ATTACHMENT DN-3

This is the attachment marked "**DN-3**" referred to in the witness statement of Denis John Nelthorpe dated 7 July 2015.

Long term financial hardship

A discussion paper

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Managing Justice provides management, development and policy consultancy services to organisations in the access to justice sector.

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Table of Contents

1. Introduction

1.1. Background

Managing Justice has been engaged by an Advisory Committee[1] to prepare this discussion paper:

- Describing the perspectives of all relevant stakeholders about borrowers in long term financial hardship
- Describing the current practices of industry and community sectors to debts owed by customers in long term financial hardship,
- Explaining the legal, regulatory or operational factors, drivers, constraints or barriers which influence how stakeholders interpret and deal with long term financial hardship, and
- Identifying some possible approaches to address the various concerns expressed by stakeholders.

1.2. Documents reviewed

In preparing this paper, the following documents have been reviewed:

- Relevant provisions of the National Credit Code (particularly section 72)
- 2013 Code of Banking Practice
- Australian Bankers' Association (ABA) Industry Guideline – Promoting understanding about banks' financial hardship programs
- Financial Ombudsman Service Approach – Financial Difficulty Series
- Credit Ombudsman Service Ltd Position Statement 2 – Financial Hardship
- Client Profiles and Project Outcomes - the Bulk Debt Negotiation Project (West Heidelberg Community Legal Service, March 2011)
- Proposed National Hardship Register – Eligibility Criteria
- Australian Securities & Investment Commission (ASIC) – Report 152: Helping home borrowers in financial hardship
- Australian Prudential Regulation Authority (APRA) – Letter to all Authorised Deposit Taking Institutions sent on 12 August 2012 concerning regulatory reporting of loans where hardship concessions are granted.

1.3. Consultations

Consultations have occurred with the following:

- Financial Institutions: ANZ Bank, Commonwealth Bank, National Australia Bank, Westpac, Bendigo & Adelaide Bank, Citi, HSBC, GE Money, Suncorp, Australian Bankers' Association (in 5 separate teleconferences)
- Debt collection agencies: Dunn & Bradstreet, Collections House, Credit Corp Group, Baycorp Group, Australian Collectors and Debt Buyers (in 2 separate teleconferences)

[1] Comprising Financial Counselling Australia, Australian Bankers' Association, Financial Ombudsman Service, Credit Ombudsman Service Ltd, Legal Aid New South Wales, Victoria Legal Aid & Footscray Community Legal Centre.

- Consumer representatives: Financial Counsellors from a range of community agencies and Consumer Credit Lawyers from Legal Aid and Community Legal Centres, Financial Counselling Australia (in 4 separate teleconferences and 1 face to face meeting)
- Other stakeholders: Australian Bankers' Association (ABA), Financial Ombudsman Service (FOS), Credit Ombudsman Service Ltd (COSL), Code Compliance Monitoring Committee (CCMC), Australian Securities & Investments Commission (ASIC), Australian Prudential Regulation Authority (APRA) (in 3 teleconferences, 1 face to face meeting and several briefing discussions)

The consultations were based around a series of questions developed by the Advisory Committee and the consultant and included consideration of a number of case studies. The cases studies were variously submitted by industry and consumer representatives, and one was developed by the consultant. A copy of the questions and case studies used in the consultation appears at Appendix A.

1.4. Structure

This paper is the result of analysis of the document review and material provided during consultations, and is structured as follows:

- Chapter 1: Introduction
- Chapter 2: Legal and Regulatory Background
- Chapter 3: What is long term financial hardship?
- Chapter 4: Extent of the problem
- Chapter 5: Who is vulnerable to long term financial hardship?
- Chapter 6: Identifying long term financial hardship
- Chapter 7: Information required to show long term financial hardship
- Chapter 8: Responding to long term financial hardship
- Chapter 9: Defining long term financial hardship
- Chapter 10: Is more consistency required?
- Appendix A: Consultation questions and case studies

2. Legal and Regulatory Background

The framework around financial hardship is contained across a number of consumer protection laws as well as industry codes, standards and practices.

2.1. National Credit Code

Section 72 of the National Credit Code describes a staged process for dealing with hardship as set out in Table 1.

Table 1

Step 1	Debtor informs creditor (either orally or in writing) that they are/will be unable to meet their obligations under a credit contract. This is effectively a request to change the contract The notice has the effect that the creditor cannot take enforcement
Step 2	Credit provider may ask for further information relevant to deciding: • Whether the debtor will be unable to meet their obligations • How to change the contract
Step 3	Debtor must provide the information requested
Step 4	Creditor must consider whether to change the contract and if so how. Creditor is not obliged to agree to change the contract, especially if: • The creditor does not believe there is a reasonable cause (such as illness or unemployment) for the debtor's inability to meet their obligations, OR • The creditor reasonably believes that the debtor would not be able to meet their obligations even if the contract were changed
Step 5	The creditor gives the debtor notice of its decision within defined timeframes
Step 6	Debtor has right to apply to an external dispute resolution scheme or to Court if dissatisfied with the creditor's decision.

Important features to note about section 72 are:

- The hardship process is initiated by the debtor
- It does not define hardship but gives the right to issue a notice whenever a debtor is unable to meet their obligations under a credit contract
- It does not distinguish between long term or short term hardship
- It does not oblige a creditor to agree to change the contract
- It permits the creditor to consider the cause of the debtor's inability to pay, but does not define reasonable cause
- It permits the creditor to consider the ability of the debtor to meet their obligations under a changed contract, but does not give guidance as to the timeframe over which the debtor should be able to meet their obligations
- It does not specify any type of change to the contract
- The giving of a notice by a debtor under section 72 has the effect (by reason of section 89A) of halting enforcement action by the creditor until the hardship request is finalised.

2.2. Code of Banking Practice

Section 28 of the ABA's Code of Banking Practice provides that banks will:

- Try and work with customers to overcome financial difficulty
- Deal with authorised representatives such as financial counsellors
- Respond promptly to requests by a customer for assistance
- Take into account information provided by the customer when making a decision about whether or not to provide hardship assistance, and the extent of that assistance
- Provide information about hardship processes available on their websites
- Train relevant staff in hardship provisions.

Further, banks may, if they identify that a customer may be experiencing financial hardship, initiate contact to discuss hardship assistance.

The ABA's website '*Doing It Tough*' (www.doingittough.info) provides bank customers with information about financial hardship and contacts for the financial hardship teams in the banks.

2.3. Government's hardship principles

Australian Banks have voluntarily agreed to adopt the Australian Government's hardship principles: *A common approach for assisting borrowers facing financial hardship*[2]. These principles are designed to ensure that credit providers tread individual fairly and support them. They cover temporary assistance options, identifying borrowers in hardship, staff training and needs-based assistance. They are consistent with the industry guideline issued by the ABA: *Promoting understanding about banks' financial hardship programs Industry Guideline.*[3]

2.4. External dispute resolution

Hardship complaints are dealt with by the external dispute resolution schemes, the Financial Ombudsman Service and the Credit Ombudsman Service. Each service has published statements about its approach to hardship complaints. The *FOS Approach to Financial Difficulty Series*[4] provides extensive information about how FOS approaches financial difficulty taking into consideration legal principles, industry codes and good industry practice in cases where the consumer and financial services provider are not able to reach agreement. COSL *Position Statement Issue 2*[5] describes how COSL deals with complaints about financial hardship having regard to the relevant law, good industry practice, applicable industry or regulatory codes of practice and fairness.

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[2] Available at www.bankers.asn.au
[3] Available at www.bankers.asn.au
[4] Available at www.fos.org.au
[5] Available at www.cosl.com.au

3. What is long term financial hardship?

No consensus about a definition of long term financial hardship emerged from the consultations. Definitions used different reference points as illustrated by the sample of definitions in Table 2.

Table 2

Definition reference point	Suggested Definitions
Time	• *Where the hardship is more than 12 months or more than 6 months if an unsecured loan* • *Where the hardship is likely to continue beyond 6 to 7 years* • *Where the hardship situation is unlikely to ever change* • *Where the debtor has no prospect of making a meaningful repayment at any point in the future*
Characteristics of the debtor	• *Someone on a continuum of vulnerability who moves in an out of their capacity to deal with financial issues* • *Someone working back to some sort of financial stabilisation rather than financial recovery* • *Where the debtor has no income other than welfare and no capacity to contribute to the debt* • *People with an asset, but on Centrelink income with a small debt are in long term financial hardship*
Characteristics of the debt	• *If there's a secured asset, it's not long term hardship, it's long term hardship after the asset is sold*
Ease of resolution	• *The ones that don't fit the standard procedures and aren't catered for by the usual response, the ones we have trouble helping* • *Where there is no solution*
Code	• *Where the debtor wants to pay but can't and this goes beyond a reasonable time, and it is not clear that they will be able to meet their obligations in the future*
Other	• *It's not financial hardship if there should never have been a loan in the first place, that's maladministration*

The views about what long term financial hardship is seemed to be influenced, not only by stakeholder experience, but also by some underlying assumptions of the consequences that should flow from a case falling in or out of the definition.

In particular, there seemed an assumption from some stakeholders (including creditors, debt collectors and consumer representatives) that once a case was identified as being one of long term financial hardship, debt waiver (or at least cessation of all attempts to recover the debt) should follow. This seemed to drive a narrow approach to the definition.

There was also an assumption by some stakeholders (not only lenders) that long term financial hardship cases were ones where the obligations to provide assistance under the Credit Code differed from the usual hardship obligation. This lead to a definition that focussed on whether the debtor would be able to meet their financial obligations, and if not, the case was one of long term financial hardship, and therefore not suitable for hardship assistance.

Other stakeholders considered a definition of long term should be time based, and suggested definitions with reference to their usual hardship processes, so that if it fell outside their usual time frames for hardship assistance (in the case of creditors) or collection (in the case of debt collectors), it was long term.

A consensus about a definition for long term financial hardship might be easier to arrive at if the purpose and consequence of the definition is made more explicit.

Four possible purposes have been identified from the assumptions that seemed to underpin the case studies submitted and the stakeholder responses about the definition. These are set out in Table 3.

Table 3

Purpose	Decision	Possible Consequence of Decision
To identify cases where hardship assistance is offered pursuant to section 72 of the Credit Code	Deciding whether the debtor will be able to restore the position	Case is escalated within usual hardship processes once long term nature of hardship is identified
To identify cases where no hardship assistance is offered but other arrangements may be made	Deciding whether a repayment plan or settlement offer is reasonable	Case is declined hardship assistance and decision is made about recovery
To identify cases where a creditor might not insist on legal right to recovery on compassionate grounds	Deciding whether there is a hardship reason not to proceed to debt recovery at this point in time	Recovery action suspended while present situation continues
To identify cases where recovery action should not be taken because long term hardship indicates no reasonable prospect of recovery	Deciding whether there is a hardship reason not to proceed to debt recovery at all	Recovery action ceases Debtor informed no further recovery action will be taken

This issue will be discussed further at chapter 10 of this paper.

4. Extent of problem

There was no quantitative data available from any stakeholder about the prevalence of long term financial hardship.

However, data reported by the Bulk Debt Negotiation Project indicates that more than $15 million in debt has been waived in the course of that project.

There were a range of views about the extent of the problem. A sample of those views appears in Table 4.

Table 4

- *Very small problem*
- *Not a big problem*
- *An increasing problem*
- *It is more recognised now*
- *It's not recognised and that makes it a bigger problem*
- *It's significant because we don't see a coherent response like we do for short term hardship*
- *We are seeing more cases, but that could be down to better awareness rather than an increase in the problem*

While there was no consensus about the extent of the problem by volume, there was consensus that cases of long term financial hardship are difficult, and therefore the time taken to deal with them can be disproportionate to their volume.

Additionally, stakeholders working with people in long term financial hardship noted the broader implications of long term financial hardship for individuals and families, in particular the impact on mental health and wellbeing and on economic and social participation.

5. Who is vulnerable to long term financial hardship?

Some stakeholders expressed the view that we are all vulnerable to long term financial hardship – if there is some significant change in our lives that means we are not able to continue to meet our credit obligations.

A number of triggers for long term financial hardship were identified, including:
- Illness or injury (of debtor or family member)
- Addiction
- Unemployment
- Relationship or marital breakdown
- Retirement (with accumulated debt not repaid during working life).

In addition, it was recognised that long term financial hardship could develop over a period of time without a single trigger, for example:
- People who have irregular income (casual employees, commission employees)
- Where expenses rise more than income (cost of living increases, interest rate increases)
- People who have been managing multiple credit cards and hit the limits.

It is noted that there may be initiatives that could be implemented to alleviate some of the causes of financial hardship[6], however, that is not the focus of this discussion and so was not further explored.

There was also some discussion about "genuine cases" with a view expressed by some creditors that the reason for the long term hardship should be:
- Beyond the control of the borrower, and
- Not a lifestyle choice.

By contrast, some stakeholders considered that the reason for the hardship was irrelevant. Others were concerned that debtors should not be treated in a more punitive way because the creditor made a judgment that they "had brought it on themselves" by doing things that decreased their income or increased their debt.

There was consensus among all those consulted that hardship assistance was not appropriate in Case Study 4, based on the debtor's refusal to engage constructively in relation to payment of the debt.

It is noted that "reasonable cause" is a consideration when offering hardship assistance under section 72 of the National Credit Code. However, not all cases of long term financial hardship are necessarily considered under that provision.

Discussion point 1
To what extent is the cause of the hardship relevant when considering how to deal with a case of long term financial hardship?

[6] Examples of other initiatives include new financial products and services, social welfare payments, employment and training programs, comprehensive credit reporting, etc.

6. Identifying long term financial hardship

There were varying views about how a situation of long term financial hardship should be identified. It was widely reported that financial counsellors played an important role in bringing the long term financial hardship of debtors to the attention of creditors.

The ABA's Code of Banking Practice contemplates that a bank might initiate contact with a customer to discuss hardship assistance.

Some stakeholders (including creditors and consumer representatives) were firmly of the view that creditors should be alert to signals of financial hardship and initiate a discussion with a debtor about hardship in response to those signals at an early stage.

There was a strong view put by some consumer advocate stakeholders that creditors should also have systems in place to actively identify debtors in hardship and contact them offering hardship assistance. This was thought to be necessary because debtors who do not seek assistance from financial counsellors or consumer lawyers may not be aware of their rights to seek hardship assistance at the stage when it would be of most benefit to them.

A contrary view was expressed by some creditors who, while acknowledging that a bank may initiate contact with a customer to discuss hardship assistance, were strongly opposed to any positive obligation on banks to actively identify financial hardship in a systemic way. There was consensus that it is good practice for creditors to initiate contact with a customer to discuss hardship assistance in appropriate cases, but any obligation to have a systemic intervention in all cases was opposed.

Discussion point 2
What is "proactive identification" and what is the purpose of it?
What is the appropriate scope of the obligation on banks and other financial institutions to identify financial hardship?
What are the consequences for creditors, customers, others?

7. Information required to show long term financial hardship

The issues that arose in relation to the information required by creditors to consider long term hardship related to:

- The extent of information required (particularly for Centrelink beneficiaries)
- The time frame in which it is required, and
- The frequency with which it is required.

Examples of comments about the extent of information required are in Table 5.

Table 5

• *Need more information than just that a person is on a Centrelink benefit* • *Shouldn't need an income and expenditure statement for someone on Newstart* • *Shouldn't need medical reports if someone is on a Disability pension* • *Need the front and the back of the Centrelink Statement and not much else* • *Need more information if debtor wants write off or settle for less* • *Need less if there is a financial counsellor involved*

It is noted that the ABA's industry guideline, *Promoting understanding about banks' financial hardship programs,* provides that banks should strive to minimise the amount of information required, particularly when that can be obtained from other sources and that banks should ensure their staff are trained appropriately to fulfil their particular role within the bank, including in financial hardship and debt collections teams.

There was a widely expressed view that debt collectors tend to do better at understanding what the various government benefits and payments mean and set their information requirements accordingly, while banks could do more to ensure that their staff understood Centrelink payments.

Many stakeholders acknowledged that Centrelink's Newstart payment is the most difficult to deal with because, although it is designed to be temporary in nature, it can be associated with long term financial hardship (for example, sole parents with children over 8, older unemployed people not yet on the age pension, and people who are still going through assessment for a Disability Support Pension, are all likely to be on Newstart).

Some stakeholders considered that longer time frames should be allowed to provide information, because debtors often had difficulty compiling the information required, and if a financial counsellor was involved, more time was needed to allow for the financial counselling to occur.

In a long term hardship situation, the issue arises of how frequently information should be provided for review. While all stakeholders acknowledged that it was appropriate and necessary to obtain updated information from time to time, there were views expressed that this should not be too frequent, and that it should not be required unless there has been a change of position.

8. Responding to long term financial hardship

The discussion of the case studies in the consultation revealed:

- Inconsistent views about whether each case study amounted to long term financial hardship, but
- A reasonably consistent set of considerations for deciding an appropriate response to each case once all the facts were known.

It is noted that the case studies incorporated decision making for the range of situations identified in Table 3, that namely cases where:

- Hardship assistance under the Credit Code may be offered
- Hardship assistance under the Credit Code may not be offered, but the creditor and debtor reach agreement so that further debt recovery action is not taken (for example repayment agreement or settle for less)
- The creditor may not proceed to debt recovery action in accordance with their legal entitlements on compassionate grounds, and
- The creditor recognises the long term nature of the financial hardship and does not proceed with legal recovery action and in some cases may waive the debt.

This section will examine various aspects of current practice.

8.1. Is "hardship assistance" offered?

For banks, the first consideration seems to be: "Is this a case where we can offer hardship assistance by varying the contract?" The answer to this question turns on the assessment of whether restoring a debtor's financial situation is possible.[7]

Case studies 1 and 2 explored this issue. Case study 1 was provided by a bank, and Case Study 2 was constructed by the consultant as a more marginal case. There was general consensus that the bank's response in Case Study 1 was appropriate, although there were differing views on whether this was a case of long term hardship or not.

Case study 2 was more controversial. The more broadly held view was that financial hardship assistance (that is varying the contract to allow the debtors to retain the home) would be declined. The circumstances that might change that position were: strong advocacy on behalf of the debtor and reputational issues for the bank if they acted to repossess the house, particularly in a small town. Some creditor stakeholders indicated that they would be prepared to provide hardship assistance for a significant period of time to give the debtors time to prove that they could meet their commitments.

[7] See: Australian Bankers' Association, *Industry Guideline, Promoting understanding about banks' financial hardship programs* at page 2.

8.2. Assistance that is not “hardship assistance”

Interestingly, those creditors that would decline hardship assistance in Case Study 2 would still be seeking to offer other assistance to the debtors on compassionate grounds. Examples given were: assistance with payment of a rental bond for new premises, assistance with the cost of modifications to new premises, and referral to counselling support at the creditor’s expense.

8.3. A moratorium

A common early response to long term financial hardship was described as “a moratorium” although this was not a term that was used with precision. It generally described the situation where repayments were not required for a time, although the terms that attached to that could differ considerably. For example, interest might continue to accrue, or, in some cases, it might be reduced, or not charged.

A moratorium is, inherently a short term response, to a long term problem. There were differing views expressed on whether this was appropriate in a case of long term financial hardship, as it could make the ultimate restoration of the position more difficult if it meant that the underlying position was deteriorating during the moratorium.

8.4. Capitalise arrears

If a debtor is able to make payments going forward, but cannot deal with arrears, then some stakeholders were of the view that capitalising arrears was an appropriate solution.

This solution had previously occurred in conjunction with “re-ageing” the loan which meant that the loan was no longer regarded as delinquent for prudential reporting purposes. The APRA letter of 8 August 2012, clarifies that such loans cannot be restored to performing status unless arrears are actually paid. This does not inhibit the ability to enter into a new credit contract, where a new decision about whether to offer credit is made in accordance with usual risk management principles and legal obligations, including the responsible lending provisions.

It was suggested that, as a consequence of the APRA letter, capitalising arrears is less frequently offered. There were varying, and contradictory, views on the impact of the APRA requirement. A sample of these appears in Table 6.

Table 6

- *APRA regulations are a driver, but don’t have a major impact*
- *Not a driver at all for individual decision making in hardship cases*
- *It has impacted on what we can offer debtors*
- *It is difficult to determine the extent, but something has affected responses.*

It is clear that the intent of the APRA letter was not to alter practices in relation to how cases of financial hardship are dealt with, but rather to:

- Clarify that a decision to re-age arrears does not make the loan performing
- Encourage sound operational and risk management practices so that a decision to add arrears to a loan occurs in the context of a new credit assessment, and
- Ensure accurate reporting of loan status for prudential purposes.

However, it appears that the requirement to report differently may have translated into changed practices in dealing with customers in financial hardship. To some extent, this may be a consequence of the manner in which banks' systems operate. For example, it is indicated that if a loan is characterised and reported in a certain way for prudential purposes, this automatically generates a systems driven process about how the bank interacts with the customer.

8.5. Restructure loan

Restructuring credit facilities (which may include capitalisation of arrears) is also an approach to long term financial hardship. It was suggested by some stakeholders that the responsible lending provisions have impacted on the ability to restructure debt and capitalise arrears, and therefore reducing the capacity for banks and other financial institutions to respond flexibly to long term financial hardship.

8.6. Time

The importance of allowing the debtor some time, whether or not formal hardship assistance is offered, was emphasised by some stakeholders. This was raised in a number of contexts including:

- Time to consider the whole situation at the beginning, rather than an automatic response of 3 months hardship assistance
- Time to explore whether there is a viable path to restoring the financial position before hardship assistance is declined
- Time to sell an asset if hardship assistance is declined
- Time for a debtor to prove that they can meet their proposed new commitments.

8.7. Alternatives to requiring the sale of an asset

If formal hardship assistance is declined, then a creditor may consider an alternative arrangement rather than requiring the sale of the debtor's home. This was most commonly referred to as an appropriate response on compassionate ground in the case of terminally ill or aged debtors. Where there is a time limited situation of this nature, then creditors report that they may make "lifetime" arrangements where they defer taking action (either to sell a secured asset or to realise an unencumbered asset through judgment enforcement) until the situation changes. This may be accompanied by a repayment arrangement and/or taking some sort of security over an asset.

8.8. Other alternatives

A creditor may, depending on the circumstances, also decide to assist the debtor by identifying an appropriate exit strategy or providing other assistance or advice. Decisions about alternative are taken on a case-by-case basis, and might include:

- Informing the debtor about the potential early release of their superannuation (or referring the customer to staff who can discuss their options in more detail)
- Providing other options, including time for the debtor to sell a property or debt waiver
- Discussing other relevant support measures that might be available (including government programs, such as mortgage assistance schemes), or
- Suggesting the debtor seek other assistance (including from a professional financial counsellor, financial adviser, legal aid officer or legal practitioner).

8.9. Accepting a repayment plan

The issue of a repayment plan arises where the debtor has some capacity to pay. Where the debtor has no assets, and is offering some repayment, some stakeholders reported that this will usually be accepted providing that the repayment is "meaningful". This was variously described as:

- A repayment that would clear the debt in 5-7 years
- A repayment that was covering interest and making some headway into the debt, or
- A repayment of at least $10 a week.

From the consultations, it appeared that smaller repayments were more likely to be accepted once the debt had moved from creditors to debt collectors, who had greater flexibility to accept smaller payments over longer periods, including by freezing interest so the debt did not grow at a faster rate than the repayments.

The issue also arose about appropriate responses to debtors whose capacity to make repayments is episodic. Examples included people in irregular work, and people who suffered from episodic illness, particularly mental illness. This presented a significant challenge to creditors. Stakeholders reported that their systems had significant difficulty in dealing with payments of this nature making it not cost effective to enter into arrangements of this type. Again stakeholders reported that the processes or systems of debt collectors tended to have more flexibility to deal with episodic payments.

8.10. Settle for less

In situations of unsecured debt, where the debtor has limited capacity to make repayments, but can raise a lump sum payment, stakeholders reported a "settle for less" arrangement might be made. This is seen as alternative to a long term repayment plan or enforcement of the debt.

8.11. Waiver/ No collection action

The bulk debt project has caused all stakeholders to give attention to situations in which a debt waiver is an appropriate option. The pilot 'National Hardship Register' is another mechanism to identify cases where debts would be taken out of the usual enforcement processes when "extreme and extended financial hardship exits"[8].

There was a high degree of consensus that there is a category of debts that it is not commercial to enforce, and that, if these are identified at an earlier stage, this approach has benefits for creditors (not engaging in futile recovery action) and for debtors (avoiding unnecessary bankruptcy, and alleviating the stress caused by having outstanding debts).

8.11.1. Which cases?

All six of the Centrelink Beneficiary cases studies used in the consultation were regarded as falling into this category.

Stakeholders expressed the view that the more difficult cases were ones where the permanent nature of the hardship situation was less certain, for example, where:

- The debtor had some prospects of re-gaining employment, or
- The debtor was a young person with no disability even if they had not yet been employed.

It was reported that, once a debt moves from creditors to debt collectors, debt collectors will take a much longer term view of the debtor's circumstances with a time frame that extends to the end of the judgment recovery time limit.

Another type of case considered in this context was the case where:

- There is a small unsecured debt
- The debtor has:
    - little capacity to make repayments from income, and
    - owns a home,
- And the situation is long term.

It is noted that there are protections in some States that prevent the sale of a home to pay small judgment debts, but this is not uniformly the case. There was discussion about whether it was appropriate for the creditor to insist on the sale of a home if they had a legal entitlement to do so, or whether there might be a waiver of the debt on hardship grounds.

There was a high degree of consensus around the principles that apply to consideration of cases for waiver/non-enforcement, but it was reported that this did not necessarily translate into consistent outcomes. Many stakeholders, speaking from the perspectives of creditors and debtors, stressed the need for a "case-by-case" approach. Others stressed the need for more consistency of both process and outcome. This issue will be explored further in chapter 9.

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[8] NHR Eligibility Criteria

8.11.2. Waiver or just a decision not to enforce?

A decision to waive, or not to pursue, a debt is one that occurs outside the section 72 of the National Credit Code, and is not covered by section 28 of the ABA's Code of Banking Practice. External dispute resolution schemes have no power to order a creditor to waive a debt.

There were a variety of legal and practical consequences reported when a case is identified as not commercial to enforce. These ranged from:

- Creditor waives the debt and advises the debtor in writing
- Creditor waives the debt and advises the debtor by telephone but not in writing
- Creditor decides to take no further action and advises the debtor
- Creditor decides to take no further action but does not advise debtor
- Creditor decides to take no further action for now, but may keep in contact with debtor.

Stakeholders reported that a formal waiver of the debt usually only occurs if the debtor, (or, more usually, their lawyer or financial counsellor) presses for this outcome.

Providing the debtor with written notice of the creditor's intentions was also likely to occur only in response to a request for this, and some creditor stakeholders reported that they would not provide notice in writing of their intentions.

Obviously, from a debtor's perspective, written notice of waiver of the debt is the most preferred outcome, as this provides certainty, and therefore alleviates stress and anxiety. However, this is not an outcome that creditors can be obliged to provide.

8.12. What practical steps would improve things?

Stakeholders were asked to identify areas where there was room for improvement, focussing on the practical side of dealing with long term financial hardship. The top seven things that creditors and consumer representatives could do to improve things appear in Table 7.

Table 7

Creditors should	Consumer representatives should
• Understand that financial hardship is wider than "hardship assistance" • Be able to better identify when people are in hardship • Have a better understanding of poverty, demographics and Centrelink payments • Not ask for more information than is necessary more frequently than is necessary • Keep the focus on resolution rather than following strict criteria and processes and have a more tailored response	• Have a better understanding of creditors' approaches and solutions • Keep a balanced approach and focus on the facts • Suggest solutions that are tailored to the situation • Ensure allegations of maladministration are well founded before they are made • Understand that a creditor may want to question information provided • Understand that the creditor may have information that their client hasn't told

• Provide better written confirmation of hardship arrangements • Be better able to deal with debtors directly on financial hardship issues	them • Don't generalise from one bad experience

8.13. Role of external dispute resolution schemes, regulatory authorities and the government

Stakeholders were also asked to comment on the role of regulatory authorities and government in dealing with long term financial hardship. The suggestions made appear in Table 8.

Table 8

Role external dispute resolution schemes, regulatory authorities and the government
• *Financial literacy initiatives* • *Better referral pathways for people in crisis* • *Provide more affordable housing* • *Increase income support* • *Develop alternatives to payday lending* • *Change policies leading to casualisation of the workforce* • *Provide more regulation around long term financial hardship* • *Provide guidance around debt collection (ASIC and ACCC)* • *Ensure consistency of regulatory responses between financial regulators (ASIC, APRA, ACCC)* • *Ensure fair treatment of customers and the availability of external dispute resolution for dealing with complaints* • *Recognise the primacy of commercial decision making (noting commercial interests can be broadly interpreted)*

Discussion point 3 **Are the current approaches to long term financial hardship adequate?** **If not, what else is needed?**

9. Defining long term financial hardship

9.1. Banks' perspective

The ABA's industry guideline, *Promoting understanding about banks' financial hardship programs*, provides an outline of how the banking industry views financial difficulty and financial hardship.

There are three categories of financial difficulty in the guideline:

- Late payment assistance
- When restoring a customer's financial situation is possible, and
- When restoring a customer's financial situation is unlikely.

The term "financial hardship" is more narrowly defined as:

> *"Financial hardship" is when a customer is willing and has the intention to pay, but is unable to meet their repayments or existing financial obligations, and with formal hardship assistance, a customer's financial situation can be restored.*

For banks, the main issues are:

- Is the debtor willing to pay?
- Are the circumstances causing an inability to pay temporary and not permanent (even if temporary is longer term)?
- Would the financial situation of the debtor be addressed or restored if hardship assistance was provided?

In the consultation, "long term financial hardship" was seen from within this frame of reference. This clearly informed the choice of cases studies submitted by the banks and related decisions.

However, in the consultation, banks were willing to discuss their responses to the Centrelink Beneficiary case studies submitted by consumers, even though these fell outside "financial hardship" as defined in the guideline.

In fact, it emerged that there was a significant degree of consistency in the approach to the Centrelink Beneficiary case studies, indicating that banks applied similar considerations to decision making about how to deal with customers experiencing financial difficulty when restoring their financial situation was unlikely (even though this is not a "financial hardship" decision under the guideline).

9.2. Debt collectors' perspective

The debt collectors' tended to have a broad perspective on long term financial hardship. They were less focussed on cases where the debtor could restore their financial position, because by the time a case was dealt with by them, the situation had usually moved beyond that.

Debt collectors also tended to have a longer time frame for what constituted "long term" that was more related to legal time limits on debt recovery action.

For debt collectors, the main issues were:

- Is the debtor willing to make a reasonable arrangement for repayment of the debt (in full or in part) to prevent further debt collection action?
- Should debt recovery action be put on hold because of long term financial hardship?
- Should debt recovery action be abandoned because of permanent financial hardship?

9.3. Consumer advocates' perspective

The consumer advocates' frame of reference for long term financial hardship was the experience of the debtor, and their objective was to improve the wellbeing (financial and otherwise) of the debtor. The path to improved wellbeing for the debtor is usually one of the following:

- The debtor exercises a legal right (seek hardship variation, make complaint to an ombudsman scheme, etc.), or
- The creditor is requested not to exercise a legal right that it has to recover a debt (for example, accept a repayment agreement or settle for less instead of taking recovery action, or debt waiver in the case of a permanent inability to pay the debt.) The reason for the request in the latter is usually a combination of seeking consideration of the hardship that a debtor is experiencing and an appeal to practicality because the debtor is effectively judgment proof.

The case studies submitted by consumer advocates as examples of "long term financial hardship" were all cases of Centrelink beneficiaries with unsecured debt, where the issue was around acceptance or repayment arrangements or debt waiver.

9.4. Summary of perspectives and reconciling the differing perspectives

There is a clear difference in perspective between:

- Banks, who see financial hardship (and therefore, long term financial hardship) as applying only to cases where they would support a customer to restore their financial situation and continue with a credit contract, and
- Consumer representatives, who tend to see long term financial hardship as applying largely to situations where the debtor is in entrenched financial difficulty, such that it is appropriate to consider debt waiver.

Since the consultation, some consumer advocates[9] have produced a draft definition of categories of financial hardship. This has been further developed with initial input from the ABA in an attempt to reconcile with the ABA's industry guideline[10], resulting in the categories in Table 9.

[9] Fiona Guthrie of Financial Counselling Australia and Carolyn Bond of Community Law Australia.
[10] Diane Tate of the ABA.

Table 9

Category	Likely length of financial hardship[11]		
A – Late payment assistance (promise by debtor to pay)	May be repeated requests[12], less than 90 days arrears, reasonable evidence		
B – When restoring a customer's financial situation is possible (variation – short term[13])	30 days to less than 6 months (Example: Hardship assistance or arrangement provides temporary relief from financial obligations, but at conclusion, the customer will revert to normal repayments)		
C – When restoring a customer's financial situation is possible (variation – long term[14])	7 months to long term, but customer can pay something (Example: Hardship assistance or arrangement provides longer term support because, say, one partner can no longer work, but the other can. It is likely, the customer will either require a longer period to return to normal payments or a new repayment plan is needed permanently)		
D – When restoring a customer's financial situation is unlikely	Due to a permanent change in the customer's financial situation or circumstances, the customer cannot (or is likely to be) unable to ever pay off debt		
Timing of Payment	**Amount that can be paid**		
	None	**Some**	**All**
Today	A, B, C, D	B, C	
30 days	D	B, C	A
90 days	D	B, C	A
6 months	D	C	B
12 months	D	C	C[15]
Permanent	D		

Discussion point 4
Are the categories in Table 9 a sensible way of looking at the different stages of financial difficulty, including long term hardship?
Should category D be considered long term financial hardship?
Whether or not category D is considered long term financial hardship, what are the expectations around how a customer in this category should be treated?

[11] Under the ABA's industry guideline, only Categories B and C represent financial hardship.
[12] Recognising the banks will have policies about how many times they may approve such requests before determining that the case should be dealt with in one of the other categories, for example, repeated requests for late payment assistance might be an indicator of financial hardship, and therefore the customer may be referred to the banks' financial hardship team.
[13] Short term examples include moving to interest-only or reduced payments for an agreed period of time.
[14] Long term examples include extending the loan's term so repayments are lower for the life of the contract.
[15] Subject to variation of the original contract, and in a time frame that may exceed 12 months.

10. Could there be a more consistent response?

It was recognised that there is currently a significant degree of variation in both:

- The processes to deal with long term financial hardship and
- The outcomes that cases achieve at the end of the process.

There is an inherent tension between seeking a system that can:

- Take a tailored, flexible approach to respond to individual circumstances, and
- Provide consistency of process and outcomes.

While most stakeholders considered that more consistency in how long term financial hardship is dealt with is a desirable goal, there was a view that steps towards achieving this could have negative consequences. A sample of stakeholders' views on this issue is set out in Table 10.

Table 10

Reasons for:	• *There needs to be better transparency so consumers who don't have an advocate are able to get fair and decent options* • *More standardisation around waiver would be better* • *Would be good to have something about waiver in the banking code of practice* • *We need more certainty for the usual cases, but there will always be exceptions.*
Reasons against:	• *It has to be a case by case approach* • *Flexibility serves everyone better* • *We can't give people the perception that they can get a free ride on debt* • *More conformity would mean lowest common denominator and this would have negative consequences* • *A formal matrix would have the unintended consequence of locking people out of credit*
How:	• *You could only have a very high level guideline* • *Needs to be more than principles, but not "tick-a-box"* • *Need flexibility within sensible parameters* • *It would be good to have a matrix that set out criteria*

Barriers:	• *We tried to write down the rules, but it was virtually impossible, so now we go with training for capacity for case assessment and making a judgement call* • *It would be impossible to get different creditors to agree on one set of rules* • *The rules would have to be very precise, but the vast majority of cases don't meet the rules* • *There is a tension between a policy that is simple and easily applied and retaining the ability to advocate for the exceptional cases.*

It is clear that there is no support for any approach that would have cases dealt with by reference to a set of criteria without an individual case assessment. Any steps towards consistency would need to retain scope for each case to be considered on its merits. This was expressed to be important from both the creditors' and debtor's perspective.

It is noted that the Bulk Debt Project and the National Hardship Register have each developed criteria that deal with identifying cases appropriate for waiver or no further action, that allow for case-by-case consideration.

Any steps towards consistency, would be made easier by clarity about category of hardship and the decisions for which more consistency is desirable.

Combining the categories from Table 9 and the questions identified in Table 3, the options seem to be as outlined in Table 11.

Table 11

A Late payment assistance	• Is it reasonable to accept late payment?
B Where restoring the customer's financial situation is achievable in the short to medium term	• Is the debtor able to restore their situation within 6 months?
C Where restoring the customer's financial situation is achievable in the longer term	• Is the debtor able to restore their position if allowed a longer time period?
D Where restoring the customer's financial situation is not achievable	• Is a repayment plan or settlement offer by the debtor reasonable? • Is there a hardship reason not to proceed to debt recovery at this time? • Is the a hardship reason not to proceed to debt recovery at all?

Discussion point 5
Are more consistent processes to deal with long term financial hardship desirable?

Discussion point 6
Are there criteria that could be used to assist with decision making about the outcomes in cases of long term financial hardship?
If so, for what types of cases and what decisions?

Discussion point 7
What would be the status of the criteria?

Appendix

Interview Questions

- How big a problem is long term financial hardship? (Can it be quantified or qualified?)

- What is a definition for long term financial hardship (as distinct from temporary payment difficulties or short term financial hardship)? What does this mean for certain borrowers categorised as permanent hardship or other (i.e. Centrelink recipients)?

- What is the current practices and approaches of financial institutions and financial counselling or community organisations to dealing with long term financial hardship, including information provided, or representations made, by customers, criteria to assess whether customers are experiencing long term financial hardship, options offered to those customers experiencing long term financial hardship, expectations of customers or their representatives, etc.?

- What is working and what could be improved in terms of borrowers experiencing long term financial hardship (what practices are efficient or inefficient)?

- What influences the practices of financial institutions and financial counsellors or community organisations when dealing with customers experiencing long term financial hardship?

- How can borrowers in long term financial hardship be identified (what information is needed)?

- Are certain borrowers vulnerable to experiencing long term financial hardship?

- What options are available for dealing with borrowers in long term financial hardship?

- What alternatives or strategies (internal and external to financial institutions) should be available for people characterised as being in long term financial hardship?

- What is the role of the government and the social-welfare system in addressing long term financial hardship?

Case studies

Case Study 1

Borrower 1 (Mr) & Borrower 2 (Mrs)

- Husband & wife with 2 school age children.
- Both borrowers long term employment stability.
- Solid net asset position. Owned home for 10 years.
- $250,000 P&I loan ($60,000 refinance existing home loan + $190,000 for home renovations).
- 30 year loan term.
- Metropolitan security valued at $510,000 (49% LVR) prior to commencement of home renovations.

Financial Difficulty Trigger:

- Borrower 1 contacted Bank advising that 3 months prior borrower 2 had fallen through a skylight in an apartment they were staying at whilst on holiday.
- Sustained serious injuries requiring major surgery and was in a wheelchair for 3 months. Now partially mobile but unable to work.
- Borrower 2 had to close a relatively successful business & was without income.
- Borrower 2 had initiated legal action (evidence presented) against the owner of the apartment; however this was expected to take an extended period to resolve.
- Borrower 1 (main income earner) working full time but reduced income coming into household.
- Loan was almost 2 monthly payments in advance at this time with 47% LVR.

Assistance Provided:

- First period of assistance – deferred payments for 6 months to enable borrower 2's injuries to stabilise and support progression of insurance claim.
- Second period of assistance – deferred payment for a further month in the knowledge borrower 2 was to then commence part time work with reduced payments of $500 to commence for up to 12 months. Evidence presented showing progress made on insurance claim. Solicitor confident borrower had good prospects for a successful claim with material compensation anticipated.
- Third review – monthly repayments (albeit still reduced) increased to $800 per month for 3 months. Further evidence progress had been made on insurance claim.
- Fourth review – confirmation mediation scheduled in 6 months time to settle insurance matter. Agreed to extension of existing reduced payment arrangement.
- Borrowers met agreed payment terms throughout period of financial difficulty assistance.

Case study 2

Husband and wife borrowers with a mortgage. The house (in a rural town) was purchased in 2010 for $300,000, with a $240,000 mortgage (which is still at $225,000). Property values have declined because of a decrease in mining near the town, and the house would now sell for around $220-240,000.

At the time the parties took out the loan the husband was in full time, but relatively low paid, employment as a farm hand earning under $50,000 and the wife worked part-time as a cleaner at the motel in town, earning less than $15,000 a year. The couple has 3 children aged 3 and 5 and 7.

In late 2012 the husband suffered a spinal injury diving into a river. He now needs to use a wheelchair. He has not worked since the injury and will never be able to return to a manual labour job (which is his only experience and training).

The couple was in advance on the mortgage when the accident happened, but in the last 6 months have not been able to make regular mortgage payments, and they have gone into arrears in the last two months. They have significant bills for medical expenses and some adjustments to the house that were necessary to accommodate the wheelchair. They are paying those debts off to the creditors who have agreed to take instalments over time. They have no other personal loans or credit card debts.

They are wanting hardship consideration on their mortgage. The wife has increased her work hours and is now earning $25,000 a year. She is expecting to be able to work full time from the beginning of the school year in 2014 when the youngest child starts school and will then earn $40,000. The husband expects his injury to stabilise in the next 3 months and he is planning to undertake a Diploma in Information Technology because there is no IT business in town, and he thinks he can earn money with a small scale computer business from home. He will finish the course by the end of 2014. They expect their income to return to more than $50,000 by 2015.

The couple is asking for hardship consideration so that they can keep their home.

Case Study 3

Loan : Secured Product
Balance: $37,497.94
Arrears: $2,693.36
Delinquency Days: 161 days
LMI: No Lenders Mortgage Insurance
LVR : 80%
Loan Funding Date: 1999

- **Situation:**
  There are personal disputes among all three borrowers since 2009. We approved reduced payments in Hardship from Aug 2009 – May 2010. The borrowers cannot commit to the minimum monthly arrangement as continuously late and dispute how much each other will pay as caused by multiple reasons such as third party sickness and fraudulent behaviour between borrowers. Due to missed payments, the account was referred to collections in Oct 2010. The customers were affected by the natural disaster in January 2013 and returned to hardship area. Reduced Repayments were subsequently approved.
- **Current Status:**
  We have recently contacted one borrower who cannot commit to an arrangement or see any foreseeable change to the circumstances, the other borrower is elderly and unable the be contacted while the third borrower is disputing any ownership of the loan.

Case Study 4
Loan : Unsecured Product
Balance: $17,710.38
Arrears: $867.00
Loan funded : 2012
Delinquency Days: 68 days

- **Situation**
  Customer was earning a high income when the loan was funded last year. The customer has changed his life style to fit a more religious and spiritual path, no longer earning the income he once did.
- **Current Status**
  We have contacted the customer and he has advised his priorities have changed and has no future solution to offer regarding this debt. His intention is to further his religious studies and has no future capacity to service this debt for the next few years. The customer cannot guarantee or confirm a steady repayment plan. The customer is setting up his own business in line with his studies and receives inconsistent and reduced income.

<u>Case studies: Centrelink beneficiary</u>

One: Sudanese Refugee – Supporting Parent Benefit

Bank debt – Sudanese refugee – separated after domestic violence – 2 young children (aged 3 and 5).

This woman came to Australia from a refugee camp. She may have been in the camp for 5–10 years including the period she would have been in secondary school. Prior to the refugee camp she would have lived in a rural village. She probably had no real primary or secondary schooling.

In Australia she would have entered into an unstable relationship at a young age in search of love and support. She would not have worked during the 5 years she was caring for her two young children.

She would be illiterate or semi illiterate and probably innumerate. She probably cannot tell the time and has never owned a watch.

She will be computer illiterate and virtually unemployable other than something like low level child care or shop assistant in a small non electronic workplace.

The debt was a joint loan possibly based on both Centrelink incomes. It was for a car which he kept when he left the relationship. She was not receiving child support and was almost certainly repatriating some of her Centrelink income to relatives still in the refugee camps. Her long term prospects were bleak.

Two: Single Mother

Bank – Single mother with 4 children including one child with significant disability. Separation is often the result of a disabled child with mother literally left holding the baby. Debt may relate to a credit card obtained before she had children. The limit gradually increased while she was supported by her ex-husband.

Creditors view Newstart as meaning client likely to go back to work. Disabled child is an indicator that long term Carer Pension more likely.

Mother/Debtor has multiple medical complaints both physical and mental. This is common when women lack support in caring for large numbers of children or a disabled child.

Debtor does not cope well – she will have periodic arrears of rent and unpaid energy bills which lead to threats of disconnection and eviction. She is likely to receive energy relief grants and/or material aid from charities. She is a client of Good Shepherd Family Care.

The agency will be concerned about her ability and capacity to care for children. They will also be concerned about her ability to pay for and take medication. She will be concerned that her children might be removed from her care. A return to Work is the least of her concerns.

This type of client will have few employment skills and no recent work history. Employment is unlikely. She is likely to end up on disability pension or Carer's Pension.

Three: Unemployed Male – 55 years – Newstart
Many debtors find themselves unemployable as they reach 55–60 years of age. These debtors will be on Newstart until they qualify for the age pension.

These debtors are usually unskilled workers. The debtors may have had a long term job whilst younger but once laid off, lack portable skills to find another position.

This debtor has been granted public housing which suggests no other assets and low prospects. The debt could be a credit card or personal loan obtained whilst working.

As unemployment becomes permanent, the debtor finds health problems are worsening. These problems – physical or mental - decrease the chances of finding employment.

It is worth noting that the debtor is single and appears to have neither a partner nor family to provide support. This may indicate a history of mental health problems such as depression or alcoholism.

Even if this debtor finds work it will be short term and his financial circumstances will be crisis driven.

Four: Heroin Addict – Disability Support Pension
The client is a 35 year old long term heroin addict. He has been in rehabilitation for two years and has been placed on a long term methadone treatment as an alternative to heroin.

This client will have a drug related criminal record which will seriously impact on employment prospects. He will remain on the methadone program long after he has left rehabilitation centre. The client will have upset/defrauded family members and may have no support outside the rehabilitation centre.

His debt is likely to be a credit card obtained whilst working between periods of imprisonment and rehabilitation.

He may move from the disability pension to Newstart after rehabilitation. His prospects are more likely to include death or imprisonment than employment. He may also face homelessness.

His criminal history and methadone use make him virtually unemployable.

Five: Unemployed – Low level mental illness – Newstart
The client is a 45 year old male. He is in private rental, is currently on Newstart and has had sporadic employment. His debt is a $10,000 credit card obtained whilst in employment. The bank has increased the credit limit without knowledge of his real circumstances.

The debtor has no significant history. He has no current relationship, has no previous partner or children and has no significant family contact.

The debtor has worked periodically but reports that jobs never last long. He admits to problems with anger management and attentiveness which impact on employment.
The client has no house, an old bomb, no super and nothing to show for 25 – 30 years post school life.

Further investigations reveal periods of homelessness and depression. He admits to seeing a counselor about sexual abuse suffered as a child. He also admits that Legal Aid had $20,000 in Citylink fines waived on the basis of special circumstances in the Magistrates' Court.

This client has occasional capacity to pay but cannot maintain regular repayments. The client is likely to continue to experience both depression and homelessness.

Six: Medical Conditions – Newstart

The debtor is a 31 year old single woman who has been forced to give up work for medical reasons. She is currently in receipt of Newstart.

Her conditions include a gradual but permanent loss of sight which has led to her being declared legally blind. She is no longer entitled to drive but has not yet been approved for a disability pension. She also has a form of Meniere's disease which affects her balance.

She is not in a relationship and rents privately. The debt (credit card) was incurred whilst she was working. Her life will get more difficult with the passage of time.

A return to the workforce is unlikely.