

Position Statement Issue 2

3 May 2010

Updated: 7 February 2011

Financial Hardship

This Position Statement aims to describe how we deal with complaints about financial hardship; what we consider our lender Financial Services Providers must do when a borrower claims that they are unable to meet the payment terms described in their loan agreement or lease ('payment terms') or seeks a variation to the payment terms on the grounds of financial hardship ('financial hardship application').

In preparing this Position Statement, we have had regard to the relevant law, good industry practice, applicable industry or regulatory codes of practice and fairness.

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1. Introduction

- 1.1 It is likely that a borrower will encounter a significant change in their financial circumstances at least once during a loan. A borrower may experience financial hardship even during a short-term loan.
- 1.2 An increasing number of borrowers are approaching COSL because they are experiencing difficulty in meeting their financial obligations. One out of every three complaints COSL received in the 2008/2009 financial year related to financial hardship.
- 1.3 Financial hardship may be due to reasons like successive increases in interest rates or a significant change in a borrower's financial circumstances (family break-up, death of spouse, workplace injury, unemployment or illness).
- 1.4 In these circumstances, a borrower may ask their lender to vary their payment obligations so that they can avoid defaulting (or avoid defaulting further) on their loan while they are experiencing financial difficulties.
- 1.5 Occasionally, a borrower may claim that their financial hardship was caused by their having been put into an inappropriate loan that they could not reasonably afford. In these cases, the loan may be unjust and the borrower should generally be placed in the same position they would have been had the improvident loan not been made. Less commonly, this may involve setting aside the loan. Where a borrower claims unjustness and seeks a financial hardship variation, we deal first with the financial hardship aspect (as this is almost always time critical) and the unjustness aspect later. However, often it will be the case that if the borrower never had the capacity to repay the loan, a financial hardship variation will not be appropriate.

2. Purpose of this Position Statement

- 2.1 The Position Statement aims to describe:
 - how we deal with complaints about financial hardship;
 - what we consider our lender Scheme Participants must do when a borrower claims that they are unable to meet the payment terms described in their loan agreement or lease (**'payment terms'**) or seeks a variation to the payment terms on the grounds of financial hardship (**'financial hardship application'**).
- 2.2 In preparing this Position Statement, we have had regard to the relevant law, good industry practice, applicable industry or regulatory codes of practice and fairness.¹

3. What is required of lenders under COSL's Rules?

- 3.1 COSL Rule 18 - 7th Edition applies to our participating Financial Services Providers, whether or not a credit contract is regulated under the National Credit Code.²

Lender must act when they become aware of financial difficulty

- 3.2 Under Rule 18, if the lender becomes aware or is informed by the borrower ('Complainant') that the borrower is or may be in financial difficulties, the lender must consider in good faith and within a reasonable time whether it is reasonably appropriate to vary the payment terms, having regard to the borrower's financial circumstances.³

¹ COSL Rule 12.1, 7th Edition COSL Rules.

² The credit contract will be regulated if, among other things, more than 50% of the loan was for personal, domestic or household purposes. Where the contract is entered into after 1 July 2010 the credit contract will also be regulated where the credit is provided to purchase, renovate or improve residential property for investment purposes; or to refinance credit that has been provided to purchase, renovate or improve residential property for investment purposes (Section 5 of Schedule 1 - National Credit Code of the National Consumer Credit Protection Act 2009)

³ COSL Rule 18.2, 7th Edition COSL Rules

Financial information from borrower

- 3.3** The lender is only required to do so if the borrower provides the lender with the financial information and documents the lender reasonably needs to assess the borrower's financial situation. The lender must allow the borrower a reasonable time to provide these.⁴

[There may be circumstances where the borrower may reasonably require more time to provide the financial information. For example, a borrower with special needs may find it difficult to gather the financial information without assistance; a borrower whose source of income comes from their own business may not have prepared profit and loss statements and tax returns; a borrower with multiple sources of income may not have readily available evidence of this; or a borrower who relies on a third party to provide proof of income may need extra time to obtain the proof. We consider, however, that the borrower must make all reasonable efforts to obtain the information and documents as quickly as possible.]

Lender must act reasonably and in good faith

- 3.4** The lender must act reasonably and in good faith in assessing the Complainant's request to vary the payment terms and must not impose unreasonable or burdensome conditions on the Complainant before agreeing to consider whether to, or agreeing to, vary the payment terms.⁵

Where financial hardship application approved

- 3.5** We do not expect a lender to agree to a financial hardship application if the Complainant is not reasonably able to meet a proposed variation.
- 3.6** If the lender decides to vary the payment terms, it must promptly give to the Complainant and any guarantor of the credit facility a written notice setting out particulars of the varied payment terms.⁶ If the payments are reduced or suspended for a period of time, the written notice should also indicate how the shortfall in scheduled payments are to be managed (for example and without limitation, by debt waiver, capitalisation, increased payments over a period or a lump sum payment).

Where financial hardship application declined

- 3.7** If the lender decides not to vary the payment terms, it must promptly inform the Complainant in writing of:
- (a) its decision and the reasons for its decision;
 - (b) the Complainant's right to make a complaint to COSL; and
 - (c) COSL's contact particulars.⁷
- 3.8** We will ask the lender to reconsider its decision to decline the financial hardship application where, for example, the borrower has put forward a reasonable payment proposal. However, unless the credit contract is regulated by the National Credit Code, we will not substitute our decision for the lender's decision (that is, we will not direct the Financial Services Provider to vary the credit contract). Refer to COSL Rule 9.6(h) – 7th Edition.

⁴ COSL Rule 18.3, 7th Edition COSL Rules.

⁵ COSL Rule 18.4, 7th Edition COSL Rules For example, requiring the borrower to seek a financial contribution from family members.

⁶ COSL Rule 18.5, 7th Edition COSL Rules

⁷ COSL Rule 18.6, 7th Edition COSL Rules

⁸ That is, regulated by the National Credit Code. The credit contract will be regulated if, among other things, more than 50% of the loan was for personal, domestic or household purposes.

4. Agreement to vary between the parties

- 3.1** It is always open to a lender and a borrower to agree between themselves to vary a credit contract, whether or not regulated⁸, for any reason (including on grounds of financial hardship).⁹ We encourage lenders and borrowers to come to those agreements, wherever appropriate.

5. Variation of regulated credit contracts

- 5.1** If the credit contract is regulated by the National Credit Code, a borrower may make a financial hardship application to the lender¹⁰ if the borrower is unable, because of unemployment, illness or 'other reasonable cause', to make the payments the contract requires.
- 5.2** The credit contract may be varied in any of the following ways:
- (a) extending the term of the credit contract and reducing payments; or
 - (b) postponing payments during a specified period (without extending the term of the loan); or
 - (c) extending the term of the credit contract and postponing payments during a specified period.¹²
- 5.3** It is implicit that when payments are postponed under section 72 National Credit Code, they can be 'caught up' by:
- (a) making a lump sum payment after the postponement; or
 - (b) making extra payments over a period of time; or
 - (c) capitalising the arrears.
- 5.4** Although section 72 National Credit Code refers to three types of variations, we recommend that a lender should also consider other types of variations, in appropriate circumstances.¹³ Without limitation, a lender may agree to:
- (a) reduce the interest rate for a specified period;
 - (b) reverse default fees, default interest and enforcement costs;
 - (c) waive default fees and default interest for a specified period;
 - (d) waive part of the arrears or principal;
 - (e) extend periods of reduced or nil repayments;
 - (f) capitalise all, or a portion of, the arrears; and

⁹ If a lender and borrower agree to vary the terms of a regulated credit contract, section 71 National Credit Code requires the lender to give the borrower written notice of the particulars of the change not later than 30 days after the date of the agreement. The lender is, however, under no obligation to agree to a change under this section.

¹⁰ However, the loan amount (or credit limit) must be less than \$500,000 under the National Credit Code or under the floating monetary threshold under the Consumer Credit Code (see: <http://www.fido.gov.au/fido/fido.nsf/byheadline/Hardship-threshold?openDocument>).

¹¹ In *Permanent Custodians Limited v Carolyn Joy Upston* [2007] NSWSC 223, the Court held that the phrase "other reasonable cause" was to be read widely. In that case, the Court found that the borrower had suffered hardship as a result of her business failing. This was despite the fact that the borrower had voluntarily left her employment to investigate her business' decline and despite the fact that she obtained employment shortly after the business was sold.

¹² Section 72(2) National Credit Code.

¹³ Although, strictly, a lender is not obliged to if the credit contract is regulated.

¹⁴ *Capital Finance Australia Ltd v Fairservice (Credit)* [2006] VCAT 624 (13 April 2006) - C. McKenzie, Deputy President.

(g) allow the borrower time to sell the property, during which the lender will not require payments or will require reduced payments.

- 5.5** The test under section 72 National Credit Code of whether a hardship variation is appropriate is whether the borrower reasonably expects to meet their obligations under the credit contract if the contract was changed in a particular way.¹⁴ If capitalising the postponed payments enables the borrower to meet their obligations under the loan, then we consider that it is appropriate for the lender to agree to this. The lender is not generally disadvantaged as the borrower will still pay interest on the capitalised amount.
- 5.6** Any capitalisation could increase the loan's loan to value ratio ('LVR') beyond that covered by a lender's mortgage insurance policy with respect to the loan ('LMI'). However, case law suggests that LMI may not be a relevant consideration for a lender to take into account when considering a financial hardship application in good faith.¹⁵
- 5.7** Within 21 days of receiving the financial hardship application, the lender is required to give the borrower a written notice stating:
- (a) whether or not the lender agrees to the borrower's request to vary the payment terms; and
 - (b) if the lender does not agree to the variation, the reasons for not agreeing; the name of the EDR scheme of which the lender is a scheme participant; and the borrower's rights under that scheme.¹⁶
- 5.8** If a lender agrees to the financial hardship application (and the loan is regulated), the lender must, within 30 days of the agreement, give the borrower and any guarantor a written notice setting out the particulars of the change in the terms of the credit contract.¹⁷

6. Allowing the borrower time to refinance or sell the property

- 6.1** If the lender has declined a financial hardship application, we consider that a lender should generally allow a borrower reasonable time to refinance where there is a realistic prospect of this¹⁸ or where the financial position of the lender is fully protected because the value of the security property significantly exceeds the outstanding balance of the loan.
- 6.2** We consider that a lender should allow a borrower reasonable time to sell the security property if the sale of the property is likely to discharge the loan. This is consistent with section 72 National Credit Code in that the sale will enable the borrower to meet their obligations under the loan. In this case, payments may be reduced or postponed during the sale period.
- 6.3** Even if the sale may not discharge the loan, a lender should consider whether it is appropriate to allow a borrower time to sell the security property, noting that:
- (a) borrowers generally prefer to "sell with dignity" rather than by mortgagee sale; and
 - (b) this saves on enforcement costs that would otherwise be borne by the borrower.

¹⁵ Ward-Miller & Anor v Perpetual Trustees Australia Limited (2001) ASC Fair Trading Tribunal of NSW.

¹⁶ Section 72(3) National Credit Code – this only applies to credit contracts entered into after 1 July 2010 (including refinances of existing credit contracts after that date).

¹⁷ Section 73(1) National Credit Code.

¹⁸ Inglis v Commonwealth Trading Bank of Australia (1972) 126 CLR 161 is authority for the proposition that, for an injunction to be granted to restrain a mortgagee sale, the undisputed amount of the mortgage debt must be paid into court. However, there are exceptions to the general rule. In Grose v St George Commercial Credit Union Ltd (1991) NSW ConVR 55-58, the court considered that an injunction to prevent the exercise of a power of sale under a mortgage could be granted based on the fact that there was a realistic prospect of refinancing. See also Notaras v Sly & Weigall [2005] NSWCA 275 at paragraph 133.

- 6.4** In allowing the borrower reasonable time to sell the security property, we accept that it may be appropriate in the particular circumstances for the lender to require the borrower to agree to some or all of the following:
- (a) The security property being put up for sale within a certain period.
 - (b) Unconditional contracts of sale to be exchanged by a certain date (this must be reasonable).
 - (c) The borrower agrees in writing that if contracts of sale are not exchanged by a certain date, the borrower will give possession of the property to the lender.
 - (d) The contract for sale provide that settlement will take place within a certain period (we consider six weeks would be reasonable in most circumstances).
 - (e) The borrower agrees to make whatever payments they can during the sale period. The borrower should provide financial information so that a reasonable payment amount may be established.
 - (f) The borrower signs an authority to allow the lender to obtain updates from time to time on the progress of the sale from the real estate agent.

7. If financial hardship is declined by lender

- 7.1** Whether or not the credit contract is regulated, the borrower may submit a complaint to us if the lender has declined their financial hardship application. Alternatively, if the loan is regulated and the loan amount is under the financial hardship threshold amount, the borrower may also apply to the Court to change the terms of the credit contract.²⁰
- 7.2** On receipt of a financial hardship application (or, more accurately, a complaint that the lender has declined the borrower's request for a payment variation), we review,²¹ among other things:
- (a) whether the borrower was in fact, and continues to be, in financial hardship;
 - (b) the borrower's financial circumstances; and
 - (c) whether the borrower is likely to be able to meet any revised payment terms being proposed, given their financial circumstances.²²
- 7.3** We also examine whether the lender considered the borrower's hardship variation application in good faith.

8. Good faith consideration of a financial hardship application

- 8.1** COSL Rule 18, 7th Edition COSL Rules imposes an obligation on each lender to consider in good faith whether a financial hardship application is reasonably appropriate, having regard to the borrower's financial circumstances.²³

¹⁹ Australian Barter Currency Exchange Pty Ltd v Uniting Church (NSW) Trust Association Limited [2009] NSWSC 607, at paragraph 29: "... the financial position of the defendant is fully protected because of the very substantial value of the mortgaged properties which significantly exceeds the amount of the loans. Even if the refinancing of the loans did not take place within six weeks, or did not take place at all, the defendant would not suffer financial loss."

²⁰ Section 74 National Credit Code.

²¹ Even if the credit contract is not regulated

²² Amortisation tables generated from a loan repayment calculator can be used to see if the borrower will be able to meet a particular payment variation.

²³ COSL Rule 18.2, 7th Edition COSL Rules

- 8.2** If the lender does not do so, it may affect its ability to:
- (a) charge the borrower default fees, default interest and enforcement costs;²⁴ and/or
 - (b) charge the borrower the costs of staying legal proceedings,

if the enforcement action could have been avoided had the lender considered the financial hardship application in good faith and, if appropriate, granted a variation of payment terms at the time.
- 8.3** However, the requirement of good faith does not impose an obligation on the lender to act for or on behalf of the borrower.²⁵
- 8.4** Also, we consider that to act in good faith the lender should:²⁶
- (c) participate in the process of negotiation, mediation or conciliation; and
 - (d) demonstrate:
 - (i) a willingness to consider the options proposed by the other party for resolution of the complaint; and
 - (ii) a willingness to put forward options for the resolution of the complaint.
- 8.5** The obligation on a lender to act in good faith will include the lender doing the following:
- (a) allowing the borrower sufficient time to provide information about their financial circumstances;
 - (b) considering the borrower's financial circumstances;
 - (c) considering whether it is reasonably appropriate to vary the payment terms, having regard to the borrower's financial circumstances;
 - (d) considering any reasonable proposal to vary the payment terms of the contract;
 - (e) considering only matters relevant to the hardship application (for example, the borrower's poor payment history²⁷ and the LVR of the loan²⁸ are generally not relevant considerations);
 - (f) not imposing an unreasonable or burdensome alternative payment arrangement; and
 - (g) giving adequate reasons for declining a financial hardship application.
- 8.6** A borrower's delay in making a financial hardship application should not generally be a reason to decline the application. To do so would preclude the borrower from seeking a remedy available under the legislation.²⁹
- 8.7** If the lender has not considered the financial hardship application in good faith, we:
- (a) will require the lender to re-consider their decision to decline the application; or
 - (b) in the case of a regulated credit contract, will consider if the credit contract should be varied in the manner described in section 72 National Credit Code.

²⁴ COSL Rule 18.7, 7th Edition COSL Rules.

²⁵ However, the lender should not disregard the interests of the borrower who will ultimately bear the burden of enforcement costs - *St George Bank Limited v McCormack* [2008] SASC 8, per Lunn J at [20].

²⁶ *Aiton v Transfield* (1999) NSWSC per Einstein J at [156].

²⁷ *Capital Finance Australia Ltd v Fairservice* [2006] VCAT 624, but the borrower's payment history may, in the circumstances, be indicative of the borrower's permanent inability to repay the loan.

²⁸ *Ward-Miller v Perpetual Trustees Australia Ltd* (2001) ASC 155-046.

9. Our considerations when determining if a loan should be varied

- 9.1 The decision to vary a credit contract is discretionary and the matters we will consider depend on the circumstances of the complaint. In determining whether and how a credit contract should be varied, we will be guided by a number of principles, including among others:
- (a) The borrower must have first made a financial hardship application to the lender and the application must have been rejected.³⁰ The application need not be in writing. However, the lender may ask the borrower to put an oral request in writing and provide written particulars of the borrower's financial situation. Circumstances where we consider that a borrower's application has been rejected include (without limitation):
 - (i) where the lender has offered an arrangement that the borrower cannot reasonably meet;
 - (ii) where the lender has not responded to the borrower's application; or
 - (iii) where the lender has informed the borrower that their request for financial hardship assistance has been declined.
 - (b) We must be satisfied that the borrower is unable reasonably to meet their obligations under the credit contract because of illness, unemployment or other reasonable cause;³¹
 - (c) The borrower must be able to demonstrate that they reasonably expect to meet their obligations under the credit contract if the credit contract is varied.³²

[This means that if the terms of the credit contract are varied, the borrower must reasonably expect to be able to pay:

 - A. the balance outstanding (including any accrued arrears, default interest and fees and enforcement expenses); and
 - B. interest on the outstanding loan balance,

at the interest rate specified in the credit contract (unless otherwise agreed) over the term of the loan, as extended if appropriate.]
Amortisation tables generated from a loan repayment calculator can be used to ascertain whether the borrower will be able to meet the proposed payment arrangement.³³
 - (d) Documentary evidence is necessary to assess the financial circumstances of the borrower.³⁴
 - (e) We will look at the borrower's circumstances at the time the borrower made the financial hardship application to us, not at the time they made it to the lender.³⁵

²⁹ Paulis v Perpetual Trustees Australia Ltd (Credit) [2007] VCAT 970 (8 June 2007) - C. McKenzie, Deputy President.

³⁰ A and B v Millbrook Finance Ltd; Millbrook Finance Ltd v A and B (Credit) [2008] VCAT 2418 (26 November 2008) - C. McKenzie, Deputy President.

³¹ The causes resulting in a borrower not being able to meet their loan repayment obligations are as varied as human experience - Capital Finance Australia Ltd v Fairservice (Credit) [2006] VCAT 624 (13 April 2006) per C. McKenzie, Deputy President at [13]; see also Allco Principal Finance Nominees Pty Ltd v Stojanovic (Credit) [2007] VCAT 1245 at [13] per C. McKenzie, Deputy President.

³² Cheer v Citigroup Pty Limited (Commercial) [2008] NSWCTTT 817 (23 January 2008). Capital Finance Australia Ltd v Fairservice (Credit) [2006] VCAT 624 (13 April 2006) - C. McKenzie, Deputy President.

³³ Permanent Custodians Limited v Carolyn Joy Upston [2007] NSWSC 223 (16 March 2007), per Cooper AJ at [179] - [180]. The calculus to establish capacity can be found at [137] - [143] and the tolerances that need to be built into any analysis can be found at [142].

- (f) The test is not what payments the borrower desires to make, but rather, whether the borrower can meet their obligations if the credit contract was changed in a particular way.³⁶
- (g) We will attempt to find a reasonable balance between the interests of the borrower and the lender.³⁷
- (h) The fact that the borrower caused their own financial hardship will not, of itself, disqualify them from seeking financial hardship relief.³⁸
- (i) A negative inference may sometimes be drawn from the length of time that the borrower has been unemployed.³⁹
- (j) We will not make judgments about the financial decisions of the borrower or how they may have prioritised one interest, or need for expenditure, above another.⁴⁰
- (k) We may sometimes take into account a commitment from a family member of the borrower to assist the borrower with payments.⁴¹
- (l) We may require the lender to enter into an interim variation if there is uncertainty as to when the borrower will be able to meet their obligations (because, for example, it is uncertain when the borrower may be able to secure employment; or when the borrower will receive a worker's compensation payout; or when the borrower's business will improve).⁴²
- (m) We may impose conditions on the borrower to, for example, regularly report to the lender about changes in their circumstances.
- (n) The borrower is entitled to make a financial hardship application on more than one occasion.⁴³ However, we will take into account whether the borrower's circumstances have changed since the previous application.
- (o) If the prospect of the borrower meeting the proposed variation is speculative, it is less likely that we will consider that a variation is reasonable (however, an interim arrangement may be suitable). Examples of these circumstances are:

³⁴ *Cheer v Citigroup Pty Limited (Commercial)* [2008] NSWCTTT 817 (23 January 2008).

³⁵ *Garnar v Capital Finance Australia Limited* [2003] VCAT 1171 (12 June 2003).

³⁶ *Capital Finance Australia Ltd v Fairservice (Credit)* [2006] VCAT 624 (13 April 2006) - C. McKenzie, Deputy President at [48].

³⁷ *Capital Finance Australia Ltd v Fairservice (Credit)* [2006] VCAT 624 at [13] per C. McKenzie, Deputy President.

³⁸ *Allco Principal Finance Nominees Pty Ltd v Stojanovic (Credit)* [2007] VCAT 1245 (17 July 2007).

³⁹ *AQT v Commonwealth Bank of Australia (Credit)* [2009] VCAT 617 (9 April 2009) - C. McKenzie Deputy President.

⁴⁰ *Allco Principal Finance Nominees Pty Ltd v Stojanovic (Credit)* [2007] VCAT 1245 (17 July 2007): "Debtor hardship applications do not happen in an ideal world of perfect decision-making."

⁴¹ *Vinuya v Permanent Custodians Limited (Commercial)* [2007] NSWCTTT 498 (20 August 2007)- J Bordon - Senior Member. A different view was expressed in *AQT v Commonwealth Bank of Australia (Credit)* [2009] VCAT 617 (9 April 2009) where the borrower's expectation that they would be able to meet their payment obligations was based on a contribution from a friend (the friend had no agreement and thus no obligation to make payments to lender).

⁴² *Paulis v Perpetual Trustees Australia Ltd (Credit)* [2007] VCAT 970 (8 June 2007), per C. McKenzie, Deputy President at [29]: "Indeed it is uncertainties of this kind (ie the length of time taken in which the borrower might obtain employment, or when pending court proceedings might be finalized) that lie at the heart of hardship applications. As long as the borrower can establish that they are able to afford the repayments if the contract is varied in the manner that is proposed, then variation of contract on the basis of hardship remains available."

- (i) where there is no indication as to whether or when the borrower will receive compensation for an injury that has caused the hardship; or
- (ii) where there is no indication as to whether or when the borrower's business will improve as expected by the borrower; or
- (iii) where there is no indication as to when the borrower will receive an inheritance, or the amount of the inheritance.

10. Direction by COSL to vary a credit contract

10.1 If we determine that a regulated credit contract should be varied, we will direct the lender to vary the payment terms of the credit contract, even where the credit limit exceeds the hardship threshold under the National Credit Code.

10.2 The lender must:

- (a) not treat the variation of the credit contract as a default⁴⁴ (and, accordingly, should not charge default fees or default interest while the variation is in place and for as long as the borrower is complying with the arrangement);
- (b) if the lender previously listed the borrower as being in default but the listing could have been avoided if the lender had acted in good faith, request the credit reference body to remove the default listing, and provide the credit reference body with all necessary information to facilitate the removal; and
- (c) while the borrower is complying with the variation, not do anything that is inconsistent with the variation, like:
 - (i) commencing or resuming enforcement action;
 - (ii) seeking judgement for the debt or taking possession of an asset securing the debt;
 - (iii) assigning any right to recover the debt; or
 - (iv) listing a default on the borrower's credit reference file.

10.3 Unless the loan is for a small amount, we recognise that if a borrower's financial difficulties are long term, they are unlikely to be able to repay their loan even if there was a variation of the loan terms. In these circumstances, we are unable to assist a borrower seeking a variation of their payment obligations.

10.4 We also recognise that a borrower may sometimes be better off selling the security property.⁴⁵ As we are not permitted to advise the borrower on these matters, we would normally refer them to a financial counsellor.

10.5 However, we consider that in such cases, the lender should generally allow the borrower reasonable time to sell the security property themselves (refer to section 6, above).

⁴³ *Harding v National Australia Bank Ltd (Credit)* [2007] VCAT 1234 (9 July 2007), per C.McKenzie, Deputy President at [41].

⁴⁴ *Allco Principal Finance Nominees Pty Ltd v Stojanovic (Credit)* [2007] VCAT 1245 (17 July 2007).

11. Default fees, default interest and enforcement cost

- 11.1 We consider that a lender is able to charge enforcement costs that are reasonably incurred if they are authorised under the credit contract. However, while the credit contract may entitle the lender to recover enforcement costs reasonably incurred by it, this must be done "having regard to the proper interests of the persons who will ultimately bear the burden of such costs".⁴⁶
- 11.2 If the borrower is able to reasonably demonstrate to us that a financial hardship application should have been approved by the lender⁴⁷ at the time the borrower made the lender aware, or at the time the lender became aware, that the borrower was experiencing financial difficulties, the lender is generally not entitled to recover default interest and fees and enforcement costs from that time.⁴⁸ However, if the lender requested documents reasonably necessary to consider the application and the borrower did not provide these, the lender is not obliged to reverse these costs.
- 11.3 For regulated loans, we will also look at whether the lender has breached section 107 National Credit Code, which provide that a lender must not recover enforcement expenses in excess of those reasonably incurred by the lender. These may include costs that have been unjustifiably or vexatiously incurred by the lender so as to impose an unwarrantable burden on the mortgagor.⁴⁹

12. Enforcement action

- 12.1 The 7th Edition of the COSL Rules sets out specific provisions about enforcement action⁵⁰ and financial hardship.
- 12.2 A lender must not commence or continue enforcement action while we are reviewing a financial hardship application.
- 12.3 By '**enforcement action**', we mean making a demand for the payment of a debt or possession of an asset securing the debt, which involves:
- (a) legal proceedings in a court to recover the debt or take possession of the asset; or
 - (b) any action (other than legal proceedings) to recover the debt or take possession of the asset.⁵¹

⁴⁵ Indeed, ASIC in its publication "Protecting wealth in the family security property: An examination of refinancing in response to mortgage stress" 2008, suggests that such a borrower should consider selling their home rather than refinancing their loan, as refinancing is likely to only increase their debt (because of refinancing costs), increase repayments and merely defer the eventual sale of their home.

⁴⁶ *St George Bank Limited v McCormack* [2008] SASC 8, per Lunn J, a Master of the Supreme Court, at [20]. In *Ristic v Greater Building Society Ltd* [2002] NSWCA 266, Mason P, with whom Santow JA and Campbell AJA agreed, when explaining the ambit of the reasonableness of incurring legal expenses, stated at [24]: "This meant that the defaulting borrower has contractual protection against unreasonable enforcement costs, whether unreasonableness stems from inapt enforcement activity or excessive legal or other costs."

⁴⁷ That is, the Complainant is able to reasonably demonstrate that they would have met the requirements of section 72 of the National Credit Code. On its face, the section only requires the applicant to show that they meet the express criteria described in that section. As long as the applicant is able to do this, the application should be approved and the credit contract varied. The lender is not entitled to take into account other considerations.

⁴⁸ COSL Rule 18.7, 7th Edition COSL Rules

⁴⁹ *Elders Trustees & Executor Co Ltd v Eagle Star Nominees Ltd* (1986) 4 BPR 9205 at 9208-9

⁵⁰ Regulatory Guide 139 of July 2010 issued by the Australian Securities and Investments Commission ('ASIC') requires the Rules of an external dispute resolution ('EDR') scheme approved by ASIC to require its Members not to commence or continue legal proceedings once a complaint has been lodged with the EDR scheme [see paragraphs 139.66 and 139.71].

⁵¹ COSL rule 45(1), 7th Edition COSL Rules

- 12.4** Once we record a financial hardship application as having been received and for as long as we deal with the application:
- (a) the lender must not initiate enforcement action;
 - (b) if enforcement action commenced before we received the financial hardship application, the lender must not continue the enforcement action⁵² and, in particular, must not seek judgment in the legal proceedings;
 - (c) the lender must not sell the debt or otherwise assign any right to recover the debt; or
 - (d) if it has not already listed a default, the lender must not list a default on the borrower's credit reference file.⁵³
- 12.5** While enforcement action is stayed, the borrower is obliged to continue making whatever payments they are able to.⁵⁴
- 12.6** There are certain circumstances where we will permit the lender to commence or continue legal proceedings. These are set out in COSL Rule 17.3, 7th Edition COSL Rules. In particular, we will permit the continuation or resumption of legal proceedings if the borrower has taken a step in the legal proceedings beyond lodging a defence or a defence and counterclaim.⁵⁵
- 12.7** The lender must not do anything which is inconsistent with:
- (a) a decision by us in the borrower's favour; or
 - (b) an agreement between the lender and the borrower on a variation of the payment terms; or
 - (c) a direction by us to the lender to vary the terms of a credit contract.⁵⁶
- 12.8** The lender may resume enforcement action if:
- (a) we determine that we have no jurisdiction to deal with the financial hardship application;
 - (b) we consider that the financial hardship application has not been made out; or
 - (c) the borrower declines to accept our determination of the financial hardship application.
- 12.9** However, the lender may only resume enforcement action if it allows the borrower 21 days in which to file a defence or a defence and counterclaim (if they have not already done so).⁵⁷

⁵² Where the lender did not consider the financial application in good faith as required by COSL Rule 18, 7th Edition COSL Rules, or declined the application on the basis of irrelevant considerations, we consider that it is not open to the lender to charge the borrower the cost of the stay in legal proceedings. Otherwise, (and despite the fact that the lender may still have declined the application), the lender may seek from the borrower reimbursement for its reasonable expenses in obtaining a stay in proceedings. We expect this would generally be recoverable under the credit contract or mortgage.

⁵³ COSL Rule 17.2(d), 7th Edition COSL Rules

⁵⁴ A and B v Millbrook Finance Ltd; Millbrook Finance Ltd v A and B (Credit) [2008] VCAT 2418 (26 November 2008) - C. McKenzie, Deputy President.

⁵⁵ However, the Complainant will not be considered to have taken a 'step' if they merely attended a directions hearing or agreed to consent orders of a procedural nature being filed in the proceedings- Note to COSL Rule 17.3, 7th Edition COSL Rules.

⁵⁶ COSL Rules 9.6(h) and 17.4, 7th Edition COSL Rules.

⁵⁷ COSL Rule 17.6, 7th Edition COSL Rules.

13. Remedies under COSL Rules

- 13.1 Where appropriate, we can require a Financial Services Provider to, among other things:
- (a) reconsider its decision to decline a financial hardship application (where, for example, the borrower has put forward a reasonable repayment proposal or where the lender has taken into account inappropriate factors); or
 - (b) where the loan is regulated, vary the payment terms of the credit contract;⁵⁸ or
 - (c) reverse default fees, default interest and enforcement costs;⁵⁹
 - (d) pay compensation to the borrower;⁶⁰ or
 - (e) do something or refrain from doing something⁶¹.

14. What we expect from Financial Services Providers

- 14.1 COSL Rule 18 makes it clear that the Financial Services Provider should consider whether it is appropriate to vary a borrower's payment obligations even where the borrower has not directly advised the Financial Services Provider that they are having financial difficulties.
- 14.2 A finance broker, who becomes aware that a borrower for whom they arranged a loan is in financial difficulties, should inform the borrower that the borrower may make an application to the lender or mortgage manager for a variation to their payments obligations on grounds of financial hardship.⁶²
- 14.3 We consider that a mortgage manager or lender should make enquiries as to whether a borrower is or may be in financial hardship when it becomes aware that the borrower has defaulted or a direct debit has been dishonoured. We recommend that the Financial Services Provider open early lines of communication with the borrower for the purpose of establishing whether this is the case and, if so, whether it is reasonably appropriate to vary the payment terms having regard to the borrower's circumstances.
- 14.4 Early communication with a borrower is also in the Financial Services Provider's interest because they may not otherwise be entitled to recover default interest, default fees and enforcement costs from the time they should have approved a financial hardship application.⁶³
- 14.5 Consequently, the Financial Services Provider should establish organisational systems (including training their staff and contractors), to identify borrowers who may be in financial difficulties. This will allow the Financial Services Provider to consider at the earliest possible time whether it is reasonably appropriate to vary the payment terms. It is in the interests of both the Financial Services Provider and the borrower that a material amount of arrears, and default fees and default interest, do not accrue on the borrower's loan.

⁵⁸ COSL Rule 9.6(h), 7th Edition COSL Rules.

⁵⁹ COSL Rule 18.7, 7th Edition COSL Rules.

⁶⁰ COSL Rules 9.6(a) and 9.7, 7th Edition COSL Rules.

⁶¹ COSL Rule 9.9, 7th Edition COSL Rules.

⁶² For finance brokers who are members of the Mortgage and Finance Association of Australia ('MFAA'), this is a requirement of clause 70 MFAA Code of Practice (July 2010 version).

- 14.6** We understand that a borrower can apply to APRA for the partial release of their superannuation benefits. Consequently, if the borrower requests the lender to do so, we expect that the lender will provide, as soon as practicable, the borrower with a letter containing the information required by APRA. While we do not express an opinion as to whether it is appropriate for a borrower to access their superannuation savings, we accept that sometimes it may be in the interests of the borrower to do so; for example, if the superannuation funds will entirely clear the arrears on the loan, avoid enforcement costs and enable the borrower to keep the property.
- 10.7** We expect that a lender will not require a borrower to apply for early release of superannuation or obtain funds from family members before considering whether to, or agreeing to, vary the payment terms.

15. Where only one of the joint-borrowers is in hardship

- 15.1** Ideally, a financial hardship application should be made by all co-borrowers. However, there are occasions where one co-borrower is in financial hardship and the other:

(a) is not able to make the repayments on their income alone; or

(b) cannot be contacted; or

(c) is not making payments (because, for example, there has been a breakdown in the relationship between the co-borrowers).

- 15.2** In each of these situations, the question arises whether the credit contract can be varied to reflect the proposed payment variation despite one of the co-borrowers either not being in financial hardship or not agreeing to the proposed payment variation.

- 15.3** We consider that the credit contract can be so varied in these circumstances on the basis that:

(a) Section 72 National Credit Code merely provides that:

"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."

(b) There is no requirement for all the co-borrowers to make a financial hardship application. Section 15AA of the Acts Interpretation Act 1901 (Cth) states that, "in the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object."⁶⁴

(c) The obligations of each co-borrower under the credit contract are 'several' as well as joint; that is, the lender is entitled to look to only one co-borrower to repay the loan and need not demand repayment from all co-borrowers. Conversely, each co-borrower is liable to repay the entire loan despite the contractual obligation of the other co-borrowers to also repay the loan.

⁶³ COSL Rule 18.7, 7th Edition COSL Rules.

⁶⁴ *Jonsson v Arkway Pty Ltd* 58 NSWLR 451 at 456 and *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook* [2006] NSWSC 1104 (24 October 2006) confirm that beneficial legislation such as the Consumer Credit Code should be interpreted broadly and liberally.

- (d) Where one co-borrower is in financial hardship, the financial position of all co-borrowers as a whole will be adversely affected.⁶⁵

Where only one borrower is in financial hardship

- 15.4** A lender should consider in good faith a financial hardship application even if it is from only one of the co-borrowers. If the lender considers that the payment arrangement proposed by the borrower is appropriate, it should inform the other co-borrower of the proposed arrangement, invite them to indicate whether they are prepared to agree to the terms of the proposed arrangement or, if not, why the lender should not give effect to the arrangement.

Where one of the co-borrowers cannot be contacted

- 15.5** In circumstances where one co-borrower is in financial hardship, but the other is not contactable and is not contributing to the loan payments, we consider that a lender should consider in good faith the financial hardship application even if it is from only one of the co-borrowers.
- 15.6** We also consider that the lender should not insist that the assets or income of the absent co-borrower be provided before it will consider the financial hardship application, because those assets and income are irrelevant in circumstances where the absent co-borrower is not contributing to the loan payments. The remaining co-borrower will, however, still need to demonstrate that they would be able to meet the payment terms (on their own) if the loan contract was varied.

Where one co-borrower does not wish to make a financial hardship application

- 15.7** Where there has been a breakdown in the relationship between co-borrowers, one co-borrower may elect not to make payments, preferring instead for the loan to go into default and the security property sold by the lender. In such a case, the co-borrower will not be prepared to support a financial hardship application by the other co-borrower or agree to a payment arrangement.
- 15.8** In these circumstances, we consider that the lender should nonetheless consider in good faith whether a temporary payment arrangement would be appropriate to allow time for the co-borrowers to settle the issue in the Family Court or in another appropriate forum.

⁶⁵ Commissioner for Consumer Affairs v Burton and General Motors Acceptance Corporation [1980] WAR 218, per Wallace J, which was in relation to section 36A of the Hire Purchase Act (WA).

16. Bankruptcy

- 16.1** We consider that a bankrupt borrower can make a financial hardship application in their own name where the bankrupt is able to meet the loan payments from the income the bankrupt is permitted to retain. In these circumstances, the outcome of the financial hardship application will not normally concern the trustee because it would not adversely affect the interest of the bankrupt's creditors.
- 16.2** Furthermore, we consider it unlikely that a variation of the credit contract on grounds of financial hardship can be characterised as property that becomes vested in the trustee⁶⁶ or that only the trustee can make a financial hardship application at its election on the creditors' behalf.⁶⁷
- 16.3** However, we are not able to consider complaints made by a bankrupt borrower where the subject matter of the complaint relates to the property which secures the debt; for example, a bankrupt seeking to recover possession of land in circumstances where the trustee in bankruptcy has declined to do so.⁶⁸

⁶⁶ Pursuant to sections 58 (1)(a) or 58(1)(b) of the Bankruptcy Act 1966 (Cth).

⁶⁷ Because, unlike a Court, COSL cannot and does not award adverse cost orders against a Complainant, no matter how manifestly hopeless their complaint is, and the interests of the creditors are not therefore prejudiced by a bankrupt making a complaint (e.g. a financial hardship application) in their personal capacity.

⁶⁸ National Australia Bank Limited v Strik [2009] NSWSC 184, per John J; Farrow Mortgage Services Pty Ltd v Winfield (1992) 2 QdR 282 at 285; Bendigo Bank Ltd v Demaria [2001] VSC 218 at [18].