The FOS Approach to
Responsible lending series: Common issues

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

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

1 At a glance

1.1 Scope

When a consumer (an individual or small business owner) cannot make their loan repayments, they sometimes say that their financial services provider (FSP) should not have given them the loan because they never had the ability to repay the loan. The consumer may lodge a dispute with FOS for compensation for the loss they have suffered as a result of the FSP providing them the loan. We call this a responsible lending dispute. When we consider responsible lending disputes, we decide whether it was appropriate for the FSP to lend the money.

This document explains some of the issues that we see often in responsible lending disputes

1.2 Summary

Who should read this document?

1. Financial services providers (FSPs) that deal with credit products.
2. Consumer representatives who help consumers with financial services disputes.
3. Consumers and small business owners who have credit facilities or are looking for finance.
4. Consumers or small businesses who wish to lodge, or have already lodged, a dispute with FOS alleging that an FSP should not have lent funds to them.

Summary of the FOS Approach

FOS can consider a responsible lending dispute where the consumer's claim for loss is less than $500,000, and FOS can award compensation up to $323,500 per claim (plus interest, if appropriate). The amount of credit provided by the FSP under the loan or credit facility does not affect our ability to consider responsible lending disputes if the compensation is within these limits.

Sometimes a consumer's dispute will involve more than one claim. This can happen where the FSP has given the consumer two or more loans, at different times. In those cases, we will consider each lending decision as a separate claim.

However, when a consumer who guaranteed a loan or credit contract wants to be released from the guarantee, we can only consider that dispute if the guaranteed debt is less than $323,500, or the FSP is seeking to recover less than $323,500 of the guaranteed debt from the consumer.

If the consumer used a broker to apply for the loan, we will consider whether the broker was the consumer's agent or the FSP's agent. Generally, a broker is the consumer's agent. In that situation, the FSP is not responsible for any errors made by the broker. We will then separately consider whether the FSP has met its own responsible lending obligations.

There may be some situations where the broker is not the consumer's agent. In those cases, we will consider whether a broker was the FSP's agent and whether the FSP is liable for any error made by the broker.

If a consumer has signed a blank or incomplete loan application, we may consider that they did not act in a reasonable manner to protect themselves. In those cases, even if we conclude that the FSP acted irresponsibly in providing the credit contract, we may decide that the consumer should bear some of their loss. This means that the amount we decide the FSP should compensate the consumer will be reduced. We will only do this if the loan is not regulated under the National Consumer Credit Protection Act (NCCP).

2 In detail

2.1 The FOS Approach

Our Terms of Reference state that we can consider a dispute where the claim for loss is less than $500,000, and we can award compensation of up to $323,500 for each claim.

A consumer's dispute may involve more than one claim. This often happens where the FSP has given the consumer two or more different loans at different times. In those cases, we will consider each lending decision as a separate claim.

FOS's power to consider a responsible lending dispute does not depend on the amount of credit provided under the credit contract. This means that we can consider a responsible lending dispute even if a consumer's loan or the limit of their credit facility is more than $500,000, so long as the claim for loss is less than $500,000.

Because we cannot consider disputes when the consumer is claiming more than $500,000 in loss, it is important that consumers think about the amount of each of their claims when they first lodge a dispute with FOS. You can read more about how we work out a consumer's loss in the FOS Approach to responsible lending – how we work out a consumer's loss at www.fos.org.au/approach.

It is important that consumers provide us with information about their claim for loss as early as possible, and that they respond to our requests for information within the timeframes we request.

If, while we are considering the dispute, it becomes apparent that a claim exceeds $500,000 then we will not be able to consider that claim. This may also affect our ability to continue to consider the dispute.

Can we consider claims made by guarantors?

Sometimes, a consumer who guaranteed another person's or company's loan or credit contract lodges a dispute at FOS asking to be released from the guarantee. The consumer may say that if the FSP had acted responsibly, it would not have entered into the credit contract with the other person or company and would not have required the consumer to provide their guarantee.

In those cases, we can only consider the guarantor's claim if the total amount of the guaranteed debt is less than $323,500, or if the amount of the guaranteed debt which the FSP is seeking to recover from the guarantor is less than $323,500. This is because we cannot set aside only part of a guarantee. You can read more about guarantees in the FOS Approach to disputes lodged by guarantors.

What if a claim involves a broker?

Sometimes, consumers use a broker to apply for a loan and the consumer says the broker did something wrong with their application. For example, sometimes a consumer claims that a broker changed figures in the loan application form or provided false information to the FSP. In these circumstances, we will consider whether the broker was the consumer's agent or the FSP's agent.

Generally, a broker is the consumer's agent. In that situation, the FSP is not responsible for errors made by the broker. However, there are limited circumstances where the broker is the FSP's agent. If the broker is the FSP's agent, the FSP may be responsible for errors made by the broker.

Sometimes an FSP may appoint a broker as its agent just to verify the consumer's identity. However, this does not make the broker its agent for all other purposes.

2.2 How we decide if a broker was acting as an agent

To decide if a broker was the FSP's agent, we ask for information from the FSP about its relationship with the broker. We will also ask the consumer to provide information about the broker's conduct and explain why they believed the broker was the FSP's agent.

We consider that a statement that the broker is not the FSP's agent is not conclusive if it exists only in an agreement between the FSP and the broker, or in an agreement between the FSP and a broker's network.

We look at many different factors when deciding whether a broker was the FSP's agent. Usually, more than one of these factors needs to be established:

- if the consumer asked the FSP questions about the loan product, whether the FSP told the consumer to ask the broker or said that that the broker could answer those questions
- whether the FSP paid commission to the broker (however, payment of commission without any other conduct will not show that the broker is an agent of the FSP)
- whether the broker had access to the FSP's internal systems – for example to check the progress of a loan application – in the presence of a consumer.
- whether the broker was allowed to use the FSP's logo in the broker's own promotional or contractual documents
- whether the broker was required to comply with the FSP's internal policies when dealing with loan applications
- whether the broker received any training from the FSP about the FSP's internal policies and practices
- the role of any other another person or intermediary in submitting and progressing the loan – for example, a mortgage originator

And if the broker wasn't an agent?

If we decide that the broker was not the FSP's agent, we will still consider whether the FSP met its own responsible lending obligations. To do this, we will consider whether it was reasonable for the FSP to rely on the information the broker provided. We will also look at whether the FSP, as a diligent and prudent lender, would still have approved the loan if it had known the consumer's true financial position. Inaccurate information in a loan application does not in itself mean the FSP should not have granted the loan.

A consumer may have a separate claim against the broker. If the broker is also a member of FOS, we will open a second file and try to consider the two disputes at the same time. If the broker is not a member of FOS, the broker might have a different external dispute resolution scheme which the consumer could apply to, or the consumer could bring a claim against the broker in a court.

If the consumer is awarded compensation for the broker's conduct by another dispute resolution scheme or a court, we will take this compensation into account when assessing the consumer's loss as a result of being provided with the loan. This means that if we conclude the FSP failed to meet its responsible lending obligations in providing the loan to the consumer, we will reduce the amount of compensation the FSP is required to pay the consumer to take into account the amount of compensation the broker has already been ordered to pay the consumer.

2.3 Consumer's contribution to their loss

We consider that a consumer should take reasonable care to protect their own interests. For example, a consumer should not sign a blank or incomplete loan application form which a broker or lender has said they will fill in. It is reasonable to assume that an FSP will rely on the details of a consumer's financial position to assess the consumer's ability to repay a loan. These details will also help the FSP to decide if it needs any further information or to make further inquiries about the consumer.

If a consumer signs a blank or incomplete loan application, we may consider it is reasonable for the consumer to take some responsibility for not protecting themselves and for entering into the credit contract.

2.4 Common errors in FSP loan assessments

When we consider responsible lending disputes, we review the FSP's lending file and work out whether the FSP acted responsibly in entering into the credit contract with the consumer.

We see some common errors in FSPs' assessments of consumer loans.

For example:

Income

- The FSP relies on a source of income which has restrictions on how it can be used, such as child maintenance payments (which should be used only for children's expenses). For example, an FSP may not consider those restrictions, even though its own lending policy says it should.
- The FSP miscalculates the consumer's monthly income from the information provided about the consumer's weekly or fortnightly salary or wages.
- The FSP adopts the consumer's income from a single pay period even when it is inconsistent with year-to-date figures shown on the consumer's payslip.
- The FSP does not discount the consumer's income from overtime or commission in accordance with the FSP's policy.
- The FSP does not verify the consumer's rental income in accordance with the FSP's policy (which usually requires a discount to be applied to allow for periods when the consumer's investment property may be vacant).
- The FSP has relied on a spouse's income to assess the consumer's ability to repay, even though the spouse will not be a co-borrower, and there is no information to show that the consumer and their spouse understood that the FSP was relying on the spouse's financial support.

Expenses

- The FSP only looks at the consumer's current credit card balances, rather than the credit card limits.
- The consumer has not repaid and cancelled their credit card facility, even though they said they would do so in the loan application.
- The consumer's living expenses are understated or based on an incorrect assumption about the consumer's household (for example, assuming the consumer is not married, or does not have dependants).
- The FSP does not take into account the amount of rent that the consumer will pay while their home is being built.

Available information

- If the consumer has other accounts or facilities with the FSP, the FSP fails to consider its corporate knowledge about the consumer's other financial commitments with the FSP, such as income receipts and expenses in the consumer's transaction account.
- The FSP overlooks information showing the consumer has other external debts. For example, as part of proving their identification to the FSP, the consumer may use a credit card they have with another FSP, but not disclose that credit card account in their loan application.
- The FSP fails to take into account the consumer's age and capacity to continue to earn an income over the term of the loan

Incomplete or incorrect calculations

- The FSP assesses the consumer's ability to make repayments based on the consumer only repaying interest. Prudent lending practice requires the FSP to base its assessment of the consumer's ability to repay both principal and interest over 25 or 30 years, even where the credit contract will have an interest-only period.
- For bridging finance (where the consumer is seeking finance to purchase a new property before they have sold their old property), the FSP inadequately assesses the debt which may still need to be serviced after sale of the old property. If interest on the loan will be paid from the proceeds of sale of the consumer's old property, the FSP fails to properly calculate the interest which will accrue during the bridging loan period.

3 Context

3.1 Case studies

Case 1: Role of a broker

John wanted to purchase a new home. The real estate agent referred him to Sam, a mortgage broker, to obtain finance. Sam asked John to sign a low documentation (low doc) application. John subsequently accepted an offer from the FSP for a $430,000 home loan, secured by a mortgage over his home. He failed to make his loan repayments on time and the FSP started legal proceedings for possession of his home. John lodged a dispute with FOS.

John said that the FSP should not have given him the home loan because he could not afford the repayments. After John signed the loan application, Sam changed information on the loan application so that it would meet the FSP's servicing requirements. If the FSP had checked the details in the loan application with John, the FSP and John would have discovered the inaccurate information and the FSP would not have provided the loan to John.

We considered that the FSP was not responsible for Sam's conduct. While the FSP did not have any agreement with Sam, it did have an agreement with a mortgage manager Sam was affiliated with. In that agreement, the mortgage manager acknowledged that it was independent and did not represent the FSP. Therefore, Sam did not have any actual authority to act as the FSP's agent. There was also no information showing that the FSP had represented to John that Sam was its agent. Even though the FSP paid commission to Sam, we considered that the commissions were not enough to establish an agency relationship.

We also considered that the FSP was entitled to rely on the information in John's loan application when assessing his ability to repay his home loan. There was no inconsistency in the loan application or other information provided to the FSP had which should have caused it to check any details with John or Sam.

We concluded that the FSP had acted responsibly when it granted the home loan to John.

Case 2: How many years until Bill retires?

In 2006 Bill (aged 51) and Joan (aged 47) applied to the FSP for finance to purchase an existing business with their son and daughter-in-law. The FSP offered Bill and Joan a $320,000 home loan to refinance their existing loan with another lender, a $270,000 variable rate interest only loan, and a $190,000 principal and interest loan. Their loans were secured by a mortgage over their home.

The business was not successful and had to close. Bill and Joan lodged a dispute at FOS, claiming that the FSP should not have given them the loans

When we reviewed the FSP's credit assessment, we found that:

- The FSP had not analysed whether the business income was sufficient to cover all of the living expenses that Bill, Joan and their son and daughter-in-law would reasonably incur.
- Bill and Joan had borrowed heavily (in relation to their overall financial position) to buy the business and had no prior experience of running a retail outlet. The FSP should have more thoroughly considered and investigated Bill and Joan's capacity to repay the loans.
- The FSP had concluded that Bill and Joan could afford the loans on the assumption that Bill would continue to work as a pilot. However, Bill and Joan had said in their business plan that Bill would not continue that job.
- The FSP should also have been aware that commercial airline pilots are generally unable to fly passenger planes after age 65. The $270,000 loan was for 30 years with the first five years being interest only. To repay a loan with that term, Bill would have had to work as a pilot until he was 82. Bill had $115,000 in superannuation, but that would only have been sufficient to repay their refinanced home loan until Bill turned 65, and Bill and Joan would have needed that money when they retired. Therefore, the only reasonable way for Bill and Joan to repay the $270,000 loan would have been for Bill and Joan to sell their home.

We concluded the FSP had not acted responsibly when it granted the loans to Bill and Joan.

3.2 References

Definitions

Term	Definition
Consumer	An individual or small business owner who uses the services of a financial services provider
Credit contract	A credit facility provided to an individual or small business which may include a regulated credit contract
FSP	financial services provider (a business that has chosen FOS as their external dispute resolution scheme)
NCCP	National Consumer Credit Protection Act
Regulated credit contract	A contract regulated by the NCCP and NCC or by the UCCC
UCCC	Uniform Consumer Credit Code

Useful Links

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

- How FOS approaches responsible lending disputes having regard to legal principles, industry codes and good industry practice
- How we work out a consumer’s loss
- Low doc loans

All four documents in this series can be found on the FOS website at:

- www.fos.org.au/approach

We have published other documents that outline the FOS Approach, including our approach to disputes lodged by guarantors. You can see them all at:

- www.fos.org.au/approach

The FOS website contains more information about what we do, the types of disputes we can consider, and our dispute resolution processes.

- www.fos.org.au