

THE FINANCIAL OMBUDSMAN SERVICE

circular 

ISSUE 5 - MARCH 2011

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## CHIEF OMBUDSMAN'S MESSAGE

Welcome to Issue 5 of The Circular.

This issue includes an update on our 2011 National Members Conference, which is being held on 2–3 June in Melbourne. Read about the highlights of the program and find out what we are offering to support dispute resolution. Registration for the conference is now open on our National Conference Website: [www.fos.org.au/conference](http://www.fos.org.au/conference)

Another major upcoming conference is the 2011 External Dispute Resolution Forum, which FOS sponsors. The forum connects consumer advocates and dispute resolution schemes. It is being held on 20 May in Sydney. You can register here: <https://s.eventarc.com/event/view/2243/tickets/2011-afccra-conference-edr-forum>

We also wanted to tell you what we have done following our major member survey. The survey helped us to set performance benchmarks and identify areas for potential improvement. You can read about the initiatives we've implemented to meet our members' needs and enhance the service we provide to our members.

Following the introduction of the new responsible lending regime in financial services, it is important that FOS provides guidance about our approach. Commentary and case studies on responsible lending are included in this issue.

Other topics we cover in this issue include:

- Financial difficulty hot topics
- Systemic issues and serious misconduct update
- General insurance instalment contracts
- Our new feedback system
- Our Find an Insurer service for general insurance members.

As always, we welcome your feedback: [publications@fos.org.au](mailto:publications@fos.org.au)

The Circular is designed to support dispute resolution by providing practical information and explaining our approach on substantive issues. Please let us know about any topics you would like us to cover in future issues.



**Colin Neave**

**Chief Ombudsman**

## EMERGING ISSUES & TRENDS

- MALADMINISTRATION - COMMON ISSUES
- FINANCIAL DIFFICULTY - COMMON ISSUES
- MARKET VALUE - STAMP DUTY AND TRANSFER FEES
- FLOODS - THE DISTINCTION BETWEEN FLOOD/STORM DAMAGE

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### MALADMINISTRATION - COMMON ISSUES

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Assessment of maladministration in consumer credit and margin loans continues to be a focus for consumer complaints about financial services providers (FSPs).

Examples of maladministration cases we see may include:

- the FSP relies on the security of the family home with some available equity to advance funds to finance investments such as property, shares or business
- despite potentially receiving some income from the investment, the borrower then struggles to meet the balance of the repayment
- the loan falls into arrears which results in financial difficulty however this cannot be dealt with until the issue of maladministration has been dealt with
- the FSP commences debt collection activity which must cease whilst the maladministration dispute is considered and our file remains open, and
- the borrower complains to FOS that the loan should never have been granted as they could never have met the repayments and that the FSP should not have relied on their family home being sold.

In resolving these disputes, we are seeing a number of complicating factors:

- some FSPs say there was no maladministration and claim the decision to lend was an assessment of credit risk which has been made in accordance with their lending guidelines without having regard to their other obligations at law or under the Code of Banking Practice (if a subscriber)
- some FSPs focus on the financial difficulty aspect of the dispute without considering the primary issue of maladministration which underlies their current financial position. The primary issue of maladministration should be addressed in the initial FSP response, and
- some FSPs are not sufficiently aware of FOS's approach to maladministration cases and are unwilling to provide the information and documentation we require such as their lending policies and original lending file.

#### MORE INFORMATION

See Responsible Lending Conduct Obligations and Maladministration - Consumer Credit on page 24.

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## FINANCIAL DIFFICULTY - COMMON ISSUES

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The large number of financial difficulty disputes being received by this office over the last half year has placed pressure on IDR departments and we have seen a marked increase in the failure to respond by some FSPs.

It will be important to see more resources deployed in those areas assisting customers in financial difficulty.

In this Circular, we discuss emerging issues for the effective resolution of disputes about financial difficulty. These issues include:

- the extent of the information FSPs require applicants to provide to FSPs when assessing a request for assistance
- what an FSP can do if a consumer does not provide requested information
- concerns about capitalising arrears out of concern this may breach the responsible lending provisions of the National Credit Code
- what happens if a repayment arrangement entered into in resolution of a dispute cannot be met and an applicant lodges a further dispute.

### MORE INFORMATION

See Financial Difficulty - Hot Topics on page 7.

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## MARKET VALUE - STAMP DUTY AND TRANSFER FEES

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The calculation of market value and total loss varies significantly from policy to policy.

Some policies expressly include stamp duty, and transfer fees in the calculation although this is not universal.

The issue has been discussed at length with the industry to ensure all insurers are adhering to policy wording and to try and clarify any grey area.

One insurer has been found to be in breach by failing to include stamp duty transfer fees despite this being explicitly provided for in the policy. This issue has been resolved.

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## FLOODS - DISTINCTION BETWEEN FLOOD/STORM DAMAGE

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Floods throughout Queensland and Victoria have focussed the debate on the availability of flood insurance, policy wording and the extent of flood cover. There has been a considerable increase in the number of inquiries from consumers as to the extent of cover and we are seeing the first of the disputes. Most claim disputes will involve the distinction between flood and storm damage.

FOS has attended community forums in Queensland and Victoria as part of the Insurance Taskforce and supported the Insurance Council of Australia's initiative to have independent hydrological panels report on the likely cause of the 'flooding'.

Some of these reports are now available and, following consultation with industry and consumer groups, FOS proposes utilising these reports to provide preliminary assessments of disputes. The parties will be provided with the assessment and a checklist of the further information required. By doing this we hope to provide the parties with an early indication of the likely success of a claim and some guidance on the additional information needed if they want to proceed with the dispute.

### MORE INFORMATION

[www.fos.org.au/circular3/Flood-claims.html](http://www.fos.org.au/circular3/Flood-claims.html)

## FINANCIAL DIFFICULTY - HOT TOPICS

- INFORMATION YOU NEED TO GIVE FOS
- VARIATION OF A CREDIT CONTRACT
- APPLICATION OF THE RESPONSIBLE LENDING PROVISIONS OF THE NCC
- PRESERVATION OF ASSETS
- REPAYMENT AGREEMENT AND SUBSEQUENT FINANCIAL DIFFICULTY

The “hot topics” discussed below are issues that often arise when we consider financial difficulty disputes. The purpose of discussing these topics is to help stakeholders to understand our dispute resolution process and our approach to financial difficulty disputes. We hope increasing applicants’ and financial services providers’ (FSP) understanding of the process and approach will result in:

- more timely resolution of disputes lodged with us, and
- resolution of more disputes by parties without the need to lodge a dispute with FOS.

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## INFORMATION YOU NEED TO GIVE FOS

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To help us to resolve disputes fairly and efficiently, applicants and FSPs need to answer questions about the dispute and provide supporting information and documents wherever possible.

### APPLICANTS

Generally, we expect applicants to provide the information we describe below as early as possible during our consideration of the dispute.

### INDIVIDUALS

#### *INFORMATION ABOUT YOUR CURRENT FINANCIAL POSITION*

Applicants should provide a current statement of financial position which includes information about their current:

- income
- expenses
- assets and
- liabilities.

Relevant supporting documents may include:

- Centrelink records
- financial records
- contracts of employment and
- other documents which show how payments can be met in the future.

FOS has developed a statement of financial position that applicants can complete. It is available on our website at [www.fos.org.au/public/download.jsp?id=6367](http://www.fos.org.au/public/download.jsp?id=6367)

### **INFORMATION ABOUT HOW TO REPAY THE DEBT**

Applicants should review their financial circumstances so they can:

- make a realistic proposal for repayment of the debt, and
- show how they will be able to repay the debt in the long term if their proposal is accepted.

Where a debt is unsecured, this information is generally required to enable us to progress the dispute.

Where a debt is secured, the dispute may progress to conciliation. Where a repayment arrangement cannot be reached, the appropriate resolution may be a timeframe for sale of the asset. Such a resolution may be facilitated at a telephone conciliation conference.

### **SMALL BUSINESSES**

Where an applicant is a small business, we expect the business to provide sufficient information to demonstrate the business is viable as a going concern. This might include:

- recent financial statements
- a business plan
- cash flow statements and projections
- aged debtor and creditor listings and
- tax records.

You will need to supply the documents which support the assumptions made in the business plan and cash flow projections.

Further details about our approach to where the applicant is a small business were outlined in Circular Issue 2 (April 2010) available at: [www.fos.org.au/circular2smallbusiness](http://www.fos.org.au/circular2smallbusiness)

### **FINANCIAL SERVICES PROVIDERS**

The initial response provided to FOS should include the following information and supporting documents:

- how the FSP has responded to the customer's request for assistance
- any previous requests for assistance and how the FSP responded to these
- the steps the FSP has taken to try and assist their customer to overcome their financial difficulty
- details of the credit facility, the arrears and the outstanding debt, and possible repayment arrangements the FSP would be prepared to consider.

Many initial responses received from FSPs do not include all of the information needed to allow us to consider the dispute. Whilst an FSP may not have current details of their customer's financial position, we expect the information outlined above to be provided with their initial response.

Where an FSP is trying to negotiate directly with their customer to resolve the dispute, they will often delay providing the requested information to FOS. This can cause delays in the progression and timely resolution of the dispute.

Requesting customers to provide excessive documentation, such as:

- rental agreements
- specialist certificates where a doctor's certificate has already been provided
- utility bills, or
- rates notices

can be a barrier to dealing with hardship assistance.

Our view is that an FSP should make an assessment based on the information it has available. Where assumptions have been made (for example, that the monthly wages relied upon have not been verified) the FSP should identify any assumptions made and what, if any, additional documentation will be required from the customer before a repayment arrangement can be entered into.

### **CONSEQUENCES OF ANY FAILURE TO PROVIDE INFORMATION**

The consequences of non compliance with a FOS request for information are set out in paragraph 7.5 of the FOS Terms of Reference (TOR) and explained in the guideline to paragraph 7.5. Non compliance without reasonable excuse may have the consequences described below:

- where an applicant does not provide information we request, we may refuse to continue to consider the dispute. In such cases, we will warn the applicant that failure to provide the information will result in file closure and upon closure of our file the FSP will be entitled to commence or continue recovery action
- where an FSP does not provide information we request, we may progress the dispute and can ultimately proceed to issue a decision, and
- where a party fails to provide information we request, we may draw an adverse inference that the information does not favour that party.

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## VARIATION OF A CREDIT CONTRACT

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Paragraph 9.1 of the FOS TOR gives FOS the power to require the FSP to undertake a course of action to resolve a dispute. This includes requiring an FSP to vary the terms of certain credit contracts in cases of financial hardship (para 9.1(f)).

FOS may only vary credit contracts that are regulated by either the Uniform Consumer Credit Code (UCCC) or the National Credit Code (NCC), such as credit cards, home loans or personal loans. Loans used primarily for business purposes are not regulated, and therefore we do not have the ability to vary the terms of these loans. However we still expect FSPs to give genuine consideration to an applicant's request for assistance where the loan is not regulated.

For contracts that are regulated, the types of variations that FOS can require include:

- extending the term of a loan
- postponing repayments for a specific period, or
- establishing a short or long term repayment arrangement.

Potential variations are not limited to those stipulated in section 72 of the NCC. They include any reasonable contractual arrangement that may help an applicant to overcome their financial difficulty.

FOS will only require an FSP to provide assistance to an applicant if we are satisfied that:

- the applicant will be in a position to meet their long term contractual
- obligations at the end of the period of assistance if the contract is varied; and
- assistance would be appropriate taking into account the applicant's current financial position.

When FOS considers whether a variation will be made, we take into account:

- the FSP's desire to see the loan repaid, and
- the applicant's interest in ultimately discharging their contractual obligations.

We expect that any assistance should result in the debt being repaid in full, even if this is over a longer period. This will generally mean that the applicant will need to demonstrate an ability to service the loan going forward. However what is appropriate for each applicant will depend on their individual circumstances, and this can only be considered if the applicant provides the relevant information and supporting documents requested by FOS.

Where a loan is secured over an asset, for example a home loan or vehicle loan, and the applicant has not demonstrated that they will be able to meet their contractual repayments in the long term, sale of the asset may be the appropriate resolution. If this is the case, we may arrange a telephone conciliation conference to discuss a timeframe for the applicant to sell the asset voluntarily.

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## APPLICATION OF THE RESPONSIBLE LENDING PROVISIONS OF THE NCC

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The responsible lending provisions of the NCC will not apply to hardship variations if a new credit contract is entered into. ASIC Information Sheet 105 states that:

The responsible lending provisions will not apply to hardship variations unless additional credit is provided (which would be unlikely in the vast majority of cases) or existing obligations are refinanced (creating a new contract instead of varying the existing contract). This does not mean that a consumer's capacity to meet revised payment obligations is not important—it is in fact an important part of the hardship process, and failure to pay sufficient regard to affordability could leave a variation open to challenge as unjust. See s76 of the National Credit Code.

ASIC Information Sheet 105 is available from [www.asic.gov.au/asic/asic.nsf/byheadline/Dealing-with-consumers-and-credit?openDocument](http://www.asic.gov.au/asic/asic.nsf/byheadline/Dealing-with-consumers-and-credit?openDocument)

### CONSOLIDATION OF LOANS

A renegotiation of the credit contract after it has been entered into may be:

- a variation of the existing contract, or
- a new credit contract.

Whether it is a variation or a new contract will depend on the nature of the proposed changes. For example:

- consolidation of a credit card debt into a home loan may invoke the responsible lending provisions if a new credit contract is formed,
- if instead funds are redrawn from the home loan in order to pay out the credit card debt, the responsible lending provisions do not apply because no new credit contract is formed.

We will assess each situation on a case-by-case basis.

### CAPITALISATION OF ARREARS

Capitalising interest that is in arrears does not of itself result in a new contract and can be achieved within the provisions of the existing contract.

For this reason, we do not believe that the FSP needs to satisfy the responsible lending provisions of the NCC as there is no increase in the credit limit if an FSP offers to capitalise the arrears in resolution of the dispute. However, the repayments should still be affordable.

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## PRESERVATION OF ASSETS

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Paragraph 13.1(b)(ii) of the FOS TOR recognises that it may be necessary for the FSP to take action to preserve assets the subject of the dispute. This may be because the assets are at risk of loss, damage or disposal.

The FSP should first contact FOS to discuss its request to preserve its assets. The request must be in writing and the FSP must explain:

- what action the FSP wants to take
- why it is necessary to take such action,

and provide relevant supporting information and documents.

Generally, FOS will agree to such a request if information is provided to show that the asset is at some additional risk of being lost, damaged or disposed of whilst it remains in the possession of the applicant. The information provided to support the application must show that it is more likely than not that there is an additional risk. Increasing arrears and an uncertain security position is generally not sufficient for FOS to provide its consent.

Circumstances where we have provided consent include disputes where:

- an applicant would not disclose the whereabouts of a security vehicle; and
- a business had closed its doors and information provided showed the stock was being removed.

FOS understands such requests are often urgent and, where possible, will treat such requests with priority.

FOS Circular 3 update provides further guidance on the operation of paragraph 13.1 of the TOR. Specifically, paragraph 13.1(a)(iii) requires an FSP to cease recovery action over an asset securing a debt which is the subject of the dispute while our file remains open. This information is available at [www.fos.org.au/public/download.jsp?id=9795](http://www.fos.org.au/public/download.jsp?id=9795).

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## REPAYMENT AGREEMENT AND SUBSEQUENT FINANCIAL DIFFICULTY

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Where a repayment agreement has been entered into in resolution of a dispute and:

- it cannot be met, or
- relevant time frames have expired and normal repayments cannot resume,

recovery action may recommence, where our file has been closed. It is preferable that the terms of settlement include a provision that the FSP will give at least seven days' notice of its intention to recommence recovery action when the terms of the agreement have not been met.

In many cases an applicant will lodge a further dispute. This often occurs where the financial difficulty is ongoing and long term and, despite the applicant's best intentions, they are unable to meet a repayment arrangement.

Paragraph 5.1 of the TOR sets out the circumstances in which FOS will not consider a dispute. These circumstances include:

- where a dispute has already been dealt with by FOS or in another forum, or
- where a dispute has already been resolved by agreement. These points are explained in the Operational Guidelines to paragraph 5.1.

We will not re-open a dispute if it has already been dealt with by us or another forum. However, if there are sufficient additional events and facts raised in the new dispute to warrant our further consideration, we may consider the new matters raised.

Additional events and facts which are sufficient to warrant FOS's consideration of the dispute arise where:

- the additional events and facts were central to the outcome of the dispute dealt with earlier (rather than surrounding or peripheral circumstances), and
- it would not be fair in all the circumstances to allow the outcome of the earlier dispute to stand.

Where the previous dispute was "dealt with" by way of a settlement agreement signed by both parties, FOS will not generally consider the dispute unless:

- the FSP has failed to comply with the terms of any settlement agreement reached, or
- new issues have arisen post the date of the settlement agreement which were not covered by the terms of settlement and which can be considered by FOS.

We may request further information from the parties to form a view about this.

As a part of any negotiated outcome, it is important that the parties to a dispute discuss and agree what will occur in relation to any outstanding debt where a default occurs under the repayment/settlement agreement. This provides clarity for the parties in the event of default, particularly where legal proceedings are on foot at the time of lodgment of the FOS dispute.

In some cases, the terms of a repayment arrangement may include a partial waiver of the debt. If so, where a subsequent event of default occurs, the amount recoverable by the FSP may depend upon the wording of any settlement agreement. This was discussed in a recent decision issued in the Supreme Court of New South Wales (*Bendigo and Adelaide Bank Limited v Tombs and Anor* [2010] NSWSC 1427, 3 December 2010).

Where a dispute has not been “dealt with” by FOS but our file was closed because the applicant failed to provide requested information or to comply with some other request by FOS, we will only reopen our file where:

- there was good reason for the applicant’s failure to comply
- there are outstanding issues
- reopening will not unfairly prejudice the FSP, and
- the applicant has now complied with FOS’s request.

Where legal proceedings were on foot at the time the dispute was lodged, then a file will only be reopened if the applicant can also establish that there are exceptional circumstances why the file should be reopened.

If you are aware of any other hot topics involving financial difficulty that you would like FOS to address, please email us at [publications@fos.org.au](mailto:publications@fos.org.au) and let us know. Our commentary will, of course, be provided on a de-identified basis.

## SYSTEMIC ISSUES & SERIOUS MISCONDUCT - UPDATE

- MAKE SAFE PROVISIONS
- POWERS OF ATTORNEY
- SECTION 22 OF THE INSURANCE CONTRACTS ACT
- CANCELLATION OF GENERAL INSURANCE CONTRACTS
- POLICIES FOR DEALING WITH CONSUMERS IN FINANCIAL DIFFICULTY

This article summarises systemic issues that we identified during the December quarter of 2010 and reported to ASIC. The article updates information about systemic issues provided in the December Circular, which includes an explanation of our systemic issues process. The December 2010 article can be found here: [www.fos.org.au/centric/the\\_circular\\_4\\_home/systemic\\_issues.jsp](http://www.fos.org.au/centric/the_circular_4_home/systemic_issues.jsp)

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### “MAKE SAFE” PROVISIONS IN GENERAL INSURANCE CONTRACTS

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FOS considered several general insurance disputes relating to a financial services provider’s (FSP) practice of applying an excess to “make safe” repairs where the claim had been denied by the FSP or withdrawn by the policyholder. We were concerned that the FSP had sought payment from the applicants of the full expenses incurred, even though the repairers in each case had also undertaken loss assessment functions.

The FSP acknowledged that, for expenses that related solely to investigation or assessment, it would not be appropriate to seek payment from policyholders. The FSP will investigate whether policyholders other than the applicants in the disputes considered by FOS may have been affected by the FSP’s practice.

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### RECOGNITION OF POWER OF ATTORNEY

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A number of disputes lodged with FOS related to action taken by a particular FSP. The FSP had prevented attorneys from performing their roles under powers of attorney to help donors who were customers of the FSP to manage their accounts. We considered whether:

- in these cases, the FSP incorrectly refused to recognise powers of attorney by denying access to accounts, and
- the FSP had taken the same action in other cases.

The FSP said that it was concerned about risks to the donors of the powers of attorney, particularly where the FSP provided credit increases that increased the donors’ liabilities and repayments.

Our view is that an act of an attorney under a power of attorney is, legally, an act of the donor. Accordingly, the correct analysis is that anything done by the attorney has the same legal effect as if it were done by the donor. It is therefore not a matter of commercial decision for the FSP as to whether it accepts the actions of the attorney. In our view, it must do so, subject to any actual or constructive notice of a misuse of the power by the attorney. Insofar as the FSP has a discretion as to whether it can accede to a request by a customer, then it can consider that matter as a commercial one in the same way.

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## FAILURE TO COMPLY WITH SECTION 22 OF THE INSURANCE CONTRACTS ACT

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FOS considered a dispute about the denial of the applicant's motor vehicle claim. We determined the dispute in favour of the applicant. We found that the information provided by the FSP at the point of sale did not comply with section 22 of the Insurance Contracts Act 1984 because:

- the information did not clearly inform the applicant of the matters referred to in section 22(1), due to its wording, and
- the information was not in accordance with Schedule 1 of the Insurance Contracts Regulations 1985, as required by section 22(2).

The FSP agreed that the information did not comply with section 22. As this information was provided to consumers other than the applicant, the issue was determined to be systemic.

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## CANCELLATION OF GENERAL INSURANCE CONTRACTS

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An FSP purported to cancel motor vehicle insurance contracts from inception due to non-disclosure of material facts. Section 28(2) of the Insurance Contracts Act 1984 (the "ICA") allows an insurer to avoid a general insurance contract where there is a fraudulent non-disclosure or misrepresentation by the insured. Avoidance of a contract applies from inception. Where there is no fraud, the ICA only permits an insurer to cancel a general insurance contract prospectively.

FOS conducted investigations to ensure that the FSP:

- has processes and procedures in place that comply with the requirements of the ICA for cancellation and avoidance of contracts, and
- does not incorrectly cancel or avoid contracts of general insurance.

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## POLICIES FOR DEALING WITH CONSUMERS IN FINANCIAL DIFFICULTY

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A number of disputes lodged with FOS raised concerns about the way in which an FSP dealt with consumers in financial difficulty. We reviewed the FSP's hardship policy and found that it required consumers in financial difficulty to provide a great deal of documentation before they could access the FSP's hardship arrangements. We expressed the view that these documentation requirements were excessive, making the policy inadequate.

When investigating and resolving systemic issues, we work with FSPs as identifying a reasonable and appropriate solution requires an in-depth appreciation of the fine detail of the business processes and resources which support the solution.

## INSTALMENT CONTRACTS OF GENERAL INSURANCE

- WHAT IS AN INSTALMENT CONTRACT?
- LEGISLATION
- DISPUTE RESOLUTION EXPERIENCE
- CASE STUDY
- SUMMARY

FOS has resolved a number of disputes concerning instalment contracts where the consumer has missed an instalment payment. In these disputes, the financial services provider (FSP) has denied a claim and/or cancelled the insurance contract.

This article:

- highlights important provisions of legislation applicable to these disputes
- provides information gained through our dispute resolution experience, and
- includes a case study based on a dispute that we determined, to illustrate the issues discussed.

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### WHAT IS AN INSTALMENT CONTRACT?

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An instalment contract of general insurance is a contract that provides for the premium to be paid by seven or more instalments over a year.

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### LEGISLATION

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The Insurance Contracts Act 1984 (the Act) imposes requirements that insurers have to meet when considering:

- cancellation of a contract or
- denial of a claim under the contract

where a consumer misses an instalment payment.

Provisions including sections 39, 59, 62 and 63 of the Act can apply in these situations. These sections are reproduced for your information at the end of this article.

### CANCELLATION OF A CONTRACT

Section 59 sets out a procedure for cancellation of an insurance contract. The section requires an insurer wishing to exercise a right to cancel an insurance contract to give the consumer written notice of the proposed cancellation. Section 59 states the time at which such a notice cancels the contract. Section 77 contains provisions relating to the giving of notices.

Section 62 applies when an insurer seeks to rely on a contractual provision inconsistent with section 59 or 77 to cancel an instalment contract for non-payment of an instalment. Section 62 states that an insurer may not rely on such a provision unless:

- at least one instalment of the premium has remained **unpaid for a period of at least one month and**
- before the contract was entered into, the insurer **clearly informed the consumer in writing** of the effect of the provision.

Section 63 states that an insurer may not cancel a contract of general insurance except as provided by the Act. ***Any purported cancellation that contravenes the Act is of no effect.***

### DENIAL OF A CLAIM

Where a consumer misses an instalment payment and the instalment contract provides that the insurer can deny a claim for non-payment, section 39 does not allow the insurer to rely on that provision unless:

- at least one instalment of the premium has remained **unpaid for a period of at least 14 days and**
- before the contract was entered into, the insurer **clearly informed the consumer in writing** of the effect of the provision.

### CONTRACTUAL PROVISIONS FOR CANCELLATIONS OR DENIALS BECAUSE OF NON PAYMENT

If an instalment contract provides for denial of a claim or cancellation of the contract for non-payment of an instalment, the insurer can only rely on the provision if it informed the consumer clearly in writing of the effect of the provision before the contract was entered into.

### EXTENSIONS OF TIME FOR INSTALMENT PAYMENTS

An insurer may extend the time that a consumer has to pay a particular instalment. If the due date for an instalment is extended, however, any steps taken to cancel the contract will need to take this into account. A purported cancellation may be void if it is not based on the extended time frame.

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## DISPUTE RESOLUTION EXPERIENCE

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Information gained through our dispute resolution experience is set out below along with comments based on that experience. This material is provided to help reduce disputes about instalment contracts and facilitate the resolution of those disputes.

### **INSURERS SHOULD CONSIDER ADVISING CONSUMERS ABOUT MISSED PAYMENTS THROUGH A NUMBER OF CHANNELS**

In a number of disputes that we have considered, the FSP has written to the consumer to inform them that they missed an instalment payment, but not attempted to contact the consumer in any other way.

We encourage insurers to consider other approaches, such as contact by telephone or email.

### **CONSUMERS SHOULD ENSURE THEIR CONTACT DETAILS AND ACCOUNT INFORMATION ARE UPDATED**

FOS has considered instalment contract disputes in which:

- the FSP has sent the consumer notice of a missed payment by post, but the consumer did not receive the notice
- instalments were to be debited against a specific credit card, but the card was cancelled and the consumer did not inform the FSP of the cancellation, and
- instalments were to be deducted from a specific bank account, but that account was closed and the consumer did not give the FSP details of another account to use.

A consumer with an instalment contract should ensure the insurer has:

- the consumer's current:
  - postal address
  - telephone numbers, and
  - email addresses and
- up to date details of any credit card or bank account from which instalments are to be paid.

### **INFORMATION TO PROVIDE TO FOS**

When considering a dispute about whether an FSP correctly cancelled an instalment contract or denied a claim under such a contract, FOS needs to take into account all relevant correspondence between the parties.

If there was a change:

- in the consumer's contact details, or
- affecting instalment payment arrangements;

the consumer should provide to FOS:

- if the consumer informed the FSP of the change in written correspondence, a copy of the correspondence
- if the consumer informed the FSP of the change in a telephone or face to face conversation, information about the conversation to answer:
  - Who did the consumer speak to?
  - When did the conversation take place (time and date)?
  - What was said in the conversation, particularly by the consumer?

**CONSUMERS SHOULD UPDATE THEIR INSURERS DIRECTLY**

A consumer in one dispute lodged with FOS advised a company related to the FSP, but not the FSP itself, of a change to the consumer's postal address. The consumer assumed that the related company would advise the FSP of the change. Consumers cannot assume that information will be passed on to insurers by related parties. Consumers should provide information to their insurers directly. Privacy laws may prevent a related party from passing on information to an insurer.

**CONSUMERS MUST ENSURE INSTALMENTS ARE PAID**

In a number of instalment contract disputes considered by FOS, for a considerable time, the consumer did not hear from the FSP or pay instalments as arranged from a credit card or bank account. FOS has consistently stated that in these cases the consumer must ensure that funds are available to cover any instalments due and that they are paid. As explained above, consumers should also keep their contact details and payment arrangements up to date.

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## CASE STUDY

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### THE CLAIM

The Applicants arranged a comprehensive motor vehicle insurance policy with the FSP on 18 March 2008. This was an instalment contract. The FSP took action to cancel the policy on 1 May 2008 following non-payment of premium instalments.

The Applicants lodged a claim after their motor vehicle suffered damage in an accident on 26 October 2009. The Applicants said they did not receive letters from the FSP to request payment of the unpaid instalments and to cancel the instalment contract. The Applicants said they were unaware the FSP had cancelled their policy.

### THE FSP'S POSITION

The FSP denied the Applicants' claim, relying on a policy provision relating to the consequences of non-payment of premium instalments.

### FOS ASSESSMENT

For approximately 18 months the Applicants failed to realise the FSP had not deducted instalment payments from a bank account as arranged. Consumers have an obligation to ensure funds are available to cover any instalments due to an insurer and that these instalments are being deducted. In this case, at least one instalment remained unpaid for a period of more than 14 days. This entitled the FSP to deny the Applicants' claim as its policy provision was in compliance with section 39 of the Act.

The FSP's purported cancellation of the instalment contract however was void. The FSP had notified the Applicants by letter that it had extended the instalment due date by 14 days from the original due date. When the FSP subsequently informed the Applicants of the cancellation, as required under the contract, it had failed to adjust the relevant dates. As a result, the FSP failed to comply with the Act and therefore the purported cancellation was ineffective.

*(This case study is based on Determination number 213726, which is on our website at [www.fos.org.au/decisions](http://www.fos.org.au/decisions), along with other determinations that deal with issues arising where consumers miss instalment payments.)*

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**SUMMARY**


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The Act imposes requirements that an insurer must meet if it seeks to cancel an instalment contract or deny a claim under the contract for non-payment of an instalment payment.

Failure to comply with the requirements may mean that a purported cancellation is void and/or that a claim denial has no effect.

**INSURANCE CONTRACTS ACT 1984 -**
***SECTION 39 - INSTALMENT CONTRACTS OF GENERAL INSURANCE***

Where a provision included in an instalment contract of general insurance has the effect of limiting the liability of the insurer by reference to non payment of an instalment of the premium, the insurer may not refuse to pay a claim, in whole or in part, by reason only of the operation of that provision unless:

- (a) at least one instalment of the premium has remained unpaid for a period of at least 14 days; and
- (b) before the contract was entered into, the insurer clearly informed the insured, in writing, of the effect of the provision.

***SECTION 59 - CANCELLATION PROCEDURE***

- (1) An insurer who wishes to exercise a right to cancel a contract of insurance shall give notice in writing of the proposed cancellation to the insured.
- (2) The notice has effect to cancel the contract at whichever is the earlier of the following times:
  - (a) the time when another contract of insurance between the insured and the insurer or some other insurer, being a contract that is intended by the insured to replace the first mentioned contract, is entered into;
  - (b) whichever is the latest of the following times:
    - (i) 4 pm on the applicable business day;
    - (ii) if a time is specified for the purpose in the contract--that time;
    - (iii) if a time is specified in the notice--that time.
- (2A) In subparagraph (2)(b)(i):
 

“applicable business day” means:

  - (a) in respect of a contract that is not a contract of life insurance:
    - (i) if the contract is in force because of section 58 - the fourteenth business day; or
    - (ii) otherwise - the third business day; or
  - (b) in respect of a contract of life insurance - the twentieth business day; after the day on which the notice was given to the insured.
- (3) This section does not apply to a contract of life insurance if the life policy that is constituted by the contract may be forfeited in accordance with subsection 210(5) of the Life Insurance Act 1995.

**SECTION 62 - CANCELLATION OF INSTALMENT CONTRACTS OF GENERAL INSURANCE**

- (1) An instalment contract of general insurance may include provisions inconsistent with section 59 or 77 with respect to the cancellation of the contract for non-payment of an instalment of the premium.
- (2) An insurer may not rely on such a provision unless:
  - (a) at least one instalment of the premium has remained unpaid, at the time when the contract is sought to be cancelled, for a period of at least one month; and
  - (b) before the contract was entered into, the insurer clearly informed the insured in writing of the effect of the provision.

**SECTION 63 - CANCELLATIONS VOID**

Except as provided by this Act, an insurer may not cancel a contract of general insurance and any purported cancellation in contravention of this section is of no effect.

**SECTION 77 GIVING NOTICES**

- (1) A notice or other document that is by this Act required or permitted to be given may be given:
  - (a) to a body corporate--in any way in which documents may be served on the body corporate; and
  - (b) to a natural person:
    - (i) personally; or
    - (ii) by post to that person at the person's last known address.
- (2) If a notice of cancellation of a contract of insurance is given to an insured by post, the notice shall be deemed to have been given at the time at which it would have been delivered in the ordinary course of post unless the insured proves that, through no fault of the insured, the insured did not receive it.

## FIND AN INSURER SERVICE

The FOS website includes a Find an Insurer tool ([www.fos.org.au/findaninsurer](http://www.fos.org.au/findaninsurer)) that consumers can use to find insurers who provide a particular type of general insurance or to find the contact details of a particular general insurer. The tool only lists members of FOS and does not list all the general insurance members of FOS at present.

## HOW THE SERVICE BENEFITS OUR MEMBERS

Signatories to the General Insurance Code of Practice are required to refer a consumer to another insurer, to FOS or to the National Insurance Brokers Association (NIBA) for further help if the consumer is looking for a type of insurance that they don't provide.

FOS created the Find an Insurer tool to help its members to fulfil this obligation and save time with consumer enquiries. Find an Insurer also helps our members by informing their potential customers of the range of products they provide.

NIBA's website includes a complementary tool, called Need a Broker ([www.needabroker.com.au](http://www.needabroker.com.au)), that consumers can use to search for insurance brokers in their area.

## HOW MEMBERS SHOULD USE THE SERVICE

If you are a general insurer and a consumer is looking for a type of insurance that you don't provide, we recommend :

- either
  - you give the consumer the link to the Find an Insurer tool - [www.fos.org.au/findaninsurer](http://www.fos.org.au/findaninsurer) (rather than FOS's phone number), or
  - you use the Find an Insurer tool yourself to generate a list of insurers that might be able to help the consumer; and
- if the consumer is interested in using a broker, you refer them to [www.needabroker.com.au](http://www.needabroker.com.au).

## HOW TO BE LISTED IN FIND AN INSURER

Not all the general insurance members of FOS are currently listed in the Find an Insurer tool. If you are not listed, but would like to be, you simply need to fill out an electronic form (<http://www.fos.org.au/public/download.jsp?id=13835>) and return it by email to [findaninsurer@fos.org.au](mailto:findaninsurer@fos.org.au). We will then add your details to Find an Insurer.

## HOW TO UPDATE YOUR DETAILS

If you are already listed in Find an Insurer but your list of products or your contact details have changed, please email the changes to [findaninsurer@fos.org.au](mailto:findaninsurer@fos.org.au). We do our best to keep the listings up to date, but we encourage you to check your listing from time to time.

If you have any queries about the Find an Insurer service, please contact Olga Greco-Alberton on 03 9631 7401.

## RESPONSIBLE LENDING CONDUCT OBLIGATIONS & MALADMINISTRATION

- CONSUMER CREDIT
- MARGIN LENDING
- CASE STUDY - LOW DOC LENDING
- CASE STUDY - INVESTMENT LENDING

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### CONSUMER CREDIT

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The national credit reforms introduced by the National Consumer Credit Protection Act 2009 (NCCP) have given birth to a statutory concept of “responsible lending” obligations which apply to loans or increases in loans.

For some years, FOS has considered disputes regarding “maladministration in lending”. FOS continues to do so under its current Terms of Reference.

The responsible lending obligations and FOS’s approach to maladministration are closely linked. A dispute is likely to raise both issues. This article discusses FOS’s approach to:

- the financial services provider (FSP)’s responsible lending obligations under the NCCP, and
- maladministration.

We provide some guidance on the inquiries we consider appropriate to assess a consumer’s ability to service their credit facility in accordance with their obligations in light of both the responsible lending obligations and maladministration. Specific commentary is provided about our approach to low doc lending.

### FOS TERMS OF REFERENCE (TOR)

The TOR allow FOS to consider a dispute raising the question of whether the FSP breached the responsible lending obligations and whether there has been maladministration.

Paragraph 5.1 of the TOR says FOS may not consider a dispute about an FSP’s assessment of the credit risk posed by a client or the security to be required for a loan – but this does not prevent FOS from considering a dispute claiming maladministration in lending, loan management or security matters. This means FOS does have jurisdiction to consider disputes about maladministration. Maladministration means:

“... an act or omission contrary to or not in accordance with a duty or obligation owed at law or pursuant to the terms (express or implied) of the contract between the Financial Services Provider and the Applicant.”

As the responsible lending obligations are a duty owed at law in lending, loan management or security matters, a dispute about whether an FSP breached those obligations is within FOS’s TOR.

FOS’s TOR also provide that, when deciding a dispute and whether a remedy such as compensation should be provided, FOS will do what in its opinion is fair in all the circumstances, having regard to:

- legal principles
- applicable industry codes or guidance as to practice
- good industry practice, and
- previous relevant decisions of FOS or a predecessor scheme (although FOS will not be bound by these).

Therefore, our approach to responsible lending disputes takes into account:

- the NCCP
- any case law on the NCCP as it is developed by the courts
- ASIC's guidelines
- industry codes and practices, and
- our past approach to claims of maladministration in lending (see Bulletins 45, 50 and 60).

### **RESPONSIBLE LENDING UNDER THE NCCP**

The NCCP provides that:

- a credit assistance provider must, after making reasonable inquiries and taking reasonable steps to verify information, make a "preliminary assessment" about whether the consumer's contract or changes to the consumer's contract will be not "unsuitable", and
- a credit provider must, after making reasonable inquiries and taking reasonable steps to verify information, make a "final assessment" about whether the consumer's contract or changes to the consumer's contract will be not "unsuitable" .

A loan will be not unsuitable if:

- it meets the consumer's requirements and objectives, and
- the consumer has the capacity to repay the loan without experiencing substantial hardship.

### **NEED TO MAKE "REASONABLE INQUIRIES"**

The responsible lending obligations require reasonable inquiries to be made about the consumer's financial situation and their requirements and objectives. In Regulatory Guide 209 (RG 209), the Australian Securities and Investments Commission (ASIC) has provided some guidance on, and examples of, the extent of the inquiries an FSP should make when assessing a consumer's application for credit.

### **CONSUMER'S FINANCIAL SITUATION**

ASIC suggests inquiries about the following matters, to assess the consumer's financial position, would be included in reasonable inquiries (see RG 209, page 12):

- the consumer's amount and source of income, including the length and nature of their employment
- the consumer's fixed expenses, such as rent, repayments to other loans/debts, child support, insurance
- the consumer's variable expenses
- any existing debts that are to be repaid from the loan
- the consumer's credit history
- the consumer's age and number of dependants
- the consumer's assets
- reasonably foreseeable changes, such as the end of a honeymoon period on a loan, impending retirement, or the end of seasonal employment, and
- geographical factors, such as remoteness (which may increase expenses).

## CONSUMER'S REQUIREMENTS AND OBJECTIVES

ASIC has provided guidance (see RG209 page 13) about what reasonable inquiries about a consumer's requirements and objectives could include. These are:

- the amount of credit needed or the maximum amount sought
- the timeframe for which it is required
- the purpose and benefit sought, and
- whether the consumer seeks particular product features or flexibility, and understands the costs of these features and any additional risks.

A consumer's loan must meet their requirements and objectives. For example, a consumer who is retired and lacks the income stream required to service a loan might benefit from a reverse mortgage product which allows them access to their equity in their property. However, a line of credit for far more than the consumer requires, with the excess applied to meet the consumer's interest payments may not be suitable as there would be a finite time before the excess funds were totally depleted, after which the loan would be fully drawn and the consumer would have no capacity to continue to service the debt.

ASIC says that an FSP's obligations are scaleable – what is required will vary depending on the circumstances.

## BASE LINE INQUIRIES TO ESTABLISH A LOAN WAS NOT UNSUITABLE

As a minimum, FOS considers there should be evidence of the consumer's capacity to repay such as:

- verification of PAYG income by reference to payslips or
- verification of self-employed income by reference to tax returns and bank statements.

This requirement, in our view, is not scaleable, but rather a mandatory consideration.

## FOS APPROACH TO ASSESSING SCALEABILITY

As ASIC has identified, FOS considers that the obligation to make reasonable inquiries is scaleable. In our view, the scale of inquiries should be established with reference to the type of consumer and the type of product. We would have regard to the circumstances of a case including the following factors:

- the potential impact on the client of entering into an unsuitable loan
- the complexity of the loan arrangements, and
- the ability of the client to understand the loan arrangements.

## USE OF GENERIC DATA TO INQUIRE ABOUT EXPENDITURE

In relation to a consumer's regular expenditure, FSPs in the industry segment offering high volume/low value credit facilities, such as credit cards, have customarily relied upon generic data to assess a consumer's living expenses. In our view, this data often fails to take into account:

- particular needs such as additional medical and pharmaceutical expenses
- voluntary commitments such as school fees, and
- additional transport costs due to remote location.

Without an assessment of individual circumstances, FSPs can offer a credit limit which the consumer cannot afford. This sometimes arises when the source of the lump sum payment to a credit card account is a balance transfer to another provider but the account is not closed.

While we do not endorse the use of generic data, we may, when investigating a dispute, consider an FSP could prudently rely upon generic data, particularly if it considered the consumer had under-estimated their financial expenditure. Each case would be assessed on its own merits.

## **GOOD INDUSTRY PRACTICE AND INDUSTRY CODES AS GUIDE TO APPROPRIATE INQUIRIES**

When considering a dispute regarding responsible lending under the NCCP, as well as referring to ASIC's guidelines, we will have regard to relevant provisions of the Code of Banking Practice (CBP) and the Mutual Banking Code of Practice (MBCP). While a FOS member against whom a dispute has been lodged may not be a subscriber to the CBP or the MBCP, we consider these codes reflect good industry practice and we will therefore have regard to the practices of subscribing banks and mutuals when considering if the FOS member has, in the circumstances giving rise to the dispute, acted appropriately.

### **CODE OF BANKING PRACTICE (CBP)**

Clause 25.1 of the CBP provides:

"Before we [the bank] offer or give you a credit facility (or increase an existing credit facility), we will exercise the care and skill of a diligent and prudent banker in **selecting and applying** our credit assessment methods and in forming our opinion about your ability to repay it." (our emphasis added).

### **MUTUAL BANKING CODE OF PRACTICE (MBCP)**

Clause 6 of the MBCP provides:

- "(6.1) We [the credit union or mutual building society] will always act as a responsible lender.
- (6.2) We will base our lending decisions, including decisions to extend existing credit facilities, on a careful and prudent assessment of your financial position. We will periodically review our credit assessment procedures and criteria for the products we issue.
- (6.3) We will generally only lend amounts to you that we believe, on the information available to us, you can reasonably afford to repay. However, different criteria will apply in the case of some products, such as bridging finance arrangements and reverse mortgage loans (if we offer these).
- (6.4) We expect you to provide honest and accurate information to us when applying for a loan or the extension of a credit facility. However, where it is prudent to do so, we will also undertake our own independent checks.
- (6.5) We will promote the responsible use of credit to our members and consumers using a range of approaches."

## **THE RESPECTIVE OBLIGATIONS OF THE CREDIT ASSISTANCE PROVIDER AND THE CREDIT PROVIDER**

The NCCP places an obligation on a credit assistance provider to assess whether a proposed credit contract is unsuitable. The credit assistance provider must have regard to the consumer's purpose and whether their financial circumstances may allow them to achieve their purpose.

A credit provider has an additional obligation when assessing the suitability of a proposed loan or credit facility over and above the reasonable inquiries a credit assistance provider may make. We take the view that a credit provider must assess the consumer's capacity to service the loan or credit facility which it proposes to offer.

The obligation imposed on the credit provider to make these inquiries as part of its “final assessment” is particularly important where the preliminary information provided by the credit assistance provider on behalf of the consumer is:

- equivocal
- not verified
- contradictory to other information the credit provider may be aware of, or
- where the circumstances of the transaction or any information provided “ring alarm bells”.

In these situations, the credit provider should make further inquiries to verify the information and ensure that any concerns are addressed.

### **FOS HAS JURISDICTION IN RESPECT OF BOTH INDIVIDUAL AND SMALL BUSINESS LENDING**

It should be noted that FOS’s jurisdiction to consider claims of maladministration encompasses all contracts between clients and their FSPs that may be the subject of a dispute at FOS. We can consider disputes from individuals and small businesses, so long as they fall within the monetary limits specified in FOS’s TOR. Essentially, we can consider a dispute where the value of the client’s claim is less than \$500,000 and we are able to award compensation to a maximum of \$280,000.

Therefore, subject to our monetary limit of \$500,000 and our compensation cap of \$280,000, although a credit contract may not be regulated under the Uniform Consumer Credit Code (UCCC) or the National Credit Code (NCC), we will consider a client’s claim that the FSP’s decision to grant the loan or credit facility amounted to maladministration in lending.

### **LOW DOC LENDING**

We do not consider that the UCCC of itself prevented low doc lending. In the Second Reading Speech introducing the Bill for the UCCC, the relevant Minister said of section 70(2)(l):

“One area of concern is housing lending and, in particular, the serious issue of over commitment.

The Consumer Credit Code has not been drafted with the intention of requiring credit providers to make inquiries beyond those ordinarily made by prudent lenders ...

It is intended to deal with those lenders who consciously lend without making proper inquiries into the debtor’s ability to pay rather than those lenders and consumers who have gone down this path and made a conscious decision based on the best information available.”

Similarly, we consider that the provisions of the NCCP may still allow for low doc lending if adequate inquiries are made and the statutory provisions regarding responsible lending are satisfied. We anticipate no doc lending on the levels previously experienced is unlikely to be sustainable given the new obligations.

The fact that an FSP has entered into a low doc loan is not sufficient, of itself, to establish that the loan was unsuitable under the responsible lending obligations or that there has been maladministration. However, there is a significant risk with low doc lending that further investigation may mean the FSP cannot establish whether it complied with its obligations.

We recognise that there is a place for low doc loans to cater for those self-employed clients who are unable to provide more traditional evidence of their income. However, in our view, low doc loans should not as a general rule be granted to PAYG employees.

## SELF-CERTIFICATION OF FINANCIAL DETAILS

We do not consider a declaration from the client will protect an FSP from having the loan considered:

- maladministration or
- in breach of responsible lending obligations, or
- unjust

if the circumstances were such that the FSP ought to have made inquiries but chose not to do so.

A client's false declaration, whether it was made knowingly or inadvertently, is a relevant factor to be taken into account, but is not decisive.

This view is supported by the comments of the trial judge in *Permanent Mortgages Pty Ltd v Cook* [2006] NSWSC 1104:

"I find it impossible to escape the conclusion that [the first defendant] knew he was making a false statement of a material kind when he made it and that the falsity was of some significance, apart from being detrimental to himself. However, I accept that he was probably unaware of the nature of that significance. As I have already indicated, provided the formalities were observed, the Plaintiff, in my view, was indifferent to the underlying factual situation. ... In all the circumstances, while the false declaration of the Defendants and their procuring of what must have been the false statement of an accountant should be deprecated and taken into account as a relevant factor within s70 (2) (a), they are not, in my opinion, necessarily decisive of the issues before me."

In relation to whether the loan was unjust, the trial judge made the following comments:

"Whether I should hold the mortgage unjust in this case involves a balancing exercise. On the one hand are the circumstances that the Defendants speak English as their first language; were experienced consumers; had the services of a solicitor; were extremely anxious to obtain the loan; and were prepared to sign false statements and procure false certificates. On the other hand, the beneficial nature of the Code indicates that it was intended to protect the unsophisticated and meagerly educated, such as the Defendants, from their own foolishness. Given the means of the Defendants and their credit history, the Plaintiff, in my view, was aware, or would have been aware, had it made the most perfunctory of inquiries, that the Defendants were not capable of servicing the loan even at the lower rate of interest and could only satisfy their obligations by selling the mortgaged property for a sum sufficient to cover the principal and interest."

Based on the requirement in paragraph 8.2 of FOS's TOR to do what is fair when deciding disputes, it may be that, in some cases where a client has made a false declaration, we will apportion liability (and reduce any compensation accordingly). We will consider (among other factors):

- Did the client knowingly provide inaccurate information?
- If not (usually because the information has been provided on their behalf by an agent or intermediary), did the client fail to protect themselves (for example, by signing a blank form trusting their representative to accurately complete it)?
- Did the FSP fail to apply its policies and procedures which, if adhered to, would have disclosed the inaccuracies?

## ASSESSMENT OF LOW DOC LENDING

When investigating a dispute about a low doc loan, we consider the following matters:

- Did the client fully understand the process, so that it can be said that a conscious decision has been made?
- Have clear questions been asked of the client in assessing the relevant and available information? For example, gross income may be misunderstood to mean turnover, rather than income;
- Have the monthly repayments been accurately calculated and disclosed at the time of application?
- Was legal or financial advice recommended and/or required?
- Did the FSP engage in good industry practice by exercising the care and skill of a diligent and prudent lender in:
  - selecting and applying credit assessment methods; and
  - forming an opinion about the client's ability to repay?
- Was there information in the application which should have led a reasonable and prudent lender to make further inquiries, but the FSP chose not to?
- Did the FSP act prudently by assessing the entire transaction contemplated by the client to see if there is capacity to repay from proven sources? For example, it is not always appropriate to rely solely on the receipt of rent from a rental property, given the vagaries of the rental market, either generally or in a particular location;

And finally, it is important to be aware that an acknowledgment by the client that the client does not rely on the FSP's assessment of capacity to repay may not excuse the FSP if it fails to make a proper assessment.

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## MARGIN LENDING

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Changes to the Corporations Act (Act) which came into effect from 1 January 2011, mean a financial services provider (FSP) that issues margin lending facilities to a retail client must comply with new responsible lending provisions.

The issue of a margin lending facility/margin loan includes:

- new margin loans, and
- increases in the credit limit of margin loans

granted on or after 1 January 2011.

For some years, FOS has considered disputes regarding “maladministration in lending”. FOS continues to do so under its current Terms of Reference including disputes about margin loans and leveraged investments – see Investment Lending Case Study on page 41.

This article provides guidance on how FOS assesses disputes between retail clients and their FSPs about the issue of a margin loan in light of these new responsible margin lending conduct obligations (Conduct Obligations).

### FOS TERMS OF REFERENCE (TOR)

The TOR allow FOS to consider a dispute raising the question of whether the FSP breached the Conduct Obligations.

Paragraph 5.1 of the TOR says FOS may not consider a dispute about an FSP’s assessment of the credit risk posed by a borrower or the security to be required for a loan – but this does not prevent FOS from considering a dispute claiming maladministration in lending, loan management or security matters. This means FOS does have jurisdiction to consider disputes about maladministration.

Maladministration means:

“... an act or omission contrary to or not in accordance with a duty or obligation owed at law or pursuant to the terms (express or implied) of the contract between the Financial Services Provider and the Applicant.”

As the Conduct Obligations are a duty owed at law in lending, loan management or security matters, a dispute about whether an FSP breached the Conduct Obligations is within FOS’s TOR.

### CONDUCT OBLIGATIONS

The legislation prohibits an FSP from issuing margin lending facilities unless the Conduct Obligations are fulfilled (s985E(1)).

The Conduct Obligations require the FSP to:

- (1) make reasonable inquiries about a retail client’s financial situation (s985G(1)(a));
- (2) take reasonable steps to verify the retail client’s financial situation (s985G(1)(b)); and,
- (3) assess whether the margin lending facility will be unsuitable for the retail client (s985E(1)(c) and s985F).

In this article, we explore FOS's approach to each of these three aspects of the Conduct Obligations. We expect that regulations will be made to prescribe matters referred to in the Conduct Obligations and that ASIC will issue guidance on these obligations. If and when this material takes effect, we will take it into account.

## 1. REASONABLE INQUIRIES ABOUT A CLIENT'S FINANCIAL SITUATION

### FINANCIAL SITUATION

FOS takes the view that the purpose of inquiries into a client's financial situation is to assess whether the client would be able to:

- meet all the repayments, fees, charges and transaction costs of a possible margin call, and
- service the loan and meet possible margin calls from income and liquid assets, rather than from long-term savings or from equity in a residential home, without suffering significant hardship.

Whether an FSP has made reasonable inquiries about a client's financial situation turns on whether information has been obtained to make this assessment.

### REASONABLE INQUIRIES

Therefore FOS takes the view the reasonable inquiries an FSP ought to make in order to assess a client's financial situation include enquiring into:

- the client's gross and disposable income
- the reliability of the client's income, and
- the availability of assets to meet possible margin calls.

When the potential returns from an underlying portfolio are included in the calculation of the client's income, FOS will look at whether those returns were treated appropriately by the FSP. While such income may be taken into account, an FSP must assess the reliability of that income and whether or not this income was the sole or main source of funds to service the margin loan.

### SCALABILITY OF INQUIRIES

In FOS's view, the requirement on an FSP to make inquiries will be scalable having regard to the circumstances of a case including the following factors:

- the potential impact on the client of entering into an unsuitable margin loan
- the complexity of the margin loan, and
- the ability of the client to understand the margin loan facility.

#### Potential impact

More extensive inquiries into the client's financial situation are likely to be appropriate where the potential impact of an unsuitable margin loan is serious. For instance, in "double gearing" situations, FOS would expect the FSP to conduct more extensive inquiries into the client's financial situation.

#### Complexity

More extensive inquiries into the client's financial situation are likely to be appropriate where the loan is a non-standard margin loan (as defined by s761EA(5)) that is, for example, in the nature of a securities lending agreement.

## Financial skills

More extensive inquiries into the client's financial situation are likely to be appropriate where the client is not well versed in financial matters and is therefore less likely to understand the effect of the margin loan facility.

## ANTICIPATED REGULATIONS - DOUBLE GEARING

The Explanatory Memorandum for the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 ("the Explanatory Memorandum") notes (at 1.82):

"Regulations will be made to prescribe specific matters that lenders must take into account, which are intended to include important considerations such as whether clients have taken out a second loan to finance their equity contribution for the margin loan, and whether they used their homes to secure the second loan."

The explanatory memorandum suggests a second loan or double gearing situation may signify another variable that affects scalability.

## 2. REASONABLE STEPS TO VERIFY A CLIENT'S FINANCIAL SITUATION

When assessing whether an FSP took reasonable steps to verify a client's financial situation, FOS will have regard to:

- the normal business practices of a prudent margin lender, and
- the verification practices applied in other credit areas.

The legislation requires FSPs to take reasonable steps to verify the client's financial situation (section 985G(2)).

## VERIFICATION OF INCOME AND RELIABILITY OF INCOME

Examples of the type of information an FSP may need to provide to FOS about its verification of income and reliability of income include:

- where the client is a PAYG employee:
  - payslips
  - confirmation of employment, and
  - recent income tax returns / group certificates;
- where the client is self-employed:
  - recent income tax returns
  - a statement from the client's accountant, and
  - business activity statements.

## VERIFICATION OF CREDITWORTHINESS

FOS may ask an FSP to establish its verification of the creditworthiness of the client. A credit check is considered to be an action undertaken by a prudent lender in the normal course of its business.

## VERIFICATION OF ASSETS

Examples of the type of information an FSP may need to provide to FOS about its verification of the client's assets include:

- real property title search(es)
- valuation of real property(ies)
- share / securities holding statements, and
- asset and liability statements prepared by the client's accountant.

## INFORMATION WHICH MAY NOT HAVE TO BE VERIFIED

Subsection 985G(3) provides FSPs need not verify information about a client's financial situation which is provided in a Statement of Advice (SOA) prepared for the client by a financial services licensee who is authorised to provide financial product advice in relation to margin lending facilities.

The FSP can only rely on the unverified information in the SOA if:

- the SOA was prepared not more than 90 days prior to the date of the issue of the margin lending facility
- the SOA recommends the client acquire the margin loan facility or that its limit be increased
- the limit of the margin loan facility or the increase in the limit of the facility is not greater than that recommended in the SOA, and
- the SOA includes the information used to prepare the SOA.

The Explanatory Memorandum (at 1.94) adds:

"It is envisaged that margin lenders could make arrangements for information relevant to a margin loan to be excerpted from an SoA and presented to them in a particular format. Lenders will have to obtain appropriate confirmation that any information excerpted in this way forms part of an SoA, including the date of the SoA."

## 3. ASSESSING WHETHER THE FACILITY WILL BE UNSUITABLE

Under the legislation (sections 985E & F), the assessment of whether a facility will be unsuitable for the client must:

- be made within 90 days before the facility is issued, and
- cover the period during which the facility is issued.

The Act specifies that an assessment of whether the facility will be unsuitable need not be made for any increase in the credit limit of an existing loan because of changes in the market value of the underlying security.

The Act (see s985H(2)(a) and s985K(2)(a)) provides that a margin lending facility will be unsuitable for the client if it is likely that if the client received a margin call they:

- would not be able to comply with their financial obligations under the facility, or
- would not be able to do so without suffering substantial hardship.

Note 2 to s985H(1) provides that an FSP may assess the margin loan as being not unsuitable under s985H(2), but may still assess the facility as being unsuitable for other reasons. While the Act does not provide any further detail, FOS considers an FSP must assess a margin loan as unsuitable if, for example, the margin loan is not fit for purpose (see s12ED(1) of the Australian Securities and Investments Commission Act).

In light of these legislative requirements, FOS will consider issues including:

- whether or not the FSP's assessment specifically addressed the ability of the client to cope with the consequences of a margin call, with a particular focus on:
  - the time the client was allowed to meet the margin call, and
  - the nature of the assets at the client's disposal to meet the margin call.
- whether or not the assessment specifically addressed the ability of the client to deal with a negative equity situation.

### **DOCUMENTING INQUIRIES, VERIFICATION AND ASSESSMENT**

FOS may ask FSPs to provide:

- information about the inquiries made
- documents evidencing the inquiries made
- information about verification procedures
- documents evidencing the verification procedures undertaken, and
- documents reflecting the assessment of unsuitability made.

FOS expects FSPs to establish that:

- their inquiries about the client's financial situation were reasonable
- the information about the client's financial situation was verified, and
- an assessment was made that the margin loan was not unsuitable by providing documents that record and reflect:
  - the inquiries process
  - the inquiries made into the client's financial situation
  - the verification process
  - the verification process that was followed and
  - the assessment of unsuitability.

An absence of these documents to establish that inquiries were made and verified and an assessment was made that the facility was not unsuitable will affect an FSP's ability to satisfy FOS that the FSP met the Conduct Obligations.

### **CONFIDENCE IN INFORMATION**

Subsections 985H(3)(b) and 985K(3)(b) make clear that when assessing whether a margin loan will be unsuitable, an FSP may only take into account:

- information it has reason to believe to be true, or
- information it would have reason to believe to be true if it had made the inquiries or verification under s985G.

When determining whether or not an FSP had reason to believe information was true, FOS will:

- take into account all of the facts of the dispute, and
- apply a reasonable, prudent margin lender test.

### **CALCULATION OF COMPENSATION**

If FOS concludes an FSP has failed to comply with the Conduct Obligations, FOS will consider what loss the client has suffered as a result. The aim of compensation will be to put the client in the position they would have been in had the loan not been issued, or the increase not been granted.

In the case of a new margin loan where a margin call is made, FOS will assess compensation by reference to the value of the outgoings paid by the client in relation to the margin loan. These may include:

- the amount paid by the client or the value of the underlying assets sold to restore the margin loan's loan to valuation ratio to agreed levels;
- transaction costs (including acquisition and sale costs)
- repayments made on the margin loan, and
- interest paid on the margin loan.

The total outgoings paid by the client would be offset by any benefits the client obtained during the existence of the margin loan. These may include:

- dividends / income received from the underlying securities
- tax deductions, and
- tax credits.

The net amount would be the client's claim.

In the case of an increase in the credit limit of an existing margin loan, FOS will seek to put the client in the position they would have been in but for the increase in the credit limit.

### **FURTHER CAUSES OF ACTION**

#### **Margin lenders**

In addition to assessing a dispute to determine whether there has been a breach of the Conduct Obligations, FOS assesses whether there has been a breach of:

- the common law requirement to exercise the due care and skill of a diligent and prudent lender
- the prohibition of misleading or deceptive conduct in relation to a the provision of a financial service (s12DA of Australian Securities and Investments Commission Act (ASIC Act)) or financial product (s1041H of the Corporations Act)
- the statutory warranty to provide a financial service with due care and skill and provide materials in relation to the service fit for the purpose for which they were provided (s12ED(1) of the ASIC Act)
- the obligation to provide the financial services the FSP is licensed to provide efficiently, fairly and honestly (s912A(1)(a) of the Corporations Act), and
- the disclosure requirements, for example to provide:
  - a Product Disclosure Statement, or
  - disclosure information in a Product Disclosure Statement.

### Financial advisers

Financial advisers who provide personal financial advice to retail clients to acquire or increase a margin loan may be liable to their clients for breaches of:

- the suitability rule in s945A(1) of the Corporations Act;
- the common law duty to act as a reasonable and prudent financial adviser;
- s12DA of the ASIC Act and/or s1041H of the Corporations Act where the advice to borrow to invest constitutes a representation to the client that the financial adviser considers the client to have the capacity to service the margin loan;
- the disclosure conduct rules in the Corporations Act, namely the obligation to give the client:
  - a Product Disclosure Statement, and
  - a Statement of Advice.

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## LOW DOC LENDING CASE STUDY

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### THE LOAN

Mr and Mrs Z applied for a loan from the financial service provider (FSP) to:

- refinance an existing loan, and
- obtain additional finance of approximately \$200,000 to assist them in purchasing another property.

The FSP approved their loan based on:

- their income as disclosed in their application, and
- their declaration that the loan was within their ability and capacity to service.

Mr and Mrs Z disclosed:

- partnership income of \$400,000
- rental income of \$40,000, and
- a parenting allowance of \$20,000.

The FSP did not make any independent enquiries to verify this information.

### THE COMPLAINT

Mr and Mrs Z subsequently claimed that the FSP's decision to lend amounted to maladministration as they did not have the capacity to service the additional loan of \$200,000.

### FOS INVESTIGATION

The case manager considered a prudent and diligent lender ought to have been alerted to make further enquiries when presented with a Low Doc income declaration listing:

- pre-tax income of \$440,000 and
- a parenting allowance of \$20,000.

The level of income was, on the face of it, inconsistent with an entitlement to a parenting allowance of \$20,000.

The case manager obtained from Mr and Mrs Z a copy of their partnership tax return prepared one month prior to their loan application. The tax return revealed a net partnership income of \$45,000.

The case manager also found that Mr and Mrs Z had:

- made two previous loan applications in which they had made similar income declarations (although these loans had not proceeded), and
- two opportunities to correct their misquoted income, and failed to do so.

## FOS ASSESSMENT

As the FSP had failed to make enquiries, the case manager concluded that the FSP's approval of the loan was maladministration in lending.

However, the case manager also took into account:

- the Ombudsman's criteria of fairness in the circumstances of the case, and
- section 12GF (1B) of the ASIC Act which deals with proportionate liability in claims of misleading conduct.

In light of these principles, the case manager did not consider that the FSP should be liable for Mr and Mrs Z's loss in its entirety.

The case manager concluded that Mr and Mrs Z should bear two thirds of their loss and the FSP was responsible for one third of the loss.

## FSP RESPONSE

The FSP rejected the case manager's conclusions, and said:

- it had met its guidelines for low doc lending, and was entitled to rely on Mr and Mrs Z's income declaration, and
- the approach had serious consequences for low doc lending for the industry and was contrary to the acceptance of low doc lending by the Australian Prudential Regulatory Authority ("APRA").

## OMBUDSMAN'S DECISION

The Ombudsman agreed with the case manager's assessment.

In his decision, the Ombudsman noted the following:

- (1) APRA has a supervisory role in the Australian financial market. Complying with APRA's requirements does not provide a protection to an FSP in relation to whether or not it has engaged in maladministration in lending,
- (2) A lender's obligation to lend responsibly is encapsulated in
  - the common law;
  - to the extent the loan is regulated, section 70(2)(l) of the Uniform Consumer Credit Code ("UCCC") (and now section 76(2)(l) of the National Credit Code);
  - for subscribing FSPs, clause 25.1 of the Code of Banking Practice ("CBP"); and
  - section 12DA of the ASIC Act;
- (3) The UCCC does not, of itself, prevent low doc lending. However, the common law and the CBP require an FSP to exercise the care and skill of a diligent and prudent lender, and arguably a diligent and prudent lender would not rely solely on information provided by the customer to a loan;
- (4) The fact that an FSP has entered into a low doc loan is not sufficient to establish maladministration. However, it is a known risk of low doc lending, and the risk is assumed by the FSP;
- (5) There is a legitimate place for low doc loans to cater for those self-employed borrowers who are unable to provide more traditional evidence of their income. However, a customer's self-declaration of financial details will not protect the FSP from having the loan considered maladministration or unjust if the circumstances were such that the FSP ought to have made enquiries but chose not to do so;

- (6) Relying on the comments of the trial judge in *Permanent Mortgages Pty Ltd v Cook* [2006] NSWSC 1104, a customer's false declaration, whether knowingly or inadvertently, is a relative factor to be taken into account, but is not decisive, such that the FSP should avoid liability for maladministration in lending;
- (7) In this case, the FSP was privy to financial information inconsistent with the customers earning \$440,000, namely that they were also receiving parenting allowance. If the FSP had adopted good industry practice and sought clarification, any reasonable inquiry would have revealed that Mr and Mrs Z did not have the capacity to service the \$200,000 loan.

The Ombudsman agreed with the case manager's conclusion that there had been maladministration in lending, and that apportionment of liability as suggested by the case manager was appropriate.

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## INVESTMENT LENDING CASE STUDY

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### THE LOANS

A mortgage broker sourced Ms V's details from a default listing made by the local council as a result of unpaid council rates. The broker contacted Ms V and offered to obtain finance for her to:

- consolidate her existing loans
- pay outstanding bills, and
- invest additional funds with him at a return of 10%p.a., which would be at least 3%p.a. above the interest rate payable on the loan.

The broker completed an application for finance on Ms V's behalf applying for:

- an \$80,000 home loan, and
- a \$250,000 interest only investment loan.

The application disclosed Ms V earned an annual income of \$60,000 as the head chef of Eat-a-Lot restaurant. Annexed to the application in support was a letter from Eat-a-Lot restaurant confirming Ms V's employment and income.

The financial services provider (FSP) approved Ms V's application. It made available to her \$80,000 for debt consolidation and paid directly to her broker the investment loan proceeds of \$250,000. Ms V granted a mortgage over her family home.

For two years, Ms V received regular returns from her broker. Then she was advised that her broker was ill and that his investments would be realised to return capital advanced by investors. Ms V subsequently could not make contact with the broker and had been unsuccessful in recovering her \$250,000 investment.

### THE COMPLAINT

Ms V said that:

- she was in receipt of Centrelink benefits
- she supplemented her pension by selling home-made preserves at the local council monthly market
- her annual income was less than \$15,000
- she had never worked for a restaurant
- she had never earned \$60,000
- the signature on the loan application was not her signature
- she signed the FSP's loan offer and mortgage
- she accepted liability for the loan she had received to consolidate her debts and pay outstanding bills
- she should not be liable for the false and misleading information the broker provided to the FSP, and
- she should not be liable for the \$250,000 investment loan.

## THE FSP'S RESPONSE

The FSP said:

- the finance application had been introduced by an introducer, who was affiliated to a mortgage manager, A
- it paid commission to A for introducing successful finance applications
- it had no affiliation directly with the introducer or with the broker, and was not liable for their conduct
- Ms V's loan application was assessed in accordance with its policies and procedures
- its procedure included a telephone call to Ms V's employer to confirm her employment and income
- Ms V's verified income of \$60,000 was sufficient to service her \$330,000 loans even without relying on the anticipated 10%p.a. return from her investment with the broker, and
- it had no liability to Ms V for her investment decisions
- it had no liability for the conduct of Ms V's broker, and
- Ms V was liable to repay both loans.

## INVESTIGATION OF SIGNATURE ON LOAN APPLICATION

FOS inspected Ms V's signature on:

- a privacy consent form
- the FSP's loan offer, and
- her original dispute lodged with FOS

On a simple inspection, there were significant inconsistencies between the signatures on these documents when compared with the signature on the loan application. In the case manager's view, these inconsistencies supported the conclusion that Ms V did not sign the loan application before it was presented to the FSP.

## INVESTIGATION OF WHO WAS RESPONSIBLE FOR THE BROKER'S ACTS

In response to FOS's request for information, Ms V said:

- she had met the broker at her home
- she provided him with the information he requested about her income and financial position
- she trusted the broker
- she did not check the details completed by the broker, and
- she was not asked to sign any documents by the broker at that meeting.

FOS noted the loan application form identified:

- Ms H as agent for the introducer, not the broker
- the domain name for Ms H's e-mail address as the broker's business

This information suggested the broker and the introducer had a working relationship.

The case manager also noted the broker's name was the same as the proprietor of Eat-a-Lot restaurant who had signed the letter of employment confirming Ms V's employment and income which was cause for suspicion.

While the FSP had acknowledged it had an affiliation with A, the mortgage manager, there was no information to support a conclusion that the broker or introducer was an agent or held themselves out as representing the FSP. Therefore, there was no principal/agent relationship between the broker and the FSP that would make the FSP liable for the conduct of the broker or the introducer in submitting information supporting Ms V's loan application.

### FOS ASSESSMENT OF MALADMINISTRATION IN LENDING

The case manager noted that Ms V's loan application was approved via the FSP's automated credit approval process.

While credit modelling is widely used, the case manager noted that it is good industry practice, particularly with third party introduced business, for the information relied upon to be checked and verified by the lender. Therefore, although Ms V's application had passed the FSP's automated test for her capacity to service the loans, the FSP was required to verify the employment and income data it had relied upon.

The FSP's policy said:

- the preferred verification of income was by way of confirmation of regular credits to an account
- deposit details are more reliable than payslips or other documentation which can be easily forged
- new customers must produce original or verified account statements, and
- in some cases additional information, such as a letter from an employer, may be required to clarify information contained in an applicant's account statements.

The FSP's lending approval:

- did not show any inquiry being made about where Ms V's stated income of \$60,000 was being deposited
- did not show any statements were sighted substantiating her salary being paid into an account,
- noted the FSP spoke with the author of the letter of employment, who confirmed Ms
- V's employment and salary
- Did not include any account statement records.

The FSP relied solely on the fraudulently raised letter of employment and then telephoned the author of the fraudulent letter to confirm its content.

The case manager noted:

- the FSP's policy had specific procedures to address the risk of false loan applications being made in similar scenarios
- had the FSP requested copies of Ms V's account statements, the statements would have shown her regular Centrelink receipt
- the existence of a pension benefit, when the loan applicant was allegedly working full time would have prompted a diligent and prudent lender to make further inquiries of the applicant about their income position.

The case manager concluded that if the FSP had sought Ms V's account statements in accordance with its policy, the loans would not have been approved because, based on her existing pension and small supplemental income, serviceability was not demonstrated.

As a consequence, the FSP's approval of loan facilities totalling \$330,000 was maladministration in lending.

### WAS MS V LIABLE TO REPAY THE \$250,000 INVESTED WITH THE BROKER?

While Ms V acknowledged she received the use of \$80,000, she said she had received no benefit from the \$250,000 loan as the funds were paid directly to the broker and she should not be liable to repay a debt for which she received no benefit.

The case manager did not accept that Ms V did not have the use of the \$250,000. She was aware and agreed that those funds should be paid to her broker, whom she entrusted to invest those funds on her behalf. She had received a benefit from those funds in the form of that investment and the interest paid to her by her broker for some two years. The FSP had no liability to her for the performance or continued performance of her investment choice.

### SHOULD THERE BE AN APPORTIONMENT OF LIABILITY?

As Ms V had acknowledged receiving \$80,000 to consolidate her existing liabilities, it was reasonable for Ms V to be liable for that amount, together with the contractual rate of interest.

Any apportionment would apply to the interest accruing on the new debt created by the advance of the investment loan of \$250,000.

The case manager said it was certainly arguable that Ms V's trust in the broker was careless and as such, she failed to act reasonably to protect her own position. However, this position was somewhat countered by her lack of knowledge of the deception and fraud being perpetrated against her and the FSP.

### OUTCOME

The case manager was satisfied that Ms V did not read, complete or sign the loan application and therefore did not have knowledge of what was contained in the loan application or what documentation was presented to the FSP in support of the loan application. In circumstances where both Ms V and the FSP were victims of a crime perpetrated against them, the case manager did not consider apportionment of liability to be appropriate as it would return profit to the FSP for a loan that, if the FSP had complied with its lending policy, would never have been advanced.

Therefore, the case manager concluded Ms V should be liable for interest on \$80,000 of the debt advanced by the FSP and the remaining \$250,000, which was new debt, was repayable without interest. He completed a reconstruction of Ms V's liability to the FSP as follows.

- interest was payable on \$80,000 of the debt advanced at the FSP's prevailing variable housing interest rate from time to time
- all repayments made by Ms V to the FSP since inception of the loans was applied in reduction of the \$80,000 debt repayable with interest, and
- the residual debt was repayable without interest and fees.

Ms V's payments were sufficient to pay out the interest bearing component of her liability and left a residual non-interest bearing debt of approximately \$200,000. As the original loans had been repayable over 30 years, of which only two years had elapsed, the case manager considered that, taking into account the FSP's responsibility to work with Ms V if she was in financial difficulty, the residual debt should be repaid without interest over the remaining 28 years of the original term. This equated to a payment of approximately \$750 per month. Ms V could establish her capacity to make monthly payments of \$750 if she stayed in her family home. In the event that the family home was sold at any time within the ensuing 28 years, the case manager noted that Ms V's indebtedness should not be transferrable and the indebtedness outstanding to the FSP at the time of sale should be discharged in full at settlement. The parties accepted the case manager's recommended resolution.

## FOS FEEDBACK PROCESS

In December 2010, FOS introduced a new feedback process for stakeholders who have complaints, compliments and suggestions about our service. The process is being managed by our Complaints and Feedback Team, which consists of Silvia Renda (Manager, Business Planning & Assurance) and Andrew Clarke (Complaints Analyst).

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### WHY WE HAVE INTRODUCED THE NEW PROCESS

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ASIC Regulatory Guide 139 requires external dispute resolution schemes like FOS to have a process for receiving and considering complaints about the operation of the scheme. The process we have established actually exceeds the requirements set by ASIC. We recognise the value of having an accessible, efficient process for handling complaints and other feedback from stakeholders.

Our new feedback process will help us to continually improve our service and promote trust among our members, applicants and other stakeholders. We will use the feedback process not only to identify and fix particular problems that our stakeholders are having, but also to learn more broadly about any weaknesses (and strengths) in our organisation and the service we provide. Our Complaints and Feedback Team will analyse the root causes of problems and make recommendations to our management team, who will then set in place policies to remedy the problems.

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### HOW TO PROVIDE FEEDBACK TO FOS

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We have set up a feedback page on our website that includes a feedback form that stakeholders can fill out online: [www.fos.org.au/feedback](http://www.fos.org.au/feedback). Stakeholders can also provide feedback to us by calling 1300 78 08 08 or by sending a letter (and supporting documents) to the Financial Ombudsman Service, GPO Box 3, Melbourne VIC 3001.

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### FEEDBACK ABOUT DISPUTES

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Whatever the outcome of a dispute, it is important that we have made it easy for both parties to understand our process and have remained professional in all our dealings with them.

Stakeholders can provide feedback about how we have handled a dispute – how long we have taken, how professional and efficient we have been and how clearly we have communicated to them.

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### OMBUDSMAN AND PANEL DECISIONS

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Our feedback process cannot review complaints about Ombudsman and Panel decisions. Under our new Terms of Reference, which came into effect on 1 January 2010, Ombudsman and Panel decisions are final and not open for review by FOS. Our feedback process can only review complaints about our handling of a dispute (i.e. about our service).

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## HOW FOS HANDLES FEEDBACK

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### COMPLAINTS

We take complaints about our service very seriously. If a person's complaint cannot be resolved immediately, we will send them an acknowledgment letter within seven days of their making the complaint.

Once we have considered all their concerns, we will send them a response letter. If we agree that their complaint about our service is justified, we will explain how we will rectify the problem and how we plan to ensure that the problem does not occur again. We aim to send the response letter within 28 days of sending the acknowledgment letter.

If for any reason we are not able to conclude our review within 28 days, we will send a progress letter explaining why we need more time and stating the date by which we will send a full response.

### COMPLIMENTS AND SUGGESTIONS

Compliments and suggestions from stakeholders will help us review and improve our services. We will not send a response or contact the stakeholder unless they ask us to do so, but we will disseminate their feedback to the relevant people within our organisation.

## 2011 NATIONAL MEMBERS' CONFERENCE 2011: BUILD ON STRENGTH

FOS is holding its 2011 National Conference for members on 2-3 June at the Melbourne Convention and Exhibition Centre (MCEC).

The theme for this year's conference is **build on strength**. We encourage our members to attend the conference to discover more ways to build the strength of their approach to dispute resolution and build the strength of their relationships with customers and FOS.

Dispute resolution has moved beyond being a reactive business process – it is a crucial part of a customer service program and it is a profession. It is not about putting out spot-fires and saving face but about maintaining strong relationships with customers and identifying areas where a business can make improvements.

The National Conference Website ([www.fos.org.au/conference](http://www.fos.org.au/conference)) has extensive information about the conference program and speakers. You can also register and pay for your attendance via the website.

The FOS National Members Conference is designed to:

- expand your dispute resolution toolkit
- help you to increase the efficiency of your internal and external dispute resolution systems
- explain FOS's decisions in past cases so you can appreciate the consistency in our approach
- illustrate what best practice dispute resolution looks like
- examine the trends, issues and challenges faced by all players in the financial services sector.

The conference will give you an opportunity hear from and talk to FOS Ombudsmen and other senior FOS staff, as well as industry experts and other dispute resolution professionals.

Some of the highlights from the program include:

- 'The Return on Investment in Professional Dispute Resolution' – a business case for responsive, value-driven dispute management
- 'News from the Regulator' – an update from ASIC
- 'Macro Market Forces and Their Impact on Dispute Resolution' – a presentation on the top trends in the financial sector and how they will shape consumer complaints
- 'Systemic Issues and Serious Misconduct' – a panel discussion covering all perspectives (ASIC, FOS, industry and the law)
- 'Let's Talk About It: Resolving Disputes by Conciliation Conference' – a session on the benefits of conciliation conferences, including a conciliation demonstration
- FOS dispute case studies on natural disaster insurance claims, financial difficulty, responsible lending, financial advice, motor vehicle insurance and more
- Process and behaviour sessions on conciliation, cross-cultural negotiation, the adviser/client relationship and more.

Go to the National Conference Website ([www.fos.org.au/conference](http://www.fos.org.au/conference)) for further details about the sessions.

If you have any questions about the conference, please email [nationalconference@fos.org.au](mailto:nationalconference@fos.org.au).

We look forward to seeing you at the conference.

# 2011 EXTERNAL DISPUTE RESOLUTION FORUM

Connecting consumer advocates and  
dispute resolution schemes

CROWNE PLAZA,  
242 ARDEN STREET  
COOGEE BEACH,  
SYDNEY

## SPONSORS



# PROGRAM FRIDAY MAY 20, 2011

FACILITATOR **Paul Holmes**

## 8.00 am | Registration & Coffee

### 9.00 am Welcome and Introduction

**Colin Neave**  
*Chief Ombudsman, Financial Ombudsman Service*

### 9.10 am Opening Address

#### Watching Out for Consumers

**David Bradbury**  
*Parliamentary Secretary to the Treasurer (to be confirmed)*

### 9.30 am Put Your Best Foot Forward

How do you make sure you get the best outcome for your client in EDR? Hear from some experts: Denis Nelthorpe (Footscray CLC), Amie Cousins (FOS), Ann Miller (EWON), Steve Snelgrove (Lismore & District Financial Counselling Service).

FACILITATOR **Alison Maynard, FOS**

### 10.35 am Which Foot?

Theatresports company, ImproAustralia draw out the lessons from *Put Your Best Foot Forward*

## 10.45 am | Morning Tea

### 11.15 am Q&A Ombudsman Style

Q&A is one of the ABC's most popular shows and it's coming to the EDR Forum. With Clare Petre (EWON) taking on the role of Tony Jones and our friendly Ombudsmen sitting on the panel, we put the audience in the box seat. Get ready to ask the hard questions about the issues that concern you.

PANELLISTS **Philip Field (FOS), Fiona McLeod (EWOV), Simon Cohen (TIO), Raj Venga (COSL) and Rod Smith (SCT)**

### 12.20 pm Thank God it's EDR

You've had all your questions answered: you should know how to play the EDR game. ImproAustralia take centre stage again.

*Warning: Involves audience participation.*

## 12.30 pm | Lunch

### 1.30 pm Concurrent Sessions (Choose from one of the following)

#### 1. Practical EDR

In this interactive session you'll get an overview of EDR generally and a chance to get up close and personal with each scheme. A combination of presentation and small group processes, there is plenty of time for questions.

FACILITATOR **Fiona McLeod, EWOV**

#### 2. The Great Debate: "EDR—If it ain't broke, don't fix it"

We'll begin with a less than serious "debate" to set the scene, but finish with a more sober discussion—how do we know if an EDR scheme is effective?

DEBATERS **Affirmative Team - Paul O'Shea (UQ), Phil Powell (Anglicare), Celia Tikotin (CALC) Negative Team - Gerard Brody (BSL), Catherine Uhr (LAQ), Peter Mott (AFCCRA)**

MODERATOR **Paul Holmes**

#### 3. Negotiation Skills

Nina Harding is one of Australia's premier trainers in the art of negotiation. This is an unparalleled opportunity to improve your skills.

FACILITATOR **Nina Harding**

## 3.00 pm | Afternoon Tea

### 3.30 pm Deal or No Deal? Hardship Practices Across Industries

Do different industries approach hardship applications in similar or different ways? Hear from a panel of speakers—utilities, telcos, banks, debt collectors. What is working? What could improve?

FACILITATOR **Sue Fraser, Kildonan Uniting Care**

### 4.10 pm Closing Remarks

**Catriona Lowe**  
*Chair, Consumers Federation of Australia*

## 4.15 pm | Close

## MEMBER SURVEY

- WHAT OUR MEMBERS SAID
- WHAT WE HAVE DONE IN RESPONSE

In December 2009, FOS conducted a survey of its members. Over 4,000 members were invited to participate and almost 800 completed the survey.

The survey was designed to:

- establish performance benchmarks and identify potential areas for service improvement, and
- evaluate the suitability of the information FOS provides and the demand for new information services.

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## WHAT OUR MEMBERS SAID

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From our member survey we learned that:

- our members are generally satisfied with our service but gave a clear indication of where we needed to improve
- the key themes of member feedback was for the provision of information and training to meet business needs that was concise, timely, delivered online and designed to support effective dispute resolution
- most members view FOS as a trustworthy, credible organisation
- FOS staff are viewed positively as professional and approachable
- but more information was needed to show FOS staff knowledge of particular industries
- some members would like more information about FOS decisions and common cases so they can see the consistency of FOS's approach.

## WHAT WE HAVE DONE IN RESPONSE

Since the survey, FOS has put in place initiatives to address members' needs and feedback. The table below summarises actions we have taken in response to member feedback we received through the survey:

WHAT MEMBERS ASKED FOR	ACTIONS FOS HAS TAKEN TO MEET MEMBER NEEDS
Provide information about emerging regulatory issues	<ul style="list-style-type: none"> <li>• New regular item in quarterly FOS Circular</li> <li>• Agenda item in industry liaison meetings</li> <li>• Part of the FOS National Conference</li> </ul>
Provide more training on systemic issues	<ul style="list-style-type: none"> <li>• New regular item in quarterly FOS Circular</li> <li>• New module offered in FOS IDR Excellence programme</li> <li>• Elearning session in development for launch at National Conference</li> </ul>
Use website more	<ul style="list-style-type: none"> <li>• Terms of Reference e-learning sessions made available at no cost to members</li> <li>• Operational guidelines delivered online</li> <li>• Circular delivered online</li> </ul>
Provide more advice about avoiding disputes	<ul style="list-style-type: none"> <li>• IDR Excellence programme of 12 modules made available</li> <li>• Expanded IDR workshop offered and delivered</li> </ul>
Provide more training outside Melbourne	<ul style="list-style-type: none"> <li>• IDR programme and IDR Excellence programme offered throughout Australia</li> <li>• E-learning for TOR</li> </ul>
Present determinations better	<ul style="list-style-type: none"> <li>• Improved search function introduced</li> </ul>
Provide more case studies	<ul style="list-style-type: none"> <li>• Annual Review, Circular and National Conference developed with case studies as integral part of the communication</li> </ul>
Identify benchmarks for industries' dispute resolution	<ul style="list-style-type: none"> <li>• Comparative tables as part of FOS Annual Review launched</li> </ul>
Provide more information about best practice	<ul style="list-style-type: none"> <li>• IDR Excellence programme of 12 modules made available</li> <li>• FOS Circular articles specifically identify best industry practices</li> </ul>
Improve reporting	<ul style="list-style-type: none"> <li>• A number of enhancements were introduced to monthly and quarterly reports to allow better tracking by members against their own MIS</li> <li>• Online reporting is now in test and scheduled for release this financial year</li> </ul>
Improve invoicing	<ul style="list-style-type: none"> <li>• A number of enhancements were introduced to allow better tracking of costs against case management reports</li> </ul>

WHAT MEMBERS ASKED FOR	ACTIONS FOS HAS TAKEN TO MEET MEMBER NEEDS
Show more specialisation	<ul style="list-style-type: none"> <li>• The Annual Review, Circular and National Conference for 2011 were redesigned to better address segments of FOS membership</li> </ul>
Increase industry knowledge at FOS	<ul style="list-style-type: none"> <li>• Ongoing commitment to ensure staff remain abreast of developments and new staff had specific industry areas of expertise</li> </ul>
Provide information to meet my business needs	<ul style="list-style-type: none"> <li>• Dedicated membership email and phone line established to answer member queries</li> <li>• Automated emails established to send to members receiving their first dispute</li> <li>• Move to provide more checklists for new members</li> </ul>

FOS is committed to providing an effective and useful service to its members. We are grateful for the feedback we received in the 2010 survey and we look forward to learning our members' views when we survey again in August 2011. FOS will be surveying members about their service and information needs in August 2011 so we can develop our agenda of improvements based on members' needs.

## PROFESSIONAL DEVELOPMENT FOR MEMBERS

- USER GUIDE TO FOS PROCESS
- ON-LINE LEARNING: DISPUTE RESOLUTION PROCESS
- VIDEOS: BEHAVIOUR SKILLS
- FOS WORKSHOP: EXCELLENCE IN DISPUTE RESOLUTION

We have a number of options available for further training for your team on effective internal dispute resolution (IDR) and external dispute resolution (EDR). We have set out below the products FOS can offer you. We hope they are suitable but we are happy to talk further if you have a particular need in mind.

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### USER GUIDE TO FOS PROCESS

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On our website, you will find a 2 page user guide to our dispute resolution process which can be downloaded and printed as a ready reference.

You can access the user guide here: [www.fos.org.au/userguides](http://www.fos.org.au/userguides)

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### ON-LINE LEARNING: DISPUTE RESOLUTION PROCESS

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Also on our website, we have 3 on-line learning sessions which take you through key aspects of our dispute resolution process.

Session 1 is a very quick overview of FOS.

Session 2 is about Registration and Acceptance

Session 3 is about Case Management and Outcomes

Session 1 takes about 20 minutes and sessions 2 and 3 take about 30 minutes each.

There is no charge for using the sessions.

You can access the on-line learning sessions here: [www.fos.org.au/elearning](http://www.fos.org.au/elearning)

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### VIDEOS: BEHAVIOURAL SKILLS

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For easy to digest information about the soft skills of dispute resolution, a number of our members make use of the on-line courses offered by an external organisation: Frontline Complaints available at: [www.frontlinecomplaints.com](http://www.frontlinecomplaints.com)

These modules include:

- Complaint Handling Fundamentals
- Dealing with Challenging Customer Behaviour
- Financial Hardship
- Building Rapport with Customers
- Saying No Nicely

There is a charge to access this information.

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## FOS EXCELLENCE IN DISPUTE RESOLUTION WORKSHOP

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In response to FOS members' feedback and requests, we have developed a new professional development programme focussed on supporting excellence in resolving disputes at IDR and EDR.

Members asked for more information about the characteristics of the most effective IDR and EDR we are seeing and practical information to enhance the delivery of dispute resolution services.

We have developed a programme which has a number of modules aimed at building good working relationships with our members by providing some insight and discussion about:

1. FOS and members
2. The dispute resolution process
3. How FOS is funded
4. Excellence in IDR
5. Systemic issues and serious misconduct
6. Important steps in the process for achieving a resolution
7. Fundamentals of negotiation
8. Professional dispute resolution behaviours
9. Principles for communicating a decision
10. The skill set we look for in a dispute resolver (as opposed to a complaint handler)
11. What to do to respond to a FOS dispute

Our presentation can be tailored to:

- include those modules which best suit a member's business needs
- spend more time on areas of particular interest
- provide snapshots only

The key issues for us to correctly tailor our presentation are to know:

- who will be attending and
- how long they have - the minimum time is 3 hours, the maximum is an all day session.

There is no cost to a FOS member except to provide the venue.

If you would like to arrange a session for your chosen audience, please contact Karen Driessen at [kdriessen@fos.org.au](mailto:kdriessen@fos.org.au) or phone (03) 8623 2033.