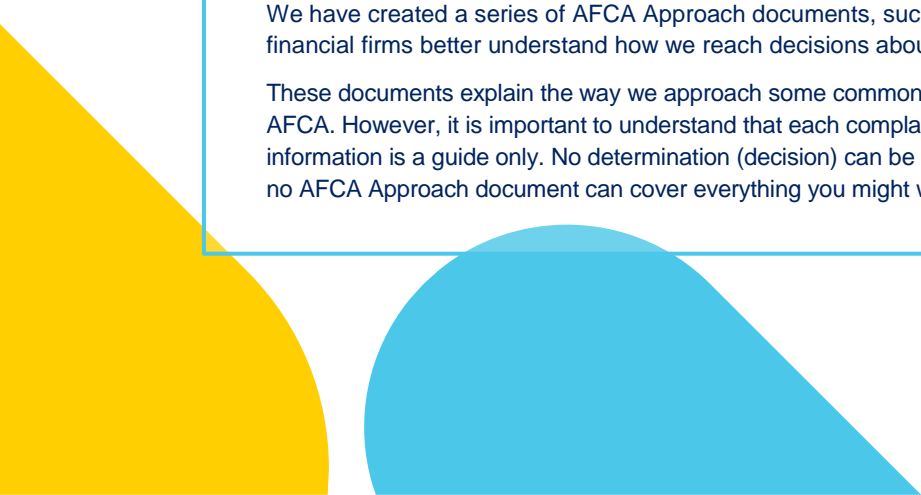


The AFCA Approach to financial difficulty: dealing with common issues

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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

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. The approach has been adopted from AFCA's predecessor scheme, the Financial Ombudsman Service.

1.2 Summary

Who should read this document?

Financial firms that deal with 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 complaints 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 the financial firm has obtained a default judgment.
- where a consumer requires further assistance.
- where there is a shortfall after the sale of a property.

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 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 complaints between consumers in financial difficulty and their financial firms 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, a financial firm may agree to a payment arrangement or contract variation 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. More information about our approach to joint facilities can be found in the AFCA Approach to Joint Facilities and Family Violence.

A financial firm should not insist on getting the consent of guarantors, caveators or second mortgagees as a condition of granting a contract variation. A financial firm 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 a financial firm to decline hardship assistance for a secured debt. However, the consumer will need to show that they would be able to repay the debt if a contract variation was granted.

Where a financial firm has obtained default judgment against a consumer, it may in some cases be appropriate for the financial firm to delay enforcing the default judgment, if the consumer requests this. Examples of where delaying enforcement might be appropriate include where the consumer is taking steps to sell the security property themselves, or is in the process of refinancing the debt with another lender.

We consider that where an unforeseen new event of financial difficulty has occurred, the financial firm 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 financial firm 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 financial firm 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 AFCA 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 financial firm sooner rather than later, and the financial firm should try to work with the consumer to work out a suitable repayment arrangement to overcome the financial difficulty.

Financial firms 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 a financial firm 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.

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 financial firm.

We expect financial firms 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 financial firm 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 a financial firm to wait for an indefinite period without payments while a Family Court matter was resolved.

More information about our approach to financial difficulty for joint facilities can be found in the AFCA Approach to joint facilities and family violence.

2.3 Complaints involving guarantors, caveators or a second mortgagee

In some cases, financial firms 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 financial firm 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 financial firm wishes to hold the guarantor liable for the increase above the existing guarantee limit. A financial firm 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 a sufficient reason for a financial firm to decline hardship assistance for a secured debt. We would still expect the financial firm 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 complaints where an individual is bankrupt, we require the consent of their Trustee in Bankruptcy to consider any complaint. If a complaint 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 financial firm 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 complaints 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 financial firm 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 financial firm 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 financial firm 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 financial firm 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 financial firm can do to further assist.

We commonly receive complaints involving requests to reconsider a financial difficulty arrangement where the original arrangement has already been the subject of a complaint to AFCA or one of its predecessor schemes. The decision of whether AFCA will reconsider a financial difficulty complaint depends on the individual circumstances of each complaint and how the earlier complaint 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 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 financial firm has an obligation under the Code of Banking Practice, the Customer Owned Banking Code of Practice and good industry practice to work with the consumer. The financial firm may wish to do this in consultation with their Lenders' Mortgage Insurer (LMI).

It is important the financial firm forms its own view on any repayment proposal. Although a lender may consult with its LMI, the financial firm 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-term to medium-term; for example, within five to seven years.

2.9 Where a financial firm has obtained default judgment

In the event that a consumer defaults on their loan obligations, a financial firm will generally be entitled to take action to recover the debt. Recovery action can include legal proceedings, which may result in the financial firm obtaining default judgment against the consumer for possession of a security property and/or repayment of the debt. This applies both to loans secured by property and to loans that are unsecured.

If the consumer subsequently requests the financial firm to suspend enforcement of the default judgment, we expect the financial firm to review and genuinely consider the consumer's request. This only applies to a default judgment, and not a judgment given after a Court has considered the merits of the case.

It may be appropriate for the financial firm to agree to suspend (stay) enforcement of a default judgment where the consumer is actively taking steps to address the debt and is seeking additional time to:

- sell the security property themselves within a reasonable time
- finalise a refinance of the amount owed
- organise their affairs, if they are suffering from personal (as distinct from financial) hardship, or
- apply to the Court to have the default judgment set aside.

Where we receive a complaint that a financial firm has declined a consumer's request to suspend enforcement of a default judgment, we will expect the consumer to demonstrate good faith towards achieving one of the outcomes listed above. This includes providing documents showing the steps that they have taken to date, for example a copy of an agency sale agreement if they are intending to sell the property, or a copy of their loan approval if they are refinancing with another lender.

We will determine the appropriate stay period, taking into account the circumstances of each case and the interests of both the consumer and the financial firm.

It is important to be aware that we cannot set aside or interfere with a default judgment. This means, for example, that once there is a default judgment it is too late for a consumer to request a contract variation on the grounds of financial hardship, such as a payment arrangement. In addition, where the financial firm has already enforced the default judgment or warrant of possession and has taken possession of the security property, we are unable to intervene. This is because the consumer cannot request a suspension of orders which have already been enforced.

3 Context

The case studies below are based on determinations by one of AFCA's predecessor schemes, the Financial Ombudsman Service. While previous determinations (by AFCA or by its predecessor schemes) are not binding precedents, where relevant they will inform AFCA's approach to an issue.

3.1 Case studies

Case 1: Repeat requests for assistance

A complaint was brought to FOS by a husband and wife – Jim and Angela – who held an investment loan with the financial firm. 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 financial firm. 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 only on Jim's income. When they fell behind in payments again, the financial firm commenced recovery action even though the couple had advised it of Angela'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 financial firm should consider Jim and Angela's second request for assistance with fresh eyes. The financial firm 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 financial firm 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 financial firm 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 financial firm.

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 financial firm 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 financial firm 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 the financial firm were able to overcome a highly uncertain situation, and the outcome was an agreement that worked for both parties.

Case 3: Factors that would not influence variation

Dave had been through a period of financial hardship and was seriously behind on his repayments. In spite of this, he had managed to start making his loan repayments again for four months.

He tried to clear the arrears by getting his superannuation released early. However, his request was declined. When Dave told the lender about this, they sent him a final demand notice for the full arrears which were sitting at more than \$22,000. The demand notice stated that if Dave did not pay the arrears, enforcement action would start.

Dave approached FOS for help. He wanted the arrears to be added to the balance of the loan, so he could continue making minimum monthly payments.

We gave the financial firm the chance to offer an arrangement that would settle the complaint. However, they believed that Dave would not be able to meet the payments going forward. As a result, it didn't put forward an offer.

We asked Dave to complete a statement of financial position. This showed us that he could meet the minimum monthly payments if the arrears were added to the loan. In view of this, we made a preliminary assessment as follows to resolve the complaint:

- Dave would need to make increased payments of approximately \$1,700 a month for six months. This is what the minimum payment would be if the arrears were to be added to the balance of the loan.
- If Dave was able to do this, the arrears would then be added onto the balance of the loan.
- The financial firm did not accept our preliminary assessment. They stated that:
 - > Dave was no longer living in the property
 - > the loan to value ratio was too high
 - > they would be in breach of their responsible lending obligations if they were to accept the variation. The lender argued that Dave had not shown that he could afford the repayments, even though he was already maintaining the minimum payments required, and
 - > they had already granted hardship assistance in the past.

We found that the above factors were not relevant to assessing a hardship request and we issued a decision that the lender vary the contract in line with our preliminary assessment.

3.2 References

Definitions

Term	Definition
CBP	Code of Banking Practice
Complaint	A complaint lodged at AFCA by a Complainant about the actions of their financial firm
Consumer	An individual or small business owner who uses the services provided by 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 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
LMI	Lender's Mortgage Insurer
NCC	National Credit Code

Term	Definition
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
- our power to vary credit contracts
- working together to find solutions
- early release of superannuation.

All five documents can be found on the AFCA website¹.

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

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

Document	Title / Link
Code of Banking Practice	http://bit.ly/291ZkqN
Customer Owned Banking Code of Practice	http://bit.ly/28Zy6i1

The National Credit Code (NCC) is included as Schedule 1 to the [National Consumer Credit Protection Act 2009](#) (Cth) (NCCP) which can be viewed here:

¹ www.afca.org.au/approach

Document	Title / Link
National Consumer Credit Protection Act	http://bit.ly/28ZokuH
	ASIC information sheet 105
	http://bit.ly/293TB4Q