Case study – unaffordable car loan

Not fit for purpose

FDRS was approached by a Financial Mentor on behalf of their client. The client purchased a vehicle from a dealership in 2022. The purchase price was over $10.000.00. The client paid a deposit, and the balance was funded by way of a financial arrangement with a financial provider.

About the loan

The loan contract included several additional items that were added to the principal sum:

- A loan establishment fee
- A brokerage fee
- A “Guaranteed Finance Protection” policy (issued as a separate document) with a premium
- Mechanical Breakdown Insurance
- The annual interest rate was fixed for the whole of the contract period at 21.95%
- The loan amount was to be repaid in 130 weekly installments.

The total amount to be paid over the life of the loan was approximately $17,500.00.

Unfortunately, the vehicle was unreliable and was returned to the dealership within the first month for repair or replacement. The car remained with the dealer for 8 months before the dealership decided to settle with the client by clearing the outstanding balance and refunding the cash deposit.

Affordability assessment

The customer then engaged a financial mentor to assist them with budgeting. The mentor requested that the financial provider suspend the current loan repayments due to financial hardship. The mentor also requested a copy of the clients’ affordability statement. While the request for a suspension was denied, the financial provider did supply an assessment which appeared to show the clients.

- weekly income
- expenses including the loan repayment and
- a final statement on the assessment that concluded a surplus of $20.00 a week after expenses.

However not all weekly payments were included in the affordability assessment. Bank statements showed several negative account balances in the 3-month period before the loan was approved. These expenses were not considered in the affordability assessment.

The Financial Mentor therefore claimed that the loan was unaffordable. Consequently, the loan placed their client in “further financial hardship”.

The Financial Provider claimed it had made “reasonable inquiries when assessing the affordability” of the loan through the car dealership. However, even a cursory examination of the loan application showed that it was incomplete.

The Financial Provider acknowledged that other weekly payments disclosed were omitted from the loan application, meaning that the “uncommitted weekly income” of $20.00 per week was too low a figure to justify a loan plus interest.

How FDRS helped

The complaint was found to be within the jurisdiction of FDRS and required further investigation.

FDRS was concerned about the size of the interest rate and the additional costs including the loan establishment fee and brokerage fee. The Guaranteed Finance Protection and Mechanical Breakdown Insurance caused serious concerns. FDRS questioned what value these insurances provided given the client’s tight financial circumstances and the limited use of the vehicle. FDRS looked at whether key features of the credit related insurance were fully explained to the client and if the insurance met the borrower’s needs. The principles of fairness also requires FDRS to consider the apparent vulnerability of borrowers.

The Financial Provider faced a potential risk of breaching the principles in part 1A of CCCFA and the guidelines provided by the Lending Code. On the surface this loan was unaffordable once the additional payments were added to the affordability calculation. There were also doubts about the value provided by the additional insurances and concerns about the level of interest and fees being charged. It was our view that the loan payments potentially caused the client substantial hardship.

Outcome

Once jurisdiction was issued, and prior to any formal investigation from FDRS, the parties reached a settlement and the financial provider agreed to refund the required amount to clear the loan.

Lessons learned

This complaint highlights the potential problems created by “add-on” insurances included in financing packages for vehicle or household purchases. Finance companies must fully explain the key features of these policies to their clients and have a genuine conversation about whether these additional items are affordable and needed by the client.

This complaint also shows that all finance companies must carefully conduct their own assessments of affordability based on interviews and discussions with clients. Great care must be taken to ensure that any automated assessments of affordability are accurate and that key information is not missed. This is especially important where the clients are vulnerable and the margin between the costs of the borrowing and the income are tight.