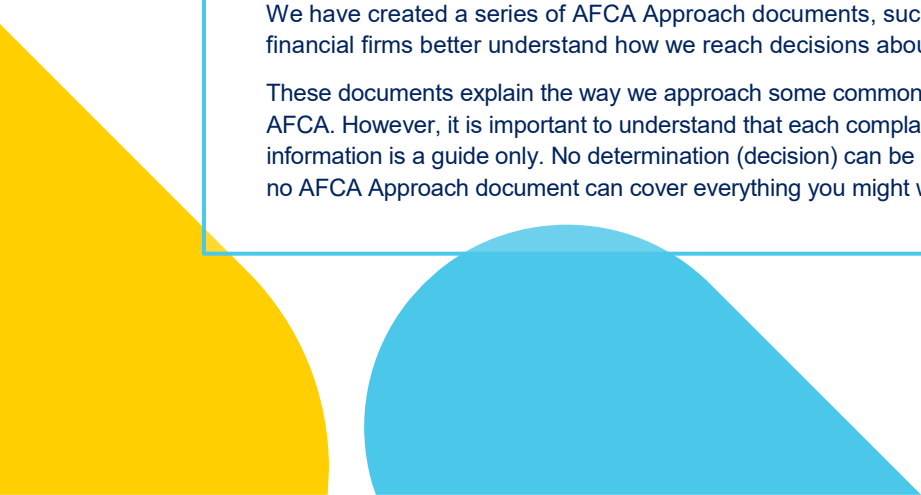


# The AFCA Approach to financial difficulty: our power to vary credit contracts

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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 Purpose of this approach

## 1.1 Scope

The purpose of AFCA's approach documents is to explain how we look at common issues and complaint types. This approach outlines how AFCA will investigate and resolve complaints from individuals and small businesses that relate to financial difficulty.

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.

This approach is consistent with AFCA's obligation to deal with complaints in a cooperative, efficient and timely way and to make decisions that are fair in all the circumstances. It is important to understand that each complaint that comes to us has a unique set of facts and this information is a guide only.

## 1.2 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.

## 1.3 Summary of our 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 make the required repayments to the loan in the future.

# 2 Jurisdiction

## 2.1 AFCA's purpose

AFCA is the independent external dispute resolution (**EDR**) scheme for the financial services sector. AFCA's purpose is to provide fair, independent and effective solutions for financial disputes. We do this by providing fair dispute resolution

services. We also work with financial firms to improve their processes and standards of service to minimise future complaints. In addition to resolving financial complaints, AFCA identifies, resolves and reports on systemic issues and serious contraventions of the law.

## 2.2 AFCA's jurisdiction

AFCA can consider complaints against financial firms that are members of AFCA.

When a complaint is not resolved by agreement, negotiation or conciliation, we make a decision. Our decision reflects what is fair in all the circumstances having regard to legal principles, applicable industry codes or guidance, good industry practice and previous decisions of AFCA or predecessor schemes (which are not binding).<sup>1</sup>

When assessing conduct of a financial firm, we have regard to the law, codes, and standards of industry practice that were in place at the time of the conduct.

We may decide that a financial firm must compensate a consumer for direct financial loss, indirect financial loss or non-financial loss.<sup>2</sup> We may also decide that a financial firm is required to take, or refrain from taking, particular actions. If a consumer accepts our decision, the financial firm is bound by that decision.<sup>3</sup>

### Fair in all the circumstances

Our decisions are intended to reflect what is fair in the circumstances of each complaint. This includes providing a fair outcome in cases where we find an error or breach has occurred.

In assessing what is fair, we apply a standard of fairness which focuses on concepts such as fair dealing, fair treatment and fair service. This allows us to assess the conduct of a financial firm over the life cycle of the firm's relationship with its customer.

The primary focus of our investigation is to assess whether the financial firm breached its obligations to the consumer. However, we also consider the conduct of the consumer when determining a fair outcome.

## 3 In detail

### 3.1 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.

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<sup>1</sup> See AFCA Rule A.14.2.

<sup>2</sup> See AFCA Rule D.3.

<sup>3</sup> See AFCA Rule A.15.3.

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 within a reasonable period if the contract is varied, even if this is over a period longer than the existing term, and
- a variation 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 the contract was varied
- a consumer providing information about their financial position to show how their circumstances have changed or will change, to enable future repayments to be made
- 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 which shows that a variation is appropriate.

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. The sale of an asset helps repay the debt and prevents the consumer from ending up in a worse position due to ongoing interest and fees. 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.

## 4 Context

### 4.1 Case studies

The case studies below are based on principles applied in determinations issued by AFCA or its predecessor schemes. 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. Parties have been de-identified to protect their privacy.

#### Case 1 – Home Loan

Nick requested assistance when he was unable to make full repayments on his home loan after he suffered a workplace injury. He was now receiving income protection payments and was meeting about 70% of his home loan repayment each month. He provided the financial firm with a Statement of Financial Position (SOFP) that showed that he could afford repayments which were approximately 70 % of his full repayments and information that supported that he would be receiving a substantial insurance settlement for his injury within 3-6 months.

The financial firm declined to vary the loan term and sought additional information from Nick, including a statement from his partner regarding the payment of household expenses. Nick lodged a complaint with AFCA. AFCA contacted the financial firm and noted that the proposal put forward appeared to be reasonable based on the information held by the financial firm. The financial firm did not agree. A determination was issued which allowed Nick to continue making payments as he had been for 6 months. At the end of the 6 months Nick could either pay the arrears in full if he had received his settlement, capitalise the arrears if he could show that he could afford the repayments, or sell the property within a further 3 months.

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

Amanda and her ex-partner obtained a home loan.

Amanda was a victim/survivor of family violence committed by her ex-partner. Her ex-partner financially abused controlled the finances and no longer contributed to the home loan.

Amanda lodged a complaint with AFCA, 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.

AFCA investigated the complaint and said it could not require the financial firm to remove her ex-partner from the home loan, as this was a commercial decision related to credit risk. Decisions about credit risk are outside AFCA's jurisdiction.

AFCA 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. AFCA said the financial firm should compensate Amanda \$5,000 in non-financial loss compensation for the stress and inconvenience she suffered as a result of its inappropriate responses.

AFCA gave Amanda six months to sell the home and apply the sale proceeds to reduce the balance of the home. AFCA also provided Amanda with a 6 month no-payment period to provide her with some breathing space and to allow her to obtain a rental property.

AFCA also said that if there was a shortfall and Amanda was still experiencing financial difficulty the financial firm should engage with her and enter into an affordable repayment arrangement for the shortfall.

## 5 References

### 5.1 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 used to provide current and accurate details of all aspects of a consumer's financial position

### 5.2 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](#)<sup>4</sup>.

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<sup>4</sup> [www.afca.org.au/approach](http://www.afca.org.au/approach)

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

Document	Title / Link
<a href="#">MoneySmart</a>	Australian Securities and Investments Commission’s MoneySmart website <a href="http://www.moneysmart.gov.au">www.moneysmart.gov.au</a>
<a href="#">Australian Bankers’ Association ‘Guide to Financial Difficulty.’</a>	Australian Bankers’ Association ‘Guide to Financial Difficulty’ <a href="https://www.ausbanking.org.au/assistance/">https://www.ausbanking.org.au/assistance/</a>
<a href="#">Financial Counselling Australia</a>	<a href="http://www.financialcounsellingaustralia.org.au">www.financialcounsellingaustralia.org.au</a>
<a href="#">Banking Code of Practice</a>	<a href="https://www.ausbanking.org.au/banking-code/">https://www.ausbanking.org.au/banking-code/</a>