

Banking and Finance - Bulletin 50 June 2006

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** On 1 July 2008, the Banking & Financial Services Ombudsman (BFSO), Financial Industry Complaints Service (FICS) and Insurance Ombudsman Service (IOS) merged to form the Financial Ombudsman Service (FOS).*

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Unsecured Credit and Maladministration

The claims of maladministration in credit card lending and the circumstances under which credit was provided to people lodging disputes with this office cover the range of situations described in Bulletin 45. The responses of lenders and the resolution of the disputes have been as varied as the circumstances giving rise to the disputes. This is to be expected and encouraged as we would like to see a case by case response to disputes rather than a rigid approach.

With 12 months having passed since we published the Bulletin on maladministration and credit card limits, we thought it an appropriate time to give further guidance to disputants and their representatives and to lenders not only about maladministration in credit card lending but also in other unsecured lending such as personal loans.

In relation to credit card lending we have relied on some recent cases which illustrate:

- the information that is relevant and necessary to support a claim;
- how we approach cases involving multiple lenders;
- the difference between maladministration and unconscionable conduct;
- how the lender can assist the customer in financial difficulty, whether or not maladministration has been established; and
- appropriate resolutions of disputes.

Credit Card Lending

Information from disputants and review by lenders

Unsolicited offers to increase the credit limit

Bulletin 45 described the information which ought to be provided by disputants or their representatives complaining about unsolicited credit limit increases. We described what was required as a "retrospective statement of position" and the types of information we suggested be provided included details of the disputant's gross income at the time, financial commitments, including mortgage payments or rent, and number of dependents. This information is required to enable the lender to apply its criteria for new credit to the financial position of the disputant at the time the unsolicited offer was made.

Retrospective assessment of appropriate credit limit

We recognise that conducting this retrospective assessment is not easy for disputants or lenders.

When considering any application for credit, we expect lenders to obtain sufficient information from the consumer about his/her personal and financial position to assess the consumer's capacity to repay the debt. The process for retrospectively assessing the appropriate credit card limit seeks to replicate the assessment which would be done if an application for new credit had been made. We consider the information sought should reflect that which the lender would have sought if it had received an

application. The best way to achieve this end is by having the disputant complete an application for new credit as at the date the unsolicited increase was offered.

Information from disputants

We encourage disputants and their representatives to provide all available information about their financial position at the time the credit limit in dispute was increased. If there have been a number of unsolicited offers and it is said that the disputant's financial position had not changed substantially, we suggest that information about the disputant's financial position as at the date of the earliest disputed increase be provided initially.

Some disputants understandably have difficulty recalling their earlier financial position. We suggest that disputants refer to documents they have or can obtain, such as duplicate account statements or tax returns, to clarify income. We have seen cases where the retrospective income information provided by a disputant was found to be inconsistent with the information on his or her account statements. We encourage disputants and their advocates to satisfy themselves about the accuracy of the information about their financial position before it is communicated to our office or to the lender.

We have seen some cases where the disputant has not provided necessary financial information or has declined to complete a replica application as at the date of the increase in issue. This meant that the lender was limited, sometimes entirely so, in completing an assessment of the appropriate credit limit.

Collection and use of information by lenders

Lenders should at an early stage examine the information held by them about the disputant's financial position. Transaction account statements may show salary deposits, Centrelink payments or other funds being deposited. Those statements and/or the credit card statements may show regular debits to meet other loan commitments, insurance premiums or other fixed expenses. A loan or other credit application may be held in another area and it may provide the required information.

The suggestions we made in Bulletin 45 about information which may be used to assess grants of credit were not intended to be followed slavishly or become an unnecessary obstacle to resolving the dispute.

If the lender would not ask for production of salary slips, Centrelink statements or other account statements from an applicant for new credit, as a general practice, it ought not to do so when undertaking a maladministration assessment process in the terms of Bulletin 45 unless there is some basis to believe that the information provided is inaccurate or incomplete.

Where the disputant has at all relevant times been on a fixed income and had largely fixed expenses, it may be quite appropriate to use current information about income and other commitments as it is unlikely the details would have changed to any significant degree.

In cases where there have been a number of unsolicited offers and it is said that the disputant's financial position had not changed substantially over the period of the offers, if there was maladministration in the first disputed increase, then it is likely that the following increases were also inappropriate. In such cases it would not be necessary for a lender to separately consider information about each subsequent increase. Rather, from the point that maladministration was established, it would be appropriate for the parties to move on to a consideration of what amount would be repayable and the current position of the disputant.

Resolution of disputes

We encourage disputants and their representatives and lenders to take a practical approach to these retrospective assessments in the interests of reaching a speedy and effective resolution of the dispute.

The following case illustrates the practical approach taken by two lenders to resolve a claim of maladministration in credit card lending. In this case we did not have to reach a view about whether there was maladministration as the two cases were able to be resolved without the need for us to investigate. The case also reflects an appropriate response to a customer in financial difficulty (discussed further later in this Bulletin).

Ms A said that on an annual income of \$38,000 she was experiencing difficulty meeting the minimum monthly payments on credit cards with two lenders with limits totalling \$41,000. She said that she had issues with the provision of the credit limits on the cards.

The first lender agreed to reduce the debt to \$13,100 on conditions that the card was cancelled and minimum payments of \$136 per month were maintained. No interest was charged on the outstanding debt. The second lender also required the closure of the account and destruction of the credit card. It reduced the debt to \$10,300 repayable at the rate of \$150 per month. Ms A accepted the offers made by each of the lenders.

Inaccurate or incomplete information provided by an applicant

We have seen a number of cases where inaccurate or incomplete information was provided to the lender in the application for a credit card. In some cases it is said that, if the lender had undertaken verification of that information, the inaccuracies or missing information could have been discovered.

As outlined in Bulletin 45, we consider that in most cases of credit card lending the lender is entitled to rely on the information provided by the applicant. However, we will consider whether the information provided was clearly incorrect or nonsensical on its face.

Mr B told us in correspondence that at the time of making internet applications for credit cards with two lenders he was a full time student and that his only income was Austudy and Centrelink payments totalling around \$150 per week. He said that the credit he had applied for was to assist him to meet expenses associated with studying overseas. The applications for credit, however, said that Mr B had been self employed as an IT consultant for five years with a gross annual salary of \$90,000 with additional income

of \$30,000. In his claim to the Ombudsman, Mr B raised a number of concerns including that the two lenders had relied on the incomplete and out of date information he had provided and had failed to carry out their own due diligence.

Our view was that the lenders were entitled to rely on the information about Mr B's work history and income to assess the application. We concluded that it was inappropriate to consider the case further particularly as it appeared that Mr B was aware that the information he had provided to the lenders and which he understood would be used to assess his application was incorrect.

Multiple cards and lenders

It is not uncommon for disputants to have more than one credit card with more than one lender and to state that there was maladministration in lending by more than one of the lenders.

As in all maladministration cases, it is important for us to be provided with details of each lender, the timing of the initial grant of credit and the limit and then details of any increases, whether by application or as a result of an unsolicited offer. Disputants and their representatives are encouraged to provide as much of this detail as possible when the dispute is first lodged with our office as this will allow us to process it appropriately and also allow a speedy response from the lenders.

In cases where there are multiple cards and lenders, before reaching a decision on the merits of that case, we will take into account all relevant available information. That information would include:

- all available information about the disputant's financial position at the time the applications were made or the unsolicited offers were accepted. This would include the financial commitments the disputant had to all lenders at that time; and
- what information was provided to each lender when the applications in issue were completed.

The disputant's financial position at the time he or she applied for credit and at the time of the credit limit increases will be relevant to each dispute with each lender. In order to respond to the dispute the lenders will need to assess whether the granting of credit amounted to maladministration. To do this they must take into account all of the disputant's financial commitments at the relevant time and so it will be necessary for us to be able to disclose all available and relevant information to the lenders.

Accordingly, in order to deal with the dispute, we require the disputant to sign an authority which authorises us to refer to all the information provided by each of the lenders and to exchange the information with each of those lenders, including information about his or her past financial position.

Disputants may elect not to provide the authority to us but if they choose not to do so, we will not consider the dispute further. This does not prevent the dispute being pursued directly with the lenders or elsewhere such as in a court, however, the files with this office will be closed.

Personal Loans

In correspondence and comments made to us it has been suggested that the approach to maladministration in credit card lending described in Bulletin 45 will be routinely applied by us to other forms of lending. This is not correct.

Whilst personal loans are similar to revolving credit products such as credit cards, in that they are unsecured and the assessment is based on credit-scoring in most cases, they differ in significant ways to a credit card account. A credit card represents an offer of available credit up to a limit that can be repaid and drawn again up to that limit or not drawn on at all, at the discretion of the cardholder. The minimum repayment varies from month to month, depending on the outstanding balance of the credit card account and is usually set at a percentage of the outstanding balance.

A personal loan is credit that is provided in a lump sum and which must be repaid at a set monthly amount over an agreed period, usually five to seven years. The nature of the provision of the credit and the repayment terms are reflected in the credit assessment of an application for a personal loan. Personal loan lending policies require some verification of income and savings. Application forms require information about employment details and history, residential details and history and asset and income details.

When assessing a claim of maladministration in granting a personal loan we will require details of the lender's policy in the first instance to determine whether the application was processed in accordance with the lender's own policy. We may also require details of the lender's credit scoring regime to determine if the information provided by the applicant was accurately input into the lender's program. This type of information will be treated as confidential by our office but the outcome of our assessment of the lending decision will be communicated to the parties to the dispute.

Personal loans to young people

We have seen a number of disputes about the granting of personal loans to young people. The circumstances of the disputes vary but a recurring theme is that the claim of maladministration arises because the young person is unable to maintain the payments to the loan due to a change in their employment situation. Some of the reasons for the change in employment are that the disputant was on probation when he or she applied for the personal loan and the employment did not continue after the probation period or that the disputant was in full or part-time work whilst on university holidays and the income ceased when the student returned to university.

In our view, it is prudent lending practice for the lender to obtain information about the nature and period of employment when assessing any application for a personal loan, including for the young applicant.

In one case, Mr R lodged a dispute on behalf of his son about the decision of a bank to lend his son \$14,000 to purchase a motor vehicle. At the time of the application his son had just turned 18 years of age and had commenced casual employment as a car detailer the day before. The job did not last and Mr R's son soon fell behind in his payments. The bank issued letters of demand. Mr R paid the arrears to avoid legal action. In time, his son got another job and maintained the repayments on the loan but could not afford to run the

car. Mr R said that, although his son continued to suffer financial difficulty, he wanted to keep the vehicle. Mr R complained that his son did not have an established work or savings history when the loan was approved and he wanted the bank to assist his son with his financial difficulties.

Taking into account the bank's lending guidelines and its obligations under the Code of Banking Practice, this office expressed the view that there was maladministration in lending. We also expressed the view that, as Mr R's son wished to retain the vehicle, he could not obtain relief from his obligation to repay the debt.

The bank offered to consider a variation of the son's contract if he was still suffering financial difficulty. Mr R said that this was not necessary because by this time his son had sufficient income to repay the personal loan. However, he said he would be satisfied with some compensation to recognise the financial difficulties and pressure that his son was placed under after he lost his job and struggled with the debt. A settlement was negotiated whereby the bank paid \$1,000 against the debt and \$500.00 to Mr R's son.

In the case above, if Mr R had been unable to support his son or his son preferred not to retain the vehicle, as there was maladministration and the personal loan ought not to have been granted, the resolution would have been that the vehicle would be sold in an arms length transaction for market value with the proceeds paid to the bank and the balance of the debt waived.

Maladministration and Unconscionable Conduct

We have seen a number of cases where the consumer makes claims of maladministration and unconscionable conduct in the context of credit card lending. Many of the comments below can be applied to other forms of lending, whether secured or unsecured.

As noted in Bulletin 45, in the absence of special circumstances, the decision by a bank to increase a consumer's credit limit when the consumer did not have the capacity to repay is considered to be maladministration, rather than unconscionable conduct.

Bulletin 45 does, though, recognise that in some cases there will have been unconscionable conduct by the bank. At common law, the elements considered by the court when assessing whether there has been unconscionable conduct are:

- whether one party (the weaker party) at the relevant time suffered from a special disadvantage or disability;
- whether the other party (the stronger party) must have known or should reasonably be expected to have known of that disadvantage or disability at the time; and
- whether, acting on that knowledge, the stronger party took advantage of the weaker party's disadvantage or disability in circumstances where it is considered to be unconscionable to have done so.

The special disadvantage may arise by reason of age, sex, need of assistance, language ability, illness, ignorance, inexperience, impaired faculties, or financial need. To attract the equitable jurisdiction, a person who takes unconscientious advantage of another need only be aware of facts raising that possibility in the mind of a reasonable person.¹

Conduct is deemed unconscionable where it can be seen in accordance with the ordinary concepts of humanity to be so unfair and against conscience that a court would intervene² or so unreasonable and oppressive so as to affront minimum standards of fair dealing.³

Section 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth) also deals with unconscionable conduct in relation to the provision of the financial services for personal, domestic or household use. This section does not require a special disadvantage for there to be unconscionable conduct.⁴

The section sets out a number of factors that should be considered and weighed as a whole. Some may weigh in favour of a characterisation of conduct as unconscionable and others may not. It is not appropriate to approach the list as exhaustive.⁵

Taking into account the matters set out in that section, it is our view that the granting of credit without a proper assessment of a capacity to repay is not, in the absence of any other special factors, unconscionable.

The factors to be taken into account and how we may consider them in the context of credit card lending are:

1. The relative bargaining powers of the parties. We take the approach that it is open to the consumer to reject an offer of increased credit by not signing the offer and that there is usually some inequality of bargaining position in relation to the terms and conditions of a credit card facility. Mere inequality of bargaining position is not usually sufficient to establish unconscionable conduct;⁶
2. Whether the consumer was obliged to comply with unreasonable terms. When considering this factor, a relevant matter for us will be that ordinarily the credit in issue will have been provided on the lender's standard terms and conditions. We will, though, consider any terms which appear to be unusual or outside industry norms;
3. Whether the consumer was able to understand the documents. We may consider whether the disputant had a credit card prior to the increase

¹ *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; 46 ALR 402

² *Zoneff v Elcom Credit Union Ltd* (1990) 94 ALR 445; ATPR ¶41-058

³ *Commonwealth v Verwayen* (1990) 170 CLR 394; 95 ALR 321

⁴ *ASIC v National Exchange Pty Ltd* (2005) 56 ACSR 131 at 138

⁵ *ASIC v National Exchange Pty Ltd* at 140

⁶ *ACCC v C G Berbatis Holdings Pty Ltd* (2003) 197 ALR 153 at 157 per Gleeson CJ and at 168 per Gummow and Hayne JJ

complained about and so whether he or she may be taken to have understood how a credit card worked and that an increase in credit was being offered;

4. Whether any undue influence pressure or tactics were used by the lender. We take into account the fact that in most cases an offer is made by letter and that on its own would not be regarded as undue influence, pressure or tactics. In the cases we see, the pressure often appears to arise from the consumer's overall financial position, rather than from any separate action of the lender; and
5. The amount for which the consumer could have obtained the services elsewhere. We take into account that in most cases the interest rate offered is on the relevant lender's standard terms and, although cheaper credit may be available elsewhere, the interest rate is usually a rate which is consistent with other suppliers in the market.

We have set out this discussion to provide information about the legal basis for a claim of unconscionable conduct. While the comments reflect our general approach, they ought not to be read as being binding in every case. In each dispute we investigate the individual circumstances of the case and reach a view having regard to the law and how it would apply to those circumstances. In many cases the applicable law is clear and the resolution of the dispute turns on the particular facts of the case.

Maladministration and Customers in Financial Difficulty

In June 2005 we published Bulletin 46 which discussed our approach to disputes about how lenders deal with customers in financial difficulty. We addressed consumers' entitlement to seek a hardship variation under section 66 of the Uniform Consumer Credit Code ("UCCC") and the obligation on banks which have subscribed to the Code of Banking Practice to try to help their customers overcome financial difficulty with credit facilities (clause 25.2).

When maladministration is in issue, as foreshadowed in Bulletin 45, an appropriate consideration of a maladministration claim will not necessarily end with the assessment of liability. We said that lenders ought to take into account the disputant's personal position and current financial circumstances to reach a resolution of the dispute which is commercially practical and does not cause unnecessary hardship.

The following summarises some of the ways in which lenders have made an assessment under section 66 of the UCCC or, for subscribing banks, under clause 25.2 of the Code of Banking Practice where maladministration has been established.

- At an early stage in our process, the lender has reviewed the credit granted, established that there was maladministration and arrived at an appropriate credit limit following the approach described in Bulletin 45 and taking into account the information provided by the disputant.
- The lender has then calculated the amount payable and whether interest is to be applied to some or any of the final amount.

- Often at the same time as communicating to the disputant and our office the outcome of the maladministration assessment undertaken, the lender has asked for information about the disputant's current financial position, usually in the form of a signed current statement of financial position.
- The lender has then made an offer to resolve the dispute which takes into account the disputant's current position. It is prudent to ensure that the final agreement also covers the consequences of any default in payment.
- Some offers include a reduction in the debt to be repaid without any interest over an agreed time at an agreed monthly payment. One such case was that of Ms A set out at page 5 above.
- In other cases an offer has been made to enter into a personal loan contract for a lesser amount, with interest payable. For some disputants a lump sum may be available to them and the lender has agreed to accept a lesser amount as full and final settlement of a larger debt.
- In some cases there is a significant portion of the debt that is written off so that the balance can be repaid at a monthly amount that the consumer can reasonably afford and over an appropriate period. This would usually be five to seven years, which is consistent with personal loan terms.

We have found this practical approach results in cases being resolved without the need for investigation. Early resolution of disputes is clearly desirable where financial difficulty is being experienced.

This approach of dealing with the debt outstanding at the time the case is being considered together with the disputant's then financial position is very pleasing. It is also pleasing to see bank members making reference in correspondence, not only to the entitlements under section 66 of the UCCC but also to clause 25.2 of the Code of Banking Practice.

As the cause of the financial difficulty experienced by a disputant may well be maladministration by the bank in question, it is important that the lender does not limit itself to the variations described in section 66 and instead have regard to the broad range of options which can and should be considered under the Code of Banking Practice. Indeed, the broad range of options available under the Code of Banking Practice ought to be applied to all cases of financial difficulty.

Systemic Issues – Concurrent Investigations

As foreshadowed in our last Bulletin, we have had discussions with the Australian Securities and Investments Commission ("ASIC") to clarify the process when there are concurrent referrals and apparent concurrent investigation by both BFSO and ASIC.

Systemic issues

A systemic issue is defined in the Ombudsman's Terms of Reference as an issue which "has been raised in a dispute or several disputes to BFSO which will affect a class of people in addition to those who have complained to us." Several disputes of the same type may indicate a systemic problem, however, issues may also be identified out of the consideration of one single dispute where it is clear that the effect of the problem will extend beyond the parties to the dispute. The identification of a systemic issue can therefore only arise when a dispute has been raised with this office.

Our quarterly systemic issues report to ASIC provides the number of possible systemic issues being investigated and the number and a description of definite systemic issues and the progress of the resolution of the systemic issue. The BFSO report to ASIC does not name the financial services provider unless it has refused to co-operate in the resolution of a systemic issue.

Concurrent investigations

Concurrent investigations may arise in circumstances where, independently of BFSO's consideration of a systemic issue, consumers lodge a complaint with ASIC. Alternatively, ASIC may initiate its own enquiry into the conduct of the financial services provider.

Concurrent investigations have occurred in the following circumstances:

1. ASIC serves a Notice To Produce Books on the financial services provider issued under section 32A of the *Australian Securities and Investments Commission Act 2001* during the course of a BFSO investigation into a possible or definite systemic issue; and
2. Either at the outset or during the course of a BFSO investigation into a possible or definite systemic issue the financial services provider reports itself to ASIC for breaches of its licence requirements.

Although there may be concurrent investigations, there may not be any overlap due to the different roles and responsibilities of the two organisations. The BFSO will primarily focus on consumer redress, whereas ASIC seeks to enforce and promote compliance with the legislation. The BFSO has regard to a number of factors in its investigations, including the law, industry codes and guidelines, good industry practice and fairness in all the circumstances. ASIC is responsible for enforcement of relevant provisions of the ASIC Act and the Corporations Act.

If a member is concerned about duplication of the investigation, or a conflict in the investigations of BFSO and ASIC, they should raise this with us so that we can discuss the issue with ASIC.

As is always the case, we welcome feedback on this Bulletin.



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