

Credit
Ombudsman
Service

Credit Ombudsman Submission

May 25

2010

This submission sets out our views about the Section E of the Discussion Paper: Clarifying requirements around the new comprehensive credit reporting data sets, released by the Department of the Prime Minister and the Cabinet

Credit
Reporting
Reform

[The Department of the Prime Minister and Cabinet](#)



© Copyright Credit Ombudsman Service Limited 2010
ABN 59 104 961 882
PO Box A252 Sydney South NSW 1235

Submission to the Department of the Prime Minister and Cabinet

25 May 2010

Ms Joan Sheedy
Assistant Secretary
Privacy and FOI Policy Branch
Department of the Prime Minister and Cabinet
One National Circuit
BARTON ACT 2600

Email: joan.sheedy@pmc.gov.au

Dear Ms Sheedy

Discussion Paper: Clarifying requirements around the new comprehensive credit reporting data sets

I am writing to you to convey our concerns about some aspects of the Discussion Paper that will undermine, or potentially undermine, our work in the important area of financial hardship.

About us

The Credit Ombudsman Service Limited ('COSL') is an external dispute resolution (EDR) scheme approved by the Australian Securities and Investments Commission (ASIC).

COSL is a not-for-profit company operating exclusively in the non-bank sector. It is funded by a combination of membership and complaint fees levied on its members, which include mortgage brokers, non-bank lenders, micro lenders, building societies, credit unions, promoters of non-bank residential lending programs, aggregators and mortgage managers.

The key objects of COSL are to:

- (a) act as the primary complaints resolution body for the non-bank sector; and
- (b) provide an alternative to legal proceedings for the resolution of complaints between consumers and financial service providers who are members of COSL.

Our Experience

It is very likely that a borrower will encounter a significant change in their financial circumstances at least once during the term of their loan. A borrower can, of course, also encounter financial difficulties while in a short-term loan.

An increasing number of borrowers have approached us because they are experiencing difficulty in meeting their loan payment obligations. In fact, one out of every three complaints we received in the 2008/2009 financial year related to financial hardship.

Financial hardship may be due to a number of reasons, such as 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).

If you would like more information please contact the Credit Ombudsman Service

Case Management: T 02 9273 8400 E info@cosl.com.au
Membership: T 02 9273 8455 E members@cosl.com.au



In about 85% of the cases we see, the borrower has either been served with a default notice under section 80 of the Credit Code or legal proceedings have commenced.

Where a borrower is experiencing financial hardship, they would be well advised to contact their lender immediately and request assistance by way of a payment moratorium or variation. If the lender declines to do so, the borrower may make a complaint to the lender's external dispute resolution scheme.

When we receive a complaint from a borrower whose financial hardship application has been declined by their lender, we assess whether it would in fact have been appropriate for the lender to agree to a payment variation. If so, we can direct the lender to vary the credit contract to give effect to the variation.

Our Submission

Given our knowledge and experience in the area of financial hardship, we make the following observations in relation to Section E of the Discussion Paper – Repayment History.

Schemes of arrangements and hardship applications

We consider that a borrower is in financial hardship when he or she is willing to make loan payments in accordance with their contractual obligations but, because of their particular circumstances at that time, are not able to.

As we understand it, it is intended that where a credit contract is varied on grounds of financial hardship, the payment cycle will be listed as "all payments current" as long as the new varied terms are being met.

However, where a borrower enters into an informal agreement to gradually repay defaulted amounts over a period of time, the payment cycle will be recorded as in arrears until the individual has cleared the arrears.

Clearing of arrears over time

While, strictly, a credit contract may be varied on the application of a debtor in any one of only three ways specified in section 66 of the Consumer Credit Code or 72 of the National Credit Code, our experience is that lenders on their own volition consider a variety of other options which may be appropriate in the circumstances.

One such option is to enter into an informal agreement whereby the borrower clears the arrears over a period of time. Lenders often prefer to do this as an alternative to a formal loan variation because it does not generally require the approval of their mortgage insurer and because mortgage insurers sometimes have policy restrictions on the number of formal variations that they will approve in a given period. From a borrower's perspective, clearing the arrears over a period of time means that interest will not be payable on a higher loan balance which would have otherwise resulted had the arrears been capitalised.

We are therefore concerned that where a borrower agrees to pay off the arrears over a period of time, it is being proposed that the payment cycle will nonetheless be recorded as in arrears despite the fact that the borrower is complying with the agreed payment arrangement. We note that even default fees and default interest are not normally charged while the hardship arrangement is in place.

We therefore submit that an informal arrangement to clear the arrears over time should be treated in the same way as a formal variation of a credit contract, i.e. the payment cycle should be listed as "all payments current" as long as the new arrangement is being met. This is because:

1. In terms of financial hardship relief, the ability to clear arrears over a period of time enables a borrower who has, for example, lost their job to catch up with missed payments when they find a job but are still not able to make a lump sum payment to clear the entire arrears in 'one go'. Understandably, it may take some months to clear the arrears.
2. If, as is being proposed in the Discussion Paper, arrangements to clear arrears over a period of time result in an adverse payment history listing, there will be a significant disincentive for borrowers to contact their lenders early to seek financial hardship assistance. We are of the view that defaulting borrowers are best advised to approach their lenders early as lenders have more options available to them and are more amenable to agreeing to a payment variation when approached early. Borrowers may also be encouraged to agree to an arrangement whereby the arrears are cleared over time, given that they will be listed as "all payments current" for as long as they meet the terms of the arrangement.
3. Industry Codes of Practice¹ presently require lenders not to list a default against a borrower while they consider a borrower's application for financial hardship relief. Similarly, COSL's Rules require its lender Members not to list a default if they have not already done so once a complaint has been received by COSL and for as long as it deals with the complaint.² This has had the positive effect of encouraging borrowers to make applications for financial hardship relief as soon as possible. The sensible requirement to desist from listing a default while a hardship application is being considered is contrary to the change proposed to be made under the Discussion Paper or at least is a disincentive for borrowers to approach their lenders early to seek financial hardship assistance.

Recording payments in arrears when a borrower has applied for financial hardship assistance

We consider that when a loan has been varied or an arrangement made to clear the arrears, the history of late payments should be changed to "all payments current" for the period between when the application was made and when the agreement takes effect. This will encourage borrowers to request financial hardship assistance as soon as possible. This is also in the public interest.

Where a financial hardship application has justifiably been declined by a lender, it does not seem unreasonable for the history of the late payments to be retained on record.

However, this outcome is neither appropriate nor reasonable where the lender has not properly assessed the application before making a decision to decline the application or has improperly declined the application by, for example, taking into consideration factors extraneous to section 72 National Credit Code. Where this has happened, the borrower may seek the assistance from the lender's external dispute resolution scheme, which may result in the hardship application ultimately being approved. In this case, the record of late

¹ Such as the Code of Practice of the Mortgage and Finance Association of Australia

² COSL Rule 16.2(d), 6th Edition



payments should be cleared from the time the initial application was made to the lender to the time the application was approved.

Other consequences of recording payment history

It is unclear whether the proposed system would also capture agreed changes where the borrower is given a 'repayment holiday' while on, for example, maternity leave. Clearly, this should not result in the listing of a negative repayment history.

Counter intuitive

Reporting missed payments is counter intuitive because:

- It allows a lender to see whether a borrower has prioritised, say, a credit card debt (at a higher rate of interest) over mortgage payments (typically at a lower rate of interest). While giving priority to making payments towards the higher interest debt first generally accords with sound financial management, a lender might draw negative inference about the borrower's willingness to pay the particular debt in respect of which a hardship application is lodged; and
- Conversely, it encourages the lender to assume that a borrower is not in financial difficulty if no missed payments are reported. Our own experience is that a borrower may be in financial difficulties even though payments have not yet been missed.

Sincerely

Raj Venga

Chief Executive Officer and Ombudsman