



## ISSUE 2 – APRIL 2010

### Introduction from Colin Neave

Welcome to the latest edition of the Financial Ombudsman Service Circular. The Circular is designed to facilitate dispute resolution by providing practical information and explaining our approach on substantive issues.

Any suggestions on how we can improve the Circular so that the information we send you is relevant, timely and succinct is appreciated and can be sent to [publications@fos.org.au](mailto:publications@fos.org.au)

Regards

**Colin Neave**  
Chief Ombudsman

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## 1. DEALING WITH CUSTOMERS IN FINANCIAL DIFFICULTY: SMALL BUSINESS

### Introduction

[Bulletins 46, 53 and 60](#) discussed the Ombudsman's approach to financial services providers' (FSPs') obligations under the Code of Banking Practice (CBP) and the Uniform Consumer Credit Code (UCCC) when dealing with customers in financial difficulty.

We have recently received an increasing number of disputes from small businesses complaining about their FSP's response to their requests for assistance when they are in financial difficulty. Whereas an individual's financial difficulty may be caused by unemployment, illness or over commitment, a small business' financial difficulty may be caused by other events including bad debts, loss of clients, competition or unexpected changes in market conditions.

The CBP places an obligation on its subscribers to try to help individual and small business customers overcome their financial difficulty. The purpose of this article is to give financial services providers some guidance on our expectations in relation to assisting small businesses in financial difficulty which will, given the nature of a commercial enterprise, differ from those which apply to an individual in terms of the information that is assessed.

Clause 25.2 of the CBP states:

*“With your agreement, we will try to help you overcome your financial difficulties with any credit facility you have with us. We could, for example, work with you to develop a repayment plan. If, at the time, the hardship provisions of the Uniform Consumer Credit Code could apply to your circumstances, we will inform you about them.”*

The Mutual Banking Code of Practice (MBCP) provides for similar obligations to be placed on credit unions and mutual building societies in respect to financial difficulty and responsible lending.

Clause 24.1 of the MBCP states:

*“We will work with you in a constructive way if you experience genuine difficulties meeting your financial commitments. With your agreement and commitment, we will try to assist you to overcome those difficulties. We will do this whether or not you have a right to seek hardship variation or change under consumer credit laws.”*

Clause 24.2 of the MBCP provides additional detail regarding a credit union or mutual building society's procedures in considering a customer's financial difficulty.

We think that the obligations under clause 24.1 of the MBCP mirror those of the CBP in respect to financial difficulty. Credit unions and mutual building societies should therefore consider the approach of our office in respect to financial difficulty disputes as outlined below and in previous publications in addition to the procedural obligations outlined in clause 24.2 of the MBCP.

### Non-code subscribers

We consider that non-code subscribers also have obligations to small businesses in financial difficulty as a result of their own internal hardship policies and good industry practice.

As previously expressed, we also consider that the provisions of the CBP, and similarly the more recently created MBCP, reflect good industry practice. A prudent FSP would conduct itself in the manner contemplated by those codes whether or not it is a subscriber.

### **Our jurisdiction**

There is often confusion as to whether we have jurisdiction in relation to small business financial difficulty disputes where the facility limit exceeds the applicable monetary limit.

In summary, we have the power to consider a dispute to the extent that any claim for financial loss does not exceed our applicable monetary limit.

In assessing whether we have jurisdiction to consider a claim about financial difficulty lodged by a small business, we will consider the amount of the loss that is claimed. The account balance or facility limit is not relevant when assessing jurisdiction. It is the amount of loss suffered that is significant. This potential loss usually encompasses the “moneys worth” of any variation sought, any default margin levied on the contractual interest being charged, enforcement expenses and costs of any Receiver or controller appointed over the secured assets.

- For disputes lodged before 1 January 2010, the Banking & Finance Terms of Reference apply and we are unable to consider a dispute where the claim exceeds \$280,000.
- For disputes lodged after 1 January 2010, our current Terms of Reference apply. Under our new Terms of Reference we are able to consider a claim for loss of up to \$500,000, however, the maximum compensation which we can award is capped at \$280,000 including a maximum award for non-financial loss (for an individual or partnership) or consequential (indirect) loss of \$3,000 per claim.

For example, if a small business held a commercial overdraft facility of \$800,000 and requested assistance because it was in financial difficulty, we would consider a dispute lodged after 1 January 2010 despite the commercial overdraft facility exceeding the monetary limit provided the claim for loss was less than \$500,000 (subject to the maximum award of \$280,000).

We also receive disputes in relation to requests for assistance to meet a demand made under a personal guarantee which was given by directors of a small business. If the director is experiencing financial difficulty in meeting their repayment obligations under the guarantee, the dispute will be within our jurisdiction irrespective of the limit of the guarantee.

However, if the guarantor is disputing their liability for amounts less than \$500,000 demanded under a guarantee, then we can only award compensation up to \$280,000. If the guarantor is seeking to set aside a guarantee in full, then the guaranteed debt must be less than \$280,000.

### **Power to vary credit contracts**

Pursuant to clause 9.1(f) of the current [Terms of Reference](#), we have a new power to vary credit contracts regulated by the UCCC or the National Consumer Code (NCC) from 1 July 2010. This power does not at this time extend to variation of business facilities. Accordingly, the approach set out in our [previous bulletins](#), which in summary requires that financial services providers can show they have given genuine consideration to requests for assistance, continues to apply to requests for assistance made by small businesses.

### **Disputes received from small businesses**

#### Definition of a small business

The definition of a small business is consistent across the CBP, the MBCP and our Terms of Reference. A small business is defined as a business having:

- a) less than 100 employees if the business is or includes the manufacturing of goods, or
- b) in any other case, less than 20 employees.

#### Nature of disputes

Disputes often concern the cancellation of business facilities on a request for assistance, demand by a financial services provider for immediate repayment of a credit facility in full, or unreasonable timeframes for refinance. Small businesses have also disputed the appointment of an investigative accountant, application of increased risk margins and higher interest rates on a request for assistance.

Where a financial services provider takes such action without first giving genuine consideration to a request for assistance, then this conduct could have the effect of seriously prejudicing the small business' ability to operate as a going concern or the opportunity to refinance.

## Discussion

Central to an FSP meeting its obligations under clause 25.2 of the CBP, clause 24.1 of the MBCP, and industry practice, is the concept of genuine consideration. We have previously stated that FSPs should:

- give genuine consideration to a repayment proposal or hardship variation application and any reasonable alternatives that will help the customer overcome their financial difficulties
- give reasons for any rejection of the proposal, preferably in writing
- ensure that those reasons reflect legitimate considerations and are referable to the particular customer's circumstances
- not start or conclude enforcement action before a decision is made and communicated, and
- respect the customer's appointment of an advisor and, if one is appointed, not deal directly with the customer.

Acting consistently and ethically, in our view, requires that FSPs:

- have clear and reasonable internal processes for assessing hardship variation or enforcement postponement requests and other repayment proposals
- be able to demonstrate that their staff have followed those processes
- record and keep any promises made, for example, about suspending enforcement action, and record and keep to any agreement reached. If that includes that the arrangement be reviewed at a certain date, FSPs should not seek to review the arrangement earlier if the customer is keeping to it. Any review should be based on a genuine consideration of the customer's position at that time;
- ensure that any collection related correspondence is consistent with what has been promised or agreed, and
- confirm in writing any agreement reached and ensure that collection agents and/or later assignees have a copy.

### Type of information required to assess an application for assistance

The principles set out above apply equally to the assessment of a request for assistance from a small business as they do to the assessment of an individual's request. However, in assessing an application from a small business for assistance in its financial difficulty, the nature of the information required to assess the application would include information, if not already held, to allow it to consider the viability of the business as a going concern. Information that an FSP may require to assess an application for assistance from a small business may include:

1. a revised business plan
2. cash flow statements and projections, profit and loss and balance sheet information
3. inventory management records (open/closing stock levels)
4. gross profit projections
5. aged debtor and creditor listings
6. documentation relevant to the small business' statutory obligations including payroll, taxation, superannuation, GST and workcover records.

### Responding to information requests

We have previously stated that we expect Applicants to work with their FSP and respond promptly to reasonable requests for assistance. Failure of a customer to respond to a request for information was dealt with in [Bulletin 53](#). We stated in that bulletin that if adequate information is held about the Applicant's current financial position then the next step is for the FSP to make an assessment as to any proposal it can make to achieve repayment of the debt on reasonable terms.

If a small business does not provide information on request, it is open for the FSP to make its assessment on the basis of information that it already holds and to state expressly any applicable provisos or assumptions made. The onus would then be on the small business to show that incorrect information has been used or that an assumption is incorrect.

### **Assisting a small business in its financial difficulty**

Whether an FSP is able to assist a small business in financial difficulty will depend on the individual circumstances facing the business. Many options may be available to an FSP, including assistance such as:

- temporary increase in overdraft limit facility
- an extension of trade finance terms
- deferment of scheduled principal repayments
- the appointment of an investigative accountant to better understand the small business, taking into account the contractual entitlement of the financial services provider to do so. We would expect that there has been appropriate consideration and communication with the small business in respect to the purpose and cost of the appointment, particularly where the FSP proposes to pass on the costs to the small business
- consolidation of debts, and/or
- restructure of finance facilities and terms to reflect changes in cash flow.

We would however expect a lender to be mindful of its responsible lending obligations under clause 25.1 of the CBP (clause 6 of the MBCP) if the provision of further credit is being considered as a means to enable its customer to overcome financial difficulty. Small businesses should note that we are unable to compel a lender to make further advances or extend an overdraft limit.

Whether an FSP is able to provide ongoing assistance will be substantially influenced by the ability of the small business to demonstrate its ongoing viability. If the small business is unable to demonstrate ongoing viability based on reasonably tested information, then we would not expect an FSP to accept further risk. In such circumstances, the assistance required may be to provide a reasonable time to refinance (and by reasonable we mean erring on giving more time than less) or work with the business to achieve an orderly winding up of the business.

We expect that an FSP should be able to demonstrate that it has genuinely considered whether providing assistance by way of varying an existing contract will allow the small business to continue to operate as a going concern in the long term. As with individuals, the aim of any assistance should be to assist the small business overcome short term financial difficulties. Provided that genuine consideration has been given to the request for assistance, it is a commercial decision for an FSP as to whether it agrees to vary any existing contracts. We have no power to review such a decision (the current [Terms of Reference](#) only enable us to review an FSP's commercial decision about varying a customer's contract where the contract is regulated by the UCCC or the NCC). Further, we accept that assistance may not necessarily be appropriate if a company cannot demonstrate its long term viability.

#### Applying increased risk margins

We consider that the application of an appropriate interest rate is a commercial decision for the FSP. However, it may not be appropriate to apply a default interest margin when the small business is already experiencing financial difficulty and is in a dialogue, or has made an arrangement, with the FSP about how to overcome those difficulties.

#### Other assistance options

In demonstrating genuine consideration, it may be appropriate for the small business to be referred to government agencies and/or small business councils for advice or availability of grants or venture capital assistance. Such services may include:

- the Federal Government's AusIndustry
- state based small business councils and advisory services, or
- the Council of Small Business Organisation of Australia (COSBOA).

## **Conciliation**

A telephone conciliation conference may take place to seek to reach a resolution of the dispute. We will take into account whether the Applicant has provided information to show that the small business is viable and whether a timeframe for the sale of the assets is an appropriate resolution.

## **Where financial difficulty cannot be overcome**

We accept that FSPs may refer the relationship to an asset realisation area where the FSP's focus changes to loss mitigation. Where a small business can no longer operate as an ongoing concern, the business may be liquidated either by its owners, creditors or other appointed controllers.

We would expect that prior to taking such steps the FSP should undertake a process of genuine consideration of the small business' financial difficulty. In our investigation we will seek supporting documentation from the FSP in respect to the steps that it took to give genuine consideration to the small business' financial difficulty prior to the referral to the asset realisation area or the appointment of an external controller.

## **Appointment of a receiver**

If a receiver is appointed on behalf of the company, we can only consider the validity of the appointment of the receiver by the FSP. We will consider whether the appointment of the receiver was in accordance with the terms and conditions of the security documentation.

That is, a receiver is appointed to act on behalf of the company and is the company's agent, rather than the FSP's agent. Accordingly, we cannot review any action by a validly appointed receiver.

The receiver is not obliged to suspend enforcement action while we are considering the dispute and we cannot intervene in any action by the receiver, such as sale of the company assets.

However, we do have the ability to consider a dispute in relation to an FSP's response to its customer's request for assistance in financial difficulty. Any such dispute can only be made to us with the consent of the receiver (as the company's representative) and may require the receiver to take such steps as attend a telephone conciliation conference.

This is because in order to conduct or assist in any negotiation between the customer and the FSP we must deal with the party authorised to negotiate on behalf of the business. Upon the appointment of a receiver, the directors or owners of the company are no longer capable of binding the company to any agreement reached between it and the bank.

Additionally, it is important to note that any award made in favour of the Applicant or the company, involving a cash payment by the bank would be paid to the receiver for distribution to its appointer (usually the FSP).

It should be noted that clause 13.1(b) of our current [Terms of Reference](#) allows us to consider an FSP's request to exercise its enforcement rights to the extent necessary to preserve the assets which are the subject of a dispute. In our next Circular, we will provide further guidance on our approach to an FSP's request under clause 13.1.

### Liquidation

Where a small business goes into voluntary liquidation or is placed into liquidation as a result of a court order, we recognise that the Liquidator controls the affairs of the company and stands in the shoes of the directors. On this basis, the Liquidator must lodge the dispute.

If the company is controlled by an Administrator the authority must be signed by the Administrator.

### **Guarantors**

We regularly consider disputes which have been raised by guarantors who have provided personal guarantees to a small business.

Where an FSP makes a claim under a guarantee, the guarantors are generally entitled to raise any claim the company may have unless the terms of the guarantee expressly do not allow it to do so and where it would be unfair to allow the FSP to recover any amount outstanding without taking into account any claim the company may have. In such circumstances, the dispute would usually be brought by the company and the guarantors. However, if the company is in liquidation, we do not require the Liquidator's consent to the dispute being lodged with our office, as the guarantors are entitled at law to raise any claim which the company may have without involving the insolvent company.

The obligations of an FSP under clause 25.2 of the CBP and clause 24.1 of the MBCP apply to the guarantors of a small business, including the obligation to give genuine consideration to the guarantor's financial difficulty. The options available to the FSP to assist in meeting its obligation may include time to pay or instalment arrangements. If a realistic repayment arrangement cannot be agreed, consideration may be given to allow a reasonable time for sale of assets by the guarantors or negotiation of a timeframe for the guarantors to seek the opportunity to refinance the business debts into their name.

## **Case studies**

### Cash flow difficulties

The Applicants owned a small business specialising in finance broking. It received its income on a fluctuating basis, as it was dependent upon the settlement of its client's financial arrangements.

The small business experienced financial difficulty as a result of a downturn in finance settlements due to the global financial crisis. This impacted on the small business' ability to meet the repayment conditions on a short term cash flow facility and its repayment obligations on other facilities. The small business was seeking assistance from the FSP in the form of the provision of a different facility, with the aim of spreading its repayment obligations over a longer term to offset the fluctuation of commission sales.

After a period of negotiation, an agreement was reached between the small business and the FSP prior to a telephone conciliation conference. Pursuant to the agreement, the short term cash flow facility was converted into a regularised principal and interest facility to be repaid over an extended term. In addition, the FSP gave concessions in relation to previous charges which had been incurred by the small business.

### Appointment of Investigative Accountant

The Applicants owned a retail store which had previously experienced a period of growth, financed by the small business through debt. Over time the small business became concerned that it would be unable to service its trade facility, and elected to sell assets which acted as underlying security to the FSP's facilities.

The repayment in full of these facilities following the sale of assets put in jeopardy the long term viability of the business as it was at risk of being unable to meet its short term obligations. In accordance with the lending agreement, the FSP appointed an Investigative Accountant for the purpose of further understanding the small business and what options were available. The small business was concerned about the cost of this review.

We conducted a telephone conciliation conference to determine whether a resolution could be reached between the parties before we conducted a detailed investigation into whether the FSP had met its obligations. An agreement was reached. A progressive reduction of facilities over time was put in place to enable the business to continue trading. In addition, arrangements were put in place to enable the injection of further funds to the business by a third party. The conclusions reached by the Investigative Accountant in his report formed the basis of the agreement. By obtaining the report, the parties were able to obtain a clearer view about the longer term direction and viability of the business. The FSP agreed to refund half the costs of the Investigative Accountant as a gesture of goodwill.

## Summary

- The principles we previously set out in [Bulletins 46, 53 and 60](#) concerning the requirement to give genuine consideration to a customer's financial circumstances apply equally to the assessment of a request for assistance from a small business as they do to the assessment of an individual's request. The application of these principles has not changed under the current [Terms of Reference](#). These principles equally apply to credit unions and mutual building societies through their MBCP.
- Our new power to vary credit contracts does not apply to business loans.
- The information gathered by an FSP to give genuine consideration to a small business' financial difficulty will differ from that required from an individual and may be more extensive.
- The options available to an FSP to assist a small business are numerous and will vary depending on the specific circumstances of the small business. Whether an extension or increase in a facility is granted ultimately remains a commercial decision that we cannot review.
- If an FSP is not able to provide ongoing support to the small business to enable it to continue as a going concern, the parties should then consider whether, and in what time frame, asset sales or refinance are appropriate.

## 2. DEBT COLLECTION AND SOCIAL SECURITY RECIPIENTS

Under the earlier [Terms of Reference](#) for the Banking & Financial Services Ombudsman, and for the FOS' Banking and Finance group under its transitional Terms of Reference, we could consider a financial services provider's (FSP's) response to a debtor's request for assistance in financial difficulty, but could not review the FSP's commercial decision.

Our current [Terms of Reference](#) now enable us to review an FSP's credit assessment of a debtor's proposal for variation in relation to a contract governed by the UCCC or similar legislation (such as the NCC).

Clause 5.1(c)(ii) of the [Terms of Reference](#) provide that we may consider a dispute about an FSP's assessment of the credit risk posed by a borrower or the security required for a loan when the dispute is about a variation of a credit contract where the Applicant is in financial difficulty. A credit contract is defined as a regulated contract under the UCCC or similar legislation.

The current [Terms of Reference](#), which came into operation on 1 January 2010, are accompanied by [Operational Guidelines](#) which are designed to provide guidance to users about how we may handle and consider disputes. The [Operational Guidelines](#) dealing with financial hardship matters under clause 5.1(c)(ii) of [Terms of Reference](#) state (at page 23) that:

*“FOS also assesses whether the FSP has met obligations under Commonwealth and state legislative protections designed to assist Centrelink recipients.”*

Clause 9 of the [Terms of Reference](#) deals with the types of remedies which we may require an FSP to undertake to resolve a dispute. The [Operational Guidelines](#) dealing with the types of remedies state (at page 72) that:

*“FOS also assesses whether Applicants may be assisted by Commonwealth and state legislative protections designed to assist Centrelink recipients.”*

Following is further information on what the Commonwealth and state legislative provisions are and how we might take those provisions into account when dealing with a dispute, particularly disputes about financial difficulty in relation to a credit contract.

## Relevant legislative provisions and Codes

### Social Security Administration Act 1991 (Cth)

Section 60(1) of the *Social Security Administration Act 1991 (Cth)* (“the Commonwealth Act”) provides that:

*“A social security payment is absolutely inalienable, whether by way of, or in consequence of, sale, assignment, charge, execution, bankruptcy or otherwise.”*

Section 60(2) of the Commonwealth Act provides for a number of exceptions which apply to the collection of certain Commonwealth debts and therefore are not relevant to any consideration of a debt owing to an FSP by a Centrelink recipient.

### State Debt Recovery legislation

Section 12 of the *Judgment Debt Recovery Act 1984 (Vic)* (“the Victorian Act”) provides as follows:

- 1) *An instalment order shall not without the consent of the judgment debtor be made if the income of the judgment debtor is derived solely from a pension benefit allowance or other regular payment under the Commonwealth Social Security Act 1947 or section 24 of the Children, Youth and Families Act 2005.*
- 2) *In subsection (1) the Commonwealth Social Security Act 1947 means the Commonwealth Act known as the Social Security Act 1947 as amended and in force for the time being and, if the provisions of that Act are re-enacted, means those provisions as re-enacted and as subsequently amended and in force for the time being.*

The Victorian Act applies to any instalment order in respect of a judgment or order for the recovery of money made or given by a Victorian court in an action.

Legislation in other states and territories is not so specific about the source of a judgment debtor’s income when a court is assessing an application for an instalment order. However, most comparable legislation does require the court to take into consideration the debtor’s means of satisfying the judgment, his or her necessary living expenses and other liabilities.

### Uniform Consumer Credit Code and the National Consumer Code

In considering an application for the variation of a credit contract regulated by the UCCC, we will take into account the general principle expressed in Section 66(1) of the UCCC (and from 1 July 2010, Section 72(1) of the NCC):

*“A debtor who is unable reasonably, because of illness, unemployment or other reasonable cause, to meet the debtor’s obligations under a credit contract and who reasonably expects to be able to discharge the debtor’s obligations if the terms of the contract were changed in a manner set out in subsection (2) may apply to the credit provider for such a change.”*

### Consumer protection legislation

Another relevant legislative provision is Section 12CB of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) which prohibits a person, in trade or commerce, in connection with the supply or possible supply of financial services from engaging in conduct that is, in all the circumstances, unconscionable. In considering whether conduct of a financial services provider is unconscionable, regard may be had to, among other matters:

- the relative bargaining strengths of the financial services provider and the consumer, and
- whether any undue influence or pressure was exerted on the consumer by the FSP or a person acting on its behalf.

It should be noted, however, that s 12CB(3) of the ASIC Act provides that a person does not engage in unconscionable conduct merely because the person issues legal proceedings.

### Codes of Conduct

Our current [Terms of Reference](#) require us, when considering a dispute, to have regard to industry codes and good industry practice as well as legal principles. It is therefore also relevant when considering a dispute about an FSP’s actions to have regard to the ASIC/ACCC debt collection guidelines and the Centrelink Code of Operations.

The ASIC/ACCC debt collection guidelines provide that debtors are legally responsible for paying debts they legitimately owe and they should not deliberately try to avoid their obligations. On the other hand, a collector must not threaten action (legal or otherwise) that they are not legally permitted to take.

In this regard, Guideline 19 provides that:

*“(b) You [the creditor] are entitled to accurately explain the consequences of non-payment of a debt, but must not misrepresent those consequences.*

*...*

*(e) Do not state or imply that:*

- *immediate possession will be taken of a debtor’s home or other property when the debt is not secured by that property, or the creditor has not obtained judgment for the debt*
- *unsecured goods may be seized and sold without further legal action*

- *unsecured basic household items can be seized if the debtor is made bankrupt*
  - *additional fees or charges will be added to the debt if payment is not made, if such fees or charges are not permitted by law*
  - *additional fees or charges will be added to the debt where there is no contractual right to add these.*
- ....”

Centrelink Code subscribers include banks, credit unions and building societies, the large majority of which are also members of the Financial Ombudsman Service.

Where the debt owed to the financial institution arises by way of an authorised overdraft, the Centrelink Code of Operations permits a financial institution to recover up to 10% of future payments to repay that debt. However, the Centrelink Code recognises:

*“.... the subsistence nature of Centrelink payments and the need for recipients of income support payments to have access to a reasonable amount of money to live on. Participating financial institutions have agreed that they will take this into account when considering the actual amount they should recover each fortnight (the Code only specifies a minimum amount customers can retain, not a standard amount).”*

### **How we apply these provisions to disputes lodged with us**

The application of these provisions will arise in dealing with disputes lodged about an Applicant’s inability to repay a credit facility due to financial difficulty, both in reviewing the FSP’s collection activity prior to the dispute being lodged with our office, and in considering the potential of any variation to resolve the dispute.

The provisions of the Commonwealth and Victorian Acts seek to limit the ability of a creditor to recover a judgment debt from a debtor’s social security income. Neither section, in our view, prevents a creditor from taking action to recover a debt from a Social Security recipient, nor enforce any judgment against other income (if any) or from unprotected assets. Indeed, the Victorian Act allows for the fact that a debtor may consent to the making of an instalment order from their Commonwealth pension where that is their sole income.

The practical outcome for the credit provider may be that, where the debtor’s sole income is a Social Security benefit and there are no unprotected assets of value against which the judgment can be enforced, debt collection activity will be a hollow exercise from a creditor’s point of view. However, the creditor could obtain a judgment and seek to enforce it at a later date should the debtor’s income no longer be protected (for example, if the debtor returns to work).

A creditor would need to be careful in these circumstances to ensure that they do not mislead the debtor into believing they must make a payment from a Social Security benefit. Should a credit provider suggest to, or direct, a Social Security recipient to make a payment without also pointing out that there is no obligation to do so while their sole source of income is a Social Security benefit (and the debtor has no other

assets), such conduct might be regarded as misleading and not in compliance with ASIC/ACCC Guidelines.

It is therefore our view that, provided the creditor does not engage in misleading or unconscionable conduct, or otherwise breach the ASIC/ACCC debt collection guidelines, there is no impediment to the creditor seeking to recover a debt from a Social Security recipient, including by issuing legal proceedings and obtaining judgment.

### **Dealing with disputes to vary a credit contract as a result of financial difficulty**

When we receive a dispute from an Applicant experiencing financial difficulty, we will seek information from them about their present financial position. Once that information has been provided, then the credit provider should make a decision about whether they are prepared to vary the loan as requested by the Applicant. If the parties are unable to agree, we will get the parties together on the telephone to see if an arrangement can be made.

If an Applicant's sole income is a Centrelink benefit and they have no unprotected assets, and the Applicant does not wish to make any payment to the loan, we would not compel them to do so. However, we would decline a request for a variation to reduce the payments to nil while the Applicant remains on Centrelink benefits. This is because the Applicant could not reasonably expect to be able to discharge their obligations if the terms of the contract were changed in the manner requested. Similarly, we would not require the credit provider to write off the debt, although the credit provider may do so in exercising their commercial judgment about whether it is worth pursuing the debt.

Our usual approach to financial difficulty disputes is to arrange a conciliation conference at which the parties may discuss and reach agreement about an appropriate variation to the Applicant's contract. However, if the only proposal that an Applicant can or wishes to make is that the debt be waived, then we can see little benefit in convening a conference. We would however refer the Applicant to a financial counsellor or consumer advisory service for assistance in dealing with their financial circumstances.

Having made a decision along those lines, our file would be closed and the credit provider would be able to commence or continue legal proceedings and possibly obtain judgment, which, having regard to the provisions of the Commonwealth and Victorian Acts outlined above, would be as far as they could go unless or until the Applicant's financial circumstances improved.

Consumers should be aware, however, that the legislative provisions referred to above would not prevent a credit provider from making a listing on a credit file, or prevent a judgment from being noted on a credit file. Such listings may prevent the consumer from obtaining credit in the future.

### 3. SECURED DEBTS AND SHORTFALL ISSUES

In recent times, our Financial Difficulty Team has frequently confronted circumstances in which customers have rationalised their financial position, or wish to do so, by selling assets which are held as security by their FSP. However, the proceeds of the sale have, or would be, insufficient to meet the customer's outstanding debt, and the FSP has refused to release its security without payment of the debt in full.

#### **Commercial decisions and legal rights**

An FSP's decision to release its security is generally a commercial decision and one which we generally do not have the power to review.

It should however be remembered that, pursuant to clause 5.1(c)(ii) of our current [Terms of Reference](#), we are able to review an FSP's decision regarding the credit risk of a customer relating to a request for a variation of a contract regulated by the UCCC or to be regulated under the NCC.

Further, we can review disputes claiming maladministration in lending, loan management or security matters.

In investigating a dispute, we will consider what is fair in all the circumstances, having regard to our dispute resolution criteria set out in the [Terms of Reference](#), including reference to legal principles. Therefore, in considering whether the FSP is entitled to refuse to discharge its security, we will consider whether it would be fair in all the circumstances for a customer's sale to proceed, even if their liability to the FSP is not satisfied. In doing so, we will, among other criteria, have regard to applicable legal principles.

#### **How have the courts dealt with it?**

In considering an FSP's legal entitlement to prevent a sale at a shortfall, we will take into account the circumstances in which a court may exercise its inherent jurisdiction to order a sale of secured property.

Legislation pertaining to property law in each state and territory, such as section 103 of the *Real Property Act 1900 (NSW)*, gives the court inherent power to order a sale of secured property in circumstances where the interests of a mortgagee may be affected. The court's power has recently been considered by White J of the New South Wales Supreme Court in *New Beach Apartments Pty Ltd v Epic Hotels Pty Ltd and 12 Ors* [2007] NSWSC 47 and *Spendright v Classfoot* [2009] NSWSC 317.

White J acknowledged that there would need to be special or exceptional circumstances warranting the court's exercise of its inherent power of sale. However, from the circumstances of the cases before His Honour and those he referred to in his judgments, it appears that a court would exercise its power to order a sale at the request of a mortgagor, and in the face of objection by the mortgagee, where the mortgagee's refusal:

- (a) is not founded on any reasonable benefit or preservation of rights accruing to it, the mortgagor or other parties interested in the property; or
- (b) is based on speculation about better sales results obtainable in the future without regard to the mortgagor's liabilities in the interim.

Therefore, in considering a dispute about an FSP's refusal to consent to a sale of secured property at a shortfall, we will consider the reasons given by the FSP for its refusal and whether any alternative course of action could result in a better outcome for them without undue detriment to the customer. Having regard to our decision making criteria including the law and fairness in all the circumstances, we may conclude that a bona fide, arms length sale by the customer should be allowed to proceed even though it may result in a shortfall arising from the receipt of sale proceeds without any commensurate security.

Should a sale result in a shortfall in repayment of a customer's debt, we would expect the FSP to work with the customer to reach an arrangement for repayment of any unsecured residual. In the event that there is a residual security, but the FSP believes it is, or would be, inadequate to secure the residual debt, having regard to their policy regarding required loan to value ratios, we might consider it appropriate for the FSP to discharge its security over the sold property subject to reasonable conditions regarding the residual security. For example, the FSP may require any remaining secured property to be placed on the market and sold within a reasonable sales period, or may require alternative security to be provided within a reasonable time frame. In the event of the customer failing to meet reasonable condition/s, it might be appropriate for any remaining property to be surrendered to the FSP.

Our comments below about lenders' mortgage insurance (LMI) may also be pertinent to our consideration of whether an FSP has adequately tried to assist their customer in financial difficulty when a sale of a security may lead, or has resulted in, insufficient monies being available to satisfy the customer's liability or inadequate security remaining to secure any residual debt.

## **Conclusion**

Where an FSP's refusal to consent to the disposal of a security does not reasonably protect its interest as mortgagee and has no realistic prospect of benefitting the customer, we may, with reference to the applicable legal principles, consider it fair in all the circumstances that the customer be entitled to complete their sale provided the net proceeds are paid to the FSP in full. This result may occur even if an FSP would be left with an unsecured shortfall or a residual loan to value ratio on the remaining debt and security exceeding its usually accepted exposure.

## 4. CUSTOMERS IN FINANCIAL DIFFICULTY AND LENDERS MORTGAGE INSURERS

In response to a customer's request for a variation of their contract, we are frequently informed by the FSP that it cannot agree to a variation due to the direction given by its LMI insurer. This may occur because the FSP has a contractual obligation to deal with, or at least inform, its insurer when the insured contract may be varied.

Alternatively, it may occur when a shortfall is realised on the sale of a security and the customer is seeking an arrangement to repay the residual debt, which would otherwise be claimed by the FSP under its LMI policy.

Where a customer is seeking a variation of their contract, whether it is as a consequence of the sale of a security or not, we consider that the obligations imposed upon FSPs under the CBP and MBCP and any internal hardship policies continue to apply, regardless of any applicable LMI policy or the direction of an LMI insurer. In our view, an FSP would fail to give real and genuine consideration to a hardship variation if it merely abides by the direction of its insurer and does not form its own view on the customer's ability to repay their loan or any residual debt under a repayment arrangement.

In considering a dispute about a variation to a credit contract we will make an assessment based on the Applicant's ability to repay the loan as varied. We will not take into account the views of an LMI insurer. In addition to any claim for loss that may have been incurred, an award for non-financial loss may be made in accordance with our guidelines if an FSP is found to have failed to give its own due and proper consideration of a variation.

Where a claim has been made under an LMI policy, and a dispute is subsequently lodged with us, we expect the FSP to contact the insurer (who may not be a member of the Financial Ombudsman Service) and request that all collection activity or recovery action cease whilst our file remains open.

This is consistent with our approach to disputed debts which have subsequently been sold to a third party (see [Bulletin 34](#)). Appropriate steps should therefore be taken to ensure that no collections activity is undertaken by a lender's mortgage insurer while we are considering the dispute.

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