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Dear Ms Cameron

AFCA's responsible lending approach consultation

Thank you for the opportunity to provide feedback on the Australian Financial Complaints Authority's (**AFCA**) draft approach to responsible lending (**Draft Approach**). This submission is made on behalf of:

- Consumer Action Law Centre
- Financial Rights Legal Centre
- Consumer Credit Legal Service (**CCLS**)
- Financial Counselling Australia.

Supporting and representing people through disputes with financial services providers involving responsible lending has been core work for our financial counsellors and lawyers since the introduction of the *National Consumer Credit Protection Act 2009* (**NCCP Act**). We see the devastating impacts of unsuitable credit products upon the finances and lives of individuals and families.

As the external dispute resolution body for consumer related credit matters, AFCA plays the important role as the only realistically accessible forum for most consumers to seek compensation for harm as a result of the provision of unaffordable credit. We welcome AFCA's development of an Approach to explain and guide how AFCA will handle disputes about responsible lending.

Overall, we strongly support the framework set out in the Draft Approach. We consider the Draft Approach to largely accurately reflect the law and ASIC guidance that applies to responsible lending, while giving important consideration to reaching fair outcomes.

Currently some AFCA recommendations and even determinations in responsible lending disputes are inconsistent, which has led to some problematic practices and caused unfair outcomes for consumers. The Draft Approach addresses many of the concerns we have with approaches to responsible lending disputes taken at times by AFCA.

A summary of recommendations is available at **Appendix A**. We have also had the benefit off seeing Redfern Legal Centre's submission. We also endorse the comments in that submission, particularly in relation to financial abuse and family or domestic violence.

We have structured our submission by grouping our responses to each of the consultation questions. In some cases this means responses to questions address various parts of the Draft Approach. Where this occurs, we have attempted to clarify this by reference to page numbers.

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Overall comments

The Draft Approach, in our view, would lead to AFCA resolving disputes about irresponsible (or responsible) lending on substantially fairer and more consistent terms. While we provide a number of recommendations on ways the Draft Approach could be enhanced, these should not be interpreted as dissatisfaction with the Draft Approach as a whole.

It is worth highlighting the following priority themes of our submission:

- Income verification (see response to question 1)
- Processes for obtaining information (see response to question 2)
- Guidance on the calculation of loss (see page 10-11)
- Calculating benefit received from a credit product, particularly regarding car loans (see responses to questions 8 and 9); and
- Finding fair ways to resolve disputes that limit the impact on the lives of complainants, on which we consider the Draft Approach to be strong and extremely valuable (see response to question 11).

Shorter, plain English version needed for self-represented complainants

While recognising responsible lending can be a complex and nuanced concept, the Draft Approach is very long, and parts are quite complex. Few self-represented complainants will likely engage with the Draft Approach document as drafted.

It is important that AFCA also develops a shortened, plain English version with key points for consumers, once the content of the Draft Approach is settled. This should aim to set out the basic aspects of the process consumers need to know and make them aware of the key points of law that will impact the complaint outcome. Examples in the consumer document that help explain key terms in that document (such as shortfall debt and adjusted debt) may also be useful. If this step is taken, it may also be worth revisiting whether consumers should be listed as an intended audience on page 4.

AFCA should also develop some media based explainers such as pictures or videos to help explain key parts of the law and the AFCA complaint process, which can be more accessible for some consumers and often have a greater impact for a lot of First Nations communities.

RECOMMENDATION 1. Develop a shorter, plain English summary document of AFCA's approach to responsible lending disputes, intended to provide self-represented complainants with the key information to help them to meaningfully engage with the dispute process and advocate for themselves. This document, or accessible versions of it, should also be accessible to people with disabilities and people from culturally and linguistically diverse backgrounds.

There may be opportunities to reduce the length of this Approach by removing some of the repetition throughout the Draft Approach – for example the document states that AFCA aims to reach conclusions that are fair in all the circumstances 12 times. Other parts (such as the executive summary) may also be reduced or removed if a separate consumer-friendly document is made.

How AFCA decides if a firm has met its responsible lending obligations

Comments on section 3.1

Guidance on vulnerability

We support the broad list of relevant sources of law, codes and other guidance that AFCA flags it may consider in responsible lending cases on page 10 (though note our comments re unjust transaction in response to question 14).

While recognising that this list is non-exhaustive, it would benefit from adding a point recognising that AFCA will consider relevant industry guidance, particularly in relation to interacting with people experiencing vulnerability.

AFCA does not have an approach document addressing vulnerability. This is a useful opportunity to recognise the importance of industry adhering to high standards when selling credit products to people experiencing vulnerability. Examples of specific documents that represent good industry practice AFCA should consider include[1]:

- The Australian Banking Association's (**ABA**) industry guideline on preventing and responding to financial abuse[2]
- The ABA's industry guideline on preventing and responding to family and domestic violence[3]
- The Final Report of the Law Council of Australia's Justice Report (and its relevant recommendations).[4]

RECOMMENDATION 2. State in the Draft Approach that where a complainant is experiencing vulnerability, AFCA will consider relevant industry guidance when assessing a responsible lending complaint.

Guidance on vulnerability is also important to set standards and processes for AFCA staff to follow when working with consumers experiencing vulnerability. For example, a vulnerable consumer might need additional time to gather documents or assistance to understand processes and decisions. In cases of family or domestic violence, gathering such information could pose a risk to safety and should not be required by AFCA if possible. Given the complexity and safety risks of family or domestic violence issues, more senior and appropriately trained staff should be allocated to cases where these issues are identified or raised.

Small amount credit contracts (SACCs) and consumer leases

We support clarifying the impact of the rebuttable presumption of unsuitability relating to SACCs on page 10 of the Draft Approach. However, it would be useful to specify that this presumption was replaced for contracts entered into from 12 June 2023, and flag in the Draft Approach the new test set out at section 133CC of the NCCP Act.[5]

RECOMMENDATION 3. Clarify the guidance in the Draft Approach on SACCs to reflect the changes made to the NCCP Act by the *Financial Sector Reform Act* 2022, relating to SACCs and consumer leases.

Question 1: the Draft Approach largely complies with RG209

The general guidance at part 3.2 of the Draft Approach, about the kinds of considerations that may impact how AFCA determines what reasonable inquiries a financial firm should have taken when assessing unsuitability, is sound. The Draft Approach is largely consistent with ASIC Regulatory Guide 209 (**RG209**) and relevant case law.

The Draft Approach recognises the broad range of factors that can influence what inquiries will be reasonable for lenders to make, which is consistent with the concept of scalability in RG209. However, we recommend revising the first sentence in part 3.2 of the Draft Approach, which asserts that "financial firms are *likely* to require information about … income, requirements and objectives …". While the extent of necessary inquiry about the factors in the second diagram on this page may vary, financial firms must put themselves in an informed state

[1] We also understand the ABA is working on a draft industry guideline on providing extra care to customers experiencing vulnerability, which may be appropriate to refer to as well

[2] https://www.ausbanking.org.au/wp-content/uploads/2021/07/ABA-Financial-Abuse-Industry-Guideline.pdf

[3] https://www.ausbanking.org.au/wp-content/uploads/2021/05/ABA-Family-Domestic-Violence-Industry-Guideline.pdf

[4] https://lawcouncil.au/justice-project/final-report

[5] With details specified in regulation 28LCA of the National Consumer Credit Protection Amendment (Financial Sector Reform) Regulations 2023. The same test now also applies to consumer leases, per section 156B NCCP Act

about the financial position of the consumer before making an unsuitability assessment.[6] The matters set out in that diagram on page 11 are fundamental to understanding this.[7]

RECOMMENDATION 4. Amend the first sentence of part 3.2 of the Draft Approach to clarify that financial firms will almost always require some information about the matters in the unsuitability assessment diagram.

Relatedly, AFCA should also make clear in this part of the Draft Approach that financial firms also have obligations to make reasonable inquiries about risk factors that may indicate a complainant is experiencing vulnerability. This is covered further in response to question 8 (and we endorse Redfern Legal Centre's comments on this issue).

Verification and benchmarks

There are a number of comments addressing verification throughout section 3 of the Draft Approach. Many of these comments usefully and appropriately refer to the need for increased verification where red flags, increased risk or inconsistent information is identified. This is logical and is again consistent with RG209 and the NCCP Act wording requiring reasonable steps and scalability. AFCA case managers may benefit from further internal guidance on examples of red flags that should warrant further inquiry. In our casework, we have seen some recommendations where a lack of verification by the financial firm has not been treated as problematic despite obvious red flags in verification documents.[8]

However, it is unclear what the baseline is that AFCA expects of financial firms when verifying a complainant's financial situation. Parts of the Draft Approach could be interpreted to suggest that verification is only required once red flags, risks or inconsistencies are identified. For example, the paragraph at the bottom of page 14 could be interpreted to suggest verification is only required if a red flag is present in information available to the firm. Read with the commentary on benchmarks at pages 17 and 18, this may be taken by financial firms to condone using an expense benchmark without any verification if a consumer's estimate of their expenses is somewhat similar to the benchmark. This interpretation would not accurately reflect the law.

While the majority decision in *ASIC v Westpac* [2020] FCAFC 111 did accept that the use of benchmarks could be a relevant consideration in an unsuitability assessment, it did not suggest that benchmarks can replace verification.[9] This case also concerned an abstract discussion that applies only to home loan cases, where consumers may reduce their spending after buying a house (though this is something the lender inquire about, rather than assume).[10] While it may support the view that not **all** verification information obtained must be used in the unsuitability assessment, it doesn't support an approach that verification need only be used to address anomalies in self-assessed information provided by consumers. We note this because past recommendations have indicated AFCA banking specialists have incorrectly instructed case managers that use of a benchmark alone is a sufficient step to undertake an unsuitability assessment.[11]

We recommend clarifying the Draft Approach so it is clear and consistent with the law and confirms that financial firms must always undertake some steps to verify a consumer's financial situation.

RECOMMENDATION 5. Clarify in the Draft Approach that AFCA would expect financial firms to perform unsuitability assessments based upon verified income and expense figures.

We also:

[6] *ASIC v Westpac* [2019] FCA 1244, at [59] and approved in *ASIC v Westpac* [2020] FCAFC 111, at [115]-[117]
[7] As recognised in *ASIC v Channic Pty Ltd (No 4)* [016] FCA 114, at [1173] and referred to in RG209 at 209.60
[8] For example, recommendations in AFCA cases 688824 and 935593
[9] At [141]; [167]-[170]
[10] *ASIC v Westpac* [2019] FCA 1244, at [74]-[77]
[11] See recommendation in AFCA case 688824 in particular

- strongly support the indication that use of the Henderson Poverty Index (HPI) as a benchmark needs to involve an additional buffer;
- endorse the comments of Redfern Legal Centre in regard to the importance of verification in preventing financial abuse, particularly of shared expenses;
- urge AFCA to specifically clarify that where the Household Expenditure Measure is less than the HPI, that the HPI should be preferred; and
- recommend AFCA introduces specific guidance for assessing variable incomes due to casual employment, overtime or annual leave loading, or indicate that evidence of these may warrant a more detailed verification process.[12]

Question 2: other comments on assessment of inquiries and verification

How AFCA obtains relevant information

We urge AFCA to clarify in the Draft Approach that it will seek to first obtain all relevant information **from financial firms**, as standard practice in responsible lending matters. The financial firm's original unsuitability assessment and related processes are the fundamental issues that are being reviewed by AFCA. It makes sense to obtain this information as a first step.

AFCA should also reduce the extent to which it requires information from complainants. The vast majority of complainants will not have detailed knowledge of responsible lending obligations or evidence the requirements were met under the NCCP Act, and the AFCA process will be novel to them. By comparison, financial firms regularly engage with AFCA, are supposed to be the experts in credit, and they are the party subject to the responsible lending obligations. So wherever possible AFCA should expect the firm to provide information that both parties would have.

To clarify that this is AFCA's intention, it may be necessary to change the first sentence under "Requesting information from complainants" on page 13 of the Draft Approach. Use of the term 'beginning' in this sentence gives the impression that AFCA will first ask complainants to provide all the information in the diagram before seeking relevant documents from the financial firm.

The text in the third part of the diagram on page 13 could also be restated, to clarify that complainants will only be required to provide supporting documents for their financial position at the time they obtain the loan if this is necessary. Recreating a person's financial position can be an onerous task and should only be requested of complainants once the documents from the financial firm have been assessed, and it is deemed necessary. An alternative when dealing with self-represented complainants (particularly if vulnerable) would be for AFCA to prepare a draft statement of financial position based on the information provided, and ask the complainant to confirm if it is correct.

[12] Such as the approach taken in the AFCA Determination for case 930610

Case Study – Georgia's story

Georgia (name changed) is a single parent of three young children, and has relied on Centrelink payments as her sole source of income since having her first child, in 2017. Georgia made a responsible lending complaint to AFCA about four consumer leases that she entered into with one financial firm between 2018 and 2021.

Soon after lodging the complaint, Georgia provided AFCA copies of documents that had been provided by the firm through the internal dispute resolution process, and copies of relevant correspondence. Once the matter was allocated to a case manager, some of those documents were requested again as they had been lost and the firm had apparently been slow to respond.

AFCA also asked for the following documents to be provided within a week:

- details about all of Georgia's major living expenses at the time each of the four leases were entered into, supported by relevant documents;
- six months of Georgia's bank statements prior to each lease being entered into;
- statements of financial position for Georgia at the time each lease was entered into;
- Georgia's tax returns for each year prior to each lease being approved;
- a statement of Georgia's current financial position; and
- more documents to evidence Georgia's current financial position.

AFCA also asked Georgia to explain why she signed the agreements if she considered the leases to be unaffordable – a question that appeared both loaded and irrelevant to the question of whether the firm complied with its lending obligations.

The information request gave the impression that it was incumbent upon Georgia to spell out every aspect of her financial position for four years, and that AFCA would not be able to make any inferences from bank statements or similar documents. Within the request, and subsequent correspondence, AFCA said that if they did not consider that they had sufficient information to form a view, they would close the complaint. It was also not clear whether the case manager had reviewed and considered the documents obtained by the financial firm for the purpose of complying with its responsible lending obligations before making these requests.

The requests made by AFCA in Georgia's case are not uncommon. Recently these requests have commonly become more onerous by AFCA attaching tight deadlines for response. They can be onerous for a consumer representative, let alone a self-represented litigant. It gives the impression that AFCA's goal is to push through complaints quickly rather than taking the time needed for clients experiencing vulnerability. We recognise the pressure AFCA is under with very high volumes of complaints, and the imperative to keep complaints progressing and resolving. However when working with vulnerable clients, extra care and sometimes extra time must be afforded.

The warning that a complaint may be closed if the request is not complied with also appears to reflect standard AFCA request format. This is problematic in responsible lending cases in particular because the main question is whether the lender complied with their obligations. While in many cases some documents from complainants will obviously help make a better decision, AFCA should be able to make some assessment about whether a breach occurred based on the claim by the complainant and the documents the lender produces, alone. In some cases AFCA should also be prepared to make adverse inferences where financial firms are unable to provide sufficient proof they obtained or verified necessary information. To close the complaint because of documents a complainant struggles to provide in time is to effectively find in favour of the lender.

It is also not clear why AFCA sometimes requires multiple forms of evidence from the complainant to document their same financial position at the time a contract was entered into (e.g. tax returns, bank statements, Centrelink statements), and why AFCA decision makers sometimes ask why a complainant entered a contract. These practices can give the complainant (particularly vulnerable ones) the impression that their integrity or honesty is the main issue in dispute. Some complainants who have had bad experiences with government entities may also be understandably reluctant to obtain documents from bodies like Centrelink and the ATO. AFCA should be aware of this when making these requests.

AFCA should also:

- Develop a guidance document that sets out the standard documents and other evidence they may need to provide to determine responsible lending complaints, and give this to complainants when they lodge a complaint
- provide complainants tips on how to obtain these documents and other evidence
- make it clear to self-represented complainants that if they are having trouble meeting deadlines to provide documents and other evidence, they can request an extension
- tell case managers and dispute resolution specialists to leave requests for documents relating to the calculation of loss for later if already requesting multiple documents to first determine if a breach of responsible lending laws has occurred.

RECOMMENDATION 6. Clarify in the Draft Approach that AFCA will first obtain relevant documents from the financial firm, and will only require complainants to provide further documents and information if necessary to assess the complaint.

RECOMMENDATION 7. Provide guidance and assistance to self-represented complainants to assist them in complying with AFCA document or information requests, and make them aware of the option to seek an extension for deadlines.

<u>Reductions in outgoings</u>

The last point in the diagram on page 17 refers to financial firms finding that a complainant will reduce their outgoings as part of an unsuitability assessment. We encourage AFCA to clarify in the Draft Approach that where financial firms have made this conclusion, that financial firms need to have specifically discussed this with the complainant and that AFCA would expect there to be documented reasons to justify the conclusion. This is in line with the record keeping expectations of RG209.263.

RECOMMENDATION 8. Clarify in the Draft Approach that if a financial firm has concluded that a complainant would cut back their spending to afford a credit product, the financial firm will be expected to provide evidence it discussed this with the complainant.

<u>Other relevant sections we strongly support</u>

Aspects of section 3.3 of the Draft Approach are also relevant to this consultation question. Some of these sections provide valuable industry guidance that is consistent with the law, logical and reasonable, but which is not consistently complied with in practice. Examples of specific parts that we strongly support include:

- Clarifying that non-compliance with a firm's own policies may be a relevant consideration if it would have impacted the responsible lending assessment. These policies form part of the service that the financial firm provides and should be relevant to the question of unsuitability of the loan, where not complied with. AFCA should consider all relevant firm policy documents as a matter of course, whether public or not – sometimes some are not public facing and so non-compliance cannot be identified by complainants or representatives.

- We strongly support the guidance on bottom page 22 clarifying that credit providers cannot simply rely on the details in broker preliminary assessments. In our experience, firms often accept information from brokers about income and expenses without verifying any of it. While the broker may have responsible lending obligations as well, the only remedy available for a complainant against a broker can sometimes be limited to that relationship, and not the fees from the resulting credit product. For this reason, it is vital that credit providers cannot avoid responsibility because of a broker's assessment. The examples of red flags that may exist in a broker's lending assessment are helpful, but we urge AFCA to ensure that this does not dilute the higher level point that broker assessments cannot be simply relied upon. See also our comments in response to Question 14 below regarding joinder.

Conversely, we are disappointed AFCA feel the need to emphasise that it does not apply best practice. We consider it may be appropriate (in a fairness jurisdiction) for AFCA to at least expect best practice of larger firms in a market, or firms that market themselves as a premium service.

Question 3: approach toward reasonably foreseeable changes

We support the inclusion of the section on reasonably foreseeable changes over the life of a loan on page 19-20. This is clearly consistent with guidance in RG209, including changes to interest rates.[13]

Question 4: retiring during the loan term

Yes, we agree that it is entirely appropriate for AFCA to expect lenders to consider the impact retirement may have upon a borrower's ability to repay a loan, if they will reach retirement age during the loan. This is consistent with RG209.64, and section 76(2)(f) of the NCC which allows the court to re-open an unjust transaction on the basis of a consumer's age impacting on their ability to protect their own interests..

If the borrower will have to sell assets to repay the loan, this is absolutely something that should be considered before the loan is entered into as it could mean the credit product will be unsuitable, particularly if the borrower is not aware of this or has no plan for dealing with it.

Question 5: interest rate buffers

Yes, we support AFCA setting an expectation that lenders will make use of a reasonable interest rate buffer where the interest rate can change over the term of the loan. The recent dramatic increase in interest rates and the strain this is putting on families with home loans demonstrates the importance of this safeguard. This is expected of authorised deposit taking institutions subject to APRA oversight for home loans, and it is just as important for other lenders to do the same.[14]

We also suggest revising the example at page by adding detail (perhaps with specific figures), as it is a very general example.

Question 6: seeking and considering further information

Section 3.4 of the Draft Approach clearly sets out an appropriate method for determining responsible lending complaints, and we support its content. We particularly support the clarification about assumptions at the top of page 25 that AFCA will make (regarding providing information and reductions in discretionary spending). These are appropriate assumptions to adopt in the vast majority of circumstances.

Question 7: use of further information

The example on page 24 is a useful one that reflects cases we often see and demonstrates the importance of verification, particularly for products that are higher risk. However, in our view the use of benchmarks to assess expenses in a suitability assessment at all for a SACC is always inappropriate, considering the NCCP Act specifically

[13] Such as at RG209.205
[14] APRA Prudential Standard APS220, Credit Risk Management

requires lenders to obtain and consider 90 days of bank statements.[15] If the example is intended to demonstrate the point that reliance on a benchmark was inappropriate because of evidence to the contrary in bank statements, it may be more appropriate to have the example involve a different credit product. It could help also specifically clarifying in the guidance that where a complainant tells a financial firm that their expenses are below a relevant benchmark, that this red flag should warrant detailed verification of their expenses, rather than just adoption of the higher benchmark.

We also strongly support the guidance that where a serviceability assessment indicates only a small surplus, this may warrant further investigation. We routinely see assessments from credit providers where a fast, imprecise serviceability assessment has been undertaken that has led to the conclusion that a borrower can afford a loan because they will have (say) $40 surplus a fortnight. Reviewing these assessments almost always leads to identification of problems with the assessment such as gross underestimates of expenses contrary to evidence in bank statements, or incomes recorded that clearly do not match reality. This point may be further enhanced by clarifying the extra steps a lender should take steps in these circumstances. For example, this kind of tiny surplus, with no room for error, should prompt a detailed manual verification process, and the lender should consider the likelihood of any unforeseen expenses arising for the borrower during the life of the loan. This guidance is clearly needed, and will help address situations that can lead to significant harm.

Case Study – Jennifer's story

Jennifer (name changed) entered into two separate consumer leases with a consumer lease provider.

The unsuitability assessments for the leases acknowledge that Jennifer's sole income source is Centrelink payments, and include very low assessments of outgoing expenses. The lease applications state that Jennifer spent only $20 per fortnight on car expenses, which would not even cover registration. The second application listed $30 as her fortnightly cost of food. Only three months earlier the lessor had listed $50 on the first application (still unrealistically low).

The consumer lease provider had sighted Jennifer's bank statements which clearly indicated a higher level of expenditure than the expenses on the lease application form. Both lease applications indicate that she would have less than $50 in fortnightly disposable income after paying the lease repayments, even if the low expense estimates were correct.

Part 2 – calculating loss and remedies

We welcome the guidance in the Draft Approach as to how AFCA will calculate the loss caused by breaches of responsible lending laws. The Draft Approach would give AFCA decision makers wide discretion to deliver resolutions that are fair with proper regard to the circumstances of the complainant, rather than delivering fairness in a vacuum. In the vast majority of cases where irresponsible lending has occurred, the borrower has suffered substantial hardship due to the credit product. Alleviating the hardship caused should be the goal of AFCA in these cases.

We agree that AFCA should look to ASIC's Regulatory Guide 277 (**RG277**) in establishing what a fair outcome looks like. Both remediation programs under RG277 and AFCA resolutions are supposed to put wronged consumers in a fair position that offsets the impact of the unlawful act of the firm. In particular, we strongly support the recognition that there should be substantial consideration of the practical impact of an outcome on the complainant's circumstances, especially where it will impact their ability to retain assets such as their car or home, or if they are experiencing vulnerability, such as victim survivors of family violence.

[15] NCCP Act, s 130(1A)

However, we urge AFCA to strengthen the language around when it will consider RG277 and the complainant's circumstances. While we understand that AFCA must determine each case on its facts, the language in the Draft Approach makes it sound as though these considerations are optional. Amending the Draft Approach so it is clear that AFCA **will** (rather than 'may') ordinarily consider these factors would be a more consistent and clearer road in reaching fair outcomes for complainants.

We also strongly support the goal of ensuring that the AFCA process delivers a comprehensive resolution. This is an area where there is room for improvement for AFCA, as we do see cases where key issues are left to the parties to negotiate, which can be a particularly challenging process for self-represented complainants, due to the power imbalance between them. AFCA should always provide full details as far as possible of the remedy in determinations, and clearer guidance should be provided in recommendations, to help facilitate fairer early resolution.

Making this section easier to navigate

This part of the Draft Approach is quite complex in some areas. We found the examples to be very useful in illustrating how the guidance would work in practice, but their value could be increased if the calculations and outcome were more clearly spelt out. The examples on page 33 and 38 would benefit from this in particular. More examples would also be welcomed.

It would also be helpful for consumers to be (whether in this or an accompanying consumer friendlier document):

- reminded of the monetary amount of any jurisdictional limits inside the document or appropriate cross referral
- provided examples of the types of loss relevant to responsible lending
- given a basic explanation of the differences between direct, indirect and non-financial loss.

Additionally, the first list of dot points on page 27 should read "and/or", instead of "or".

Question 8: assessing loss and benefit

We generally agree with the Draft Approach's high level approach to calculating benefits and loss. It sets a clear and logical process for AFCA to follow.

Benefit

The recognition in the Draft Approach that in some instances the complainant should be considered to have received a benefit that is less than the full amount of the credit contract is extremely important. The examples included in the Draft Approach on pages 31 and 32 are useful to show where this may be appropriate.

Co-borrowers

However, it would be helpful if further information was provided regarding AFCA's approach to situations where a loan is largely for the benefit of one co-borrower and how AFCA decides whether a partner and/or a household receives a direct or indirect benefit from the loan, and how this is apportioned. AFCA's approaches to financial elder abuse and joint accounts and family violence alone do not provide sufficient specific guidance on responsible lending complaints.

AFCA should assume that all firms have an awareness and understanding of the dynamics of family violence and are effectively on notice to proactively look for warning signs. Understanding the nature, effect and prevalence of domestic violence has developed significantly, across all industries over the past decade. The Victorian Royal Commission into Family Violence took place in 2015 and the FOS approach to joint facilities and family violence was published in 2017. AFCA should have higher expectations of financial firms in this regard in recent years, at least.

In particular, the Draft Approach should make clear that AFCA will examine whether a financial firm has made sufficient inquiries into the requirements and objectives of a complainant when a claim of no (or reduced) benefit is made. The requirements and objectives limb of the unsuitability assessment is not addressed at all in this section. For example, AFCA should make clear that it will expect lenders to make further inquires (such as arranging to meet with each co-borrower separately and safely) about unusual arrangements, such as:

- if a couple are co-borrowers on a loan for a car and it is not clear whether both will use it or be listed as an owner;
- where a couple are co-borrowers but one borrower handles all the interactions with the lender, or does all the talking; or
- any other signs that may have indicated a risk of financial abuse.

Where warning signs existed and the firm did not make further inquiry, AFCA should be able to reduce the calculation of the benefit a complainant received from the credit product.

RECOMMENDATION 9. Provide more guidance on how AFCA will make findings where a complainant has not received the full (or any) benefit from a credit product, and provide firms more guidance on what is a reasonable inquiry to check if a customer may be experiencing family violence or financial elder abuse.

Guidance would be welcomed specifically addressing situations where it would have been more appropriate for the co-borrower to be a guarantor (such as where elderly parents are co-borrowers providing security but not directly servicing the loan or deriving any benefit/or only little benefit).

For example, CCLS is assisting an elderly client who became a co-borrower on her son's loan using her previously unencumbered home as security. The loan was used by her son to refinance his credit card debt and purchase an investment property (of which she received only a 10% interest, and which subsequently sold for a shortfall). The elderly client now faces homelessness if she is required to sell her home to satisfy the shortfall debt. The elderly client was retired at the time the loan was obtained and AFCA stated that as only her son was expected to make repayments to service the loan, only her son's income/expenses would be considered in assessing the affordability of the loan. Our client's joint and several liability and minimum benefit from the loan (i.e. her requirements and objectives) were not duly considered. The client has rejected the preliminary view and this matter is awaiting determination at AFCA.

We consider that financial firms need to more adequately assess an applicant's requirements and objectives to determine whether they should be considered as co-borrowers or if it would be more appropriate for them to be guarantors. Co-borrower / joint and several liability should not be the default position and AFCA should question this.

RECOMMENDATION 10. Provide more guidance on how AFCA will approach review of co-borrower situations, and whether this was the appropriate legal arrangement to reflect the requirements and objectives of each co-borrower.

<u>Other examples of reduced benefit</u>

We recommend also explicitly stating in the body of the Approach that other examples of situations where it might be appropriate to assess the complainant to have received a reduced benefit are included in quick reference guide one. There are examples in that section (for example the second dot point under 'benefit' in the car loan guide on page 50) that address circumstances outside those mentioned in this section of the body of the Draft Approach. Without this guidance we are concerned that AFCA case managers may treat the examples provided in the body as an exhaustive list.

It is particularly important that AFCA does not require that a secured asset be surrendered or sold before the assessment of the benefit from the credit product is reduced. In some cases it may be reasonably certain that a complainant has suffered a capital loss on a secured personal asset, but it is not in their best interests to sell it, so the loss has not crystallised. This is discussed further in response to question 9 below, regarding car loans.

RECOMMENDATION 11. Ensure that the body of the Draft Approach does not cause AFCA decision makers to take a restrictive view on when it may consider a complainant to receive a reduced benefit.

Other comments on sections on loss and benefit

We also strongly support:

- the clarification on page 35 that financial firms may need to repay interest on overpayments. This accurately reflects necessary steps to deliver a fair outcome that accounts for all the impacts of the loan on both parties;
- recognition of the impact substantial hardship can have on an individual at the top of page 39 and confirmation that an improvement in the finances of a complainant after the loan has been made should not impact their right to compensation if the loan was originally unsuitable; and
- explicitly stating at the bottom of page 41 that compensation may be payable for indirect loss where the unsuitable loan has caused the complainant to obtain other short-term, higher cost credit.

Question 9: assessing loss and benefit for different types of loans

Investment property loans

We generally consider the guidance in the body of the Draft Approach for investment property loans to be fair and reasonable. That said, the example on page 35 involves particularly poor conduct by a financial firm, and it may be worth clarifying that this is a situation where awarding non-finanical loss in addition to compensation for the capital loss may be appropriate.

Car loan benefits in guide one

The first dot point under 'benefit' in the table on page 50 leaves it open for AFCA to identify other broad benefits a complainant has received from a car loan in calculating net loss. In some disputes we have seen, AFCA has proposed to calculate the additional benefit a consumer has received from using a car to be the difference between the purchase price and the current retail price of the car.[16] This is a flawed approach because it fails to take into account overpayment or faults with the car that were not apparent when it was purchased. It is also an inherently unfair approach to take toward car loans that is out of step with how benefit is assessed for other credit products. There is no assumption of additional benefit added to use fo the funds from a personal loan or credit card, so it is not clear why this approach is taken to use of a car, and is not sound at law.[17]

We hope that the intent of the Draft Approach is that AFCA will no longer make this kind of assessment on car loans and we recommend clarifying this so that it is clear to all parties.

Car loan loss in guide one

Relatedly and consistent with our comments in response to question 8 above, we welcome the recognition in the second dot point under 'benefit' that the assessment of benefit in cases where the complainant retains the car should sometimes reflect the true value of the car when acquired, rather than simply the price paid or the full amount of the loan. As noted above, this must not be limited to situations where the car has been surrendered or

[16] This was also proposed in a previous draft version of this document in 2019
[17] See for example *Wyzenbeek v Australasian Marine Imports Pty Ltd* [2019] FCAFC 167, [111]-[115]

sold. One example from our casework is where a person buys a lemon car, but they do not wish to sell or surrender it because they have paid for NDIS modifications to suit their circumstances, and this funding cannot be recovered.

In such situations it should be open for AFCA to find that the complainant has received a reduced benefit, particularly if the car dealer has a track record for selling lemon cars, and the financial firm has a business (eg referral or agency) relationship with the dealer.

It would also be useful for AFCA to provide practical guidance in such circumstances about how AFCA will determine whether a car was sold for an inflated value or was faulty. We suggest that where defects in a car appear very soon after they are purchased, it is presumed by AFCA that the car had these problems upon purchase. We would oppose setting a bar requiring detailed expert reports from complainants to prove defects, unless AFCA will help finance and facilitate this. Obtaining expert reports is a barrier; it can often be too costly for a person at risk of financial hardship to obtain these reports, especially if the car is not driveable.

RECOMMENDATION 12. Specify in the Draft Approach that AFCA may find a consumer has received a reduced benefit under a credit contract used to purchase a secured asset if it can be reasonably established that the asset's true value was less than was paid at the time of the contract. Provide guidance for how this can be established in practice.

When clients are sold lemon cars there can also be a number of associated costs such as car repairs, inspection and emergency maintenance. These costs should also be factored into either the gross loss on the loan or indirect loss as a result of getting into the loan in the first place.

Consumer lease loss and benefits in guide one

We support the clarification that in assessing the benefit in a consumer lease case, AFCA will look at the price other retailers were selling the leased goods for at the time of the sale. Under new laws that came into effect on 12 June 2023 via the *Financial Sector Reform Act 2022*, lessors will have to specify the value of the goods as part of the contract. We recommend that if AFCA finds the value placed on the goods by the lessor is higher than the price of the goods set by other retailers, that the lower price is preferred. This would be consistent with the intent of the legislation.

There are also some consumer lessors that sell self-branded products, or have products that they have the exclusive rights to sell in Australia. We recommend that in these circumstances, to assess the true market value of the goods, AFCA considers the price like goods were sold for by other retailers at the time the lease was entered into.

RECOMMENDATION 13. Clarify that in assessing consumer leases entered into after 12 June 2023, AFCA will ensure that the stated price of a leased good in the contract was reflective of its fair market value at that time.

Question 10: capital loss on investment property loans

We have had the benefit of seeing the Law Council of Australia's submission on this point and urge AFCA to consider the points made in that submission on this point around causation. At a minimum, AFCA's statement that in general, capital loss will not be deducted when assessing a complainant's benefit from an investment property loan should be rebuttable and flexible.

Question 11: how outstanding debts are repaid

We welcome AFCA's proposal to ensure case managers have the flexibility to ensure that decisions on outcomes involving secured outstanding debts are fair by having regard to the circumstances of the complainant, and with a preference to allow them to retain important assets, where possible. For every case before AFCA, the impact of the dispute will be far more significant on the complainant than the financial firm. This is why it is so important to

think about the practical impact of any determination on the complainant to deliver true fairness. Applying the Draft Approach's guidance on this would deliver a dramatic improvement in the value that outcomes from AFCA will provide complainants, particularly those in financial hardship.

It is extremely important for AFCA to have regard to the adverse practical implications a determination may have on a complainant, and being forced to sell their home or a car that is an essential means of transport should not be expected just because the credit product in question is secured over it. However, we are concerned that the Draft Approach will not impact some matters because it suggests consideration of these factors is optional. Where the Draft Approach talks about finding a resolution that allows a complainant keeping an asset secured by an unsuitable loan, it routinely says AFCA only 'may' do so. The language around this should be strengthened. It should be a starting point, or a rebuttable presumption, that AFCA will try to reach a fair resolution that enables people to retain a secured asset, if it is the complaint's desired outcome.

This could also be made clearer by including some more examples using this approach that reflect the bulk of irresponsible lending complaints, such as matters involving first home buyers.

The example on page 37 clearly demonstrates the value of allowing complainants to retain an asset, but it may be read to be confined to its facts and circumstances where the complainant has sold a previous home to buy another with the unsuitable loan.

We strongly endorse the reference in this example and the one on page 47 to the practice of tying the interest rate in future to the Reserve Bank's cash rate. This ensures fairness for the remainder of the life of the loan. However, it is again an example that risks being considered not relevant to the bulk of unsuitable home loan cases by AFCA decision makers because the complainant was close to retirement age.

RECOMMENDATION 14. Amend the Draft Approach to clarify that in cases where a complainant wishes to retain their home or car secured by an unsuitable loan, AFCA **will** seek to reach a fair outcome that enables this.

Unsecured loans

The guidance that for unsecured debts, payment plans for outstanding debts should be reasonable and not impose interest is also valuable. This also reflects a fair approach to resolving a dispute that has arisen because the financial firm failed to meet its legal obligations.

However, we urge AFCA to provide further guidance on how it would expect a reasonable repayment arrangement to be negotiated between the parties in these circumstances. Specifically, it would be useful if AFCA clarified:

- whether the AFCA case manager will make both parties aware of what they would likely recommend or impose as a reasonable repayment arrangement before they negotiate?
- If the complainant refuses the financial firm's terms, would it automatically lead to AFCA making a direction about the repayment terms, or would there be an opportunity for further submissions?
- Can complainants seek an Ombudsman's review on a case manager's decision on a repayment arrangement without reopening the broader dispute?

RECOMMENDATION 15. Provide more guidance on how AFCA would ensure that a repayment arrangement for the outstanding debt on an unsecured loan was reasonable, and the process to achieve this.

Resolving loans where requirements and objectives are not met

We also support the guidance on page 39-40 about how AFCA will resolve disputes where the credit contract did not meet the requirements and objectives of the complaint, and that an appropriate resolution will involve reference to a more appropriate product. However, it does appear to be silent on situations where the resolution is more complex, such as loans taken out in circumstances of complex family or domestic violence. We appreciate

these may be situations that will vary greatly based on the facts, but it would be helpful if AFCA could provide some guidance on the principles AFCA will apply in these situations.

Reducing compensation due to complainant conduct

We recommend that AFCA reconsider whether it is necessary to include the section "Reducing compensation due to complainant conduct" on pages 40-41. This section is about an AFCA case manager finding that a complainant engaged in fraud. Fraud is a criminal offence, and one that courts only tend to find in a civil jurisdiction where the evidence is strong and convincing that there has been an intention to deceive.[18] Generally speaking where there is no clear evidence of an intention to deceive, a finding of fraud should be rejected. If an AFCA case manager was going to reduce a compensation award in accordance with this part, we would expect the case manager to explicitly state in its recommendation the basis upon which it found that the complainant both:

- "knowingly provided false information" and
- possessed an "intention to deceive the financial firm".

It is not enough that a case manager finds the complainant unreliable or untrustworthy. We expect it is very rare for AFCA to make a finding that a complainant had acted fraudulently without falsified documents, which we assume are also seen in an extremely low number of AFCA matters. While the Draft Approach does mention the need to find an intent on the part of the complainant to deceive, covering the issue twice (it is also covered on page 22) gives the impression it is a more common issue. We are concerned that AFCA case managers will not appreciate the seriousness of making such a finding. AFCA should reconsider whether this part is necessary, or if it is retained, the high evidentiary bar to making a finding should be better clarified. We would also expect that a finding of fraud without a sufficient basis could be appealed to an Ombudsman.

RECOMMENDATION 16. Make it clearer in the Draft Approach that it will be extremely rare for AFCA to find a complainant has committed fraud, and such a finding would require clear and unambiguous evidence.

If this section is retained, it is essential that the commentary regarding the role that brokers may play in providing incorrect information to a lender is also retained. In our experience, there can be a tendency for brokers to encourage borrowers to overestimate their income and downplay expenses. The section should also be strengthened to clarify that incorrect estimates of income and expenses provided by a broker are not sufficient to justify a finding of fraud on the part of the complainant, even if they have signed an acknowledgement that they believe these figures to be correct.

RECOMMENDATION 17. Clarify that incorrect estimates of income and expenses provided by a complainant alone does not justify a finding that a complainant has acted fraudulently, even if the figures are provided via a broker and include an acknowledgement that the complainant believes the figures to be accurate.

Other questions

Question 12: tool for financial firms to provide information

The tool developed for financial firms to provide details of their unsuitability assessment appears to be useful and clear. We particularly support the prompt for financial firms to explain the process they have followed for any calculations. It should help parties understand the relevant amounts in dispute upfront – such as the fees that may be waived or refunded. However, it must not replace the requirement to provide the actual assessment made at the time of the loan.

[18] *Briginshaw v Briginshaw* (1938) 60 CLR 336

We would also like to see AFCA explore whether it might be useful to develop a similar tool for complainants, considering the process will almost always be novel for complainants and they may have real difficulty obtaining or setting out the relevant information.

RECOMMENDATION 18. Explore whether AFCA could make it easier for complainants to respond to document requests by creating a tool or template for them to provide information.

Question 13: quick reference guides

The quick reference guides are useful additions and we support their inclusion. However, as per our overarching comments, the Draft Approach is very long and we consider it unlikely that complainants will engage with it. We recommend that a version of guide 3 that is more consumer friendly is developed and provided to complainants after they lodge a complaint. This version should include tips on how to obtain these documents as well. Aspects of guide 1 are also repetitive – we would prefer to see more examples in place of repetition.

Question 14: other comments

Referencing in determinations

We recommend that AFCA provide explicit references in its written determinations to the specific sections of legislation, or Regulatory Guidelines, or other sources they have relied on. We understand that AFCA do not do so to ensure that determinations are accessible and readable to complainants. While plain English and readability is an important aim we do not believe that these aims are necessarily undermined by the inclusion of references. Transparency and accessibility to justice via alternative dispute resolution should also be important objectives and the inclusion of references can assist future complainants and their representatives to better understand the reasoning behind decisions made. If done so in a thoughtful, unobtrusive manner, referencing can be included without undermining readability.

RECOMMENDATION 19. Commit to providing references in determinations where key points of law are relied upon in a determination.

Sham business lending

Sham business loans are an ongoing issue in our casework that can cause significant harm to individuals. These are credit contracts where a lender has claimed that the NCCP Act does not apply to it as it is for a business purpose, but the credit was actually for a domestic, personal or household purpose.

We assume that AFCA finds that a financial firm was, or should have been, aware that a credit contract should have been subject to the NCCP Act, it will treat it as such, and this Approach will be relevant to assessing the complaint and determining the remedy, rather than AFCA's appropriate lending to small business approach. This should be clarified in one of these approach documents.

RECOMMENDATION 20. Clarify that if a credit contract should have been subject to the protections in the NCCP Act, AFCA will apply the process set out in its responsible lending approach document to resolving the dispute, even if the financial firm did not treat it as such when it entered the contract.

Unjust transactions

We appreciate the recognition at page 10 that responsible lending complaints may also breach the unjust transaction provisions. However, in our experience when making responsible lending and unjust transaction complaints to AFCA, the unjust transaction arguments are disregarded or not addressed. AFCA should:

- clarify in the Draft Approach that unjustness may form a separate claim to irresponsible lending; and

- consider developing an approach document for unjust transaction claims in the future, including information about the possible application of the *Contracts Review Act 1980* (NSW) or *Australian Securities and Investments Commission Act 2001*, and their potential application to loans.

RECOMMENDATION 21. Provide more guidance about how AFCA will address unjust transactions.

Joinder

AFCA should consider clarifying its approach toward joining a broker/credit provider in matters where information provided by a broker is relevant to the decision in dispute. We strongly encourage AFCA to commit to a more proactive approach in this space, and work towards making it common practice for AFCA to offer to join a broker/credit provider when it is aware of possible claims that the complainant may have against these parties, rather than only doing so if requested by the complainant.

It is specifically recognised in AFCA's Operational Guidelines that irresponsible lending matters involving a broker may be a situation where joinder is appropriate.[19] This acknowledgement would be far more valuable if AFCA proactively offered joinder to self represented complainants who may not be aware of this option.

RECOMMENDATION 22. AFCA should proactively offer to join member brokers or credit providers to a irresponsible lending complaint where it identifies that a self-represented complainant may have a claim against the member.

Quick reference guide two

We support clarification at the bottom of page 58 that AFCA may seek information from a financial firm about whether it had identified that the complainant spends money on gambling, and if not, why not. Firms should be able to explain their approach toward potential red flags, and Guide two should be expanded to allow for AFCA to take the same steps for other expenses that may indicate a risk of addiction (such as alcohol and tobacco). This would be consistent with RG209.205(h).

RECOMMENDATION 23. Amend Quick reference guide two to clarify that AFCA may seek information from financial firms about whether it was aware that a complainant spends money on any product associated with addiction, in the same way that the guide addresses gambling.

References in the Draft Approach

There are a number of other pieces of legislation that should appear in the list of definitions on page 42 – including the National Credit Code, the ASIC Act and the Australian Consumer Law. It may also be useful to add links to other relevant AFCA approaches here, and to relevant industry codes or related documents.

Further information

Please contact Policy Officer Tom Abourizk at Consumer Action Law Centre on 03 9670 5088 or at tom.a@consumeraction.org.au if you have any questions about this submission.

Yours Sincerely,

CONSUMER ACTION LAW CENTRE

FINANCIAL RIGHTS LEGAL CENTRE

CONSUMER CREDIT LEGAL SERVICE

FINANCIAL COUNSELLING AUSTRALIA

[19] AFCA, Operational Guidelines to the Rule, page 29

APPENDIX A - SUMMARY OF RECOMMENDATIONS

RECOMMENDATION 1. Develop a shorter, plain English summary document of AFCA's approach to responsible lending disputes, intended to provide self-represented complainants with the key information to help them to meaningfully engage with the dispute process and advocate for themselves. This document, or accessible versions of it, should also be accessible to people with disabilities and people from culturally and linguistically diverse backgrounds.

RECOMMENDATION 2. State in the Draft Approach that where a complainant is experiencing vulnerability, AFCA will consider relevant industry guidance when assessing a responsible lending complaint.

RECOMMENDATION 3. Clarify the guidance in the Draft Approach on SACCs to reflect the changes made to the NCCP Act by the *Financial Sector Reform Act* 2022, relating to SACCs and consumer leases.

RECOMMENDATION 4. Amend the first sentence of part 3.2 of the Draft Approach to clarify that financial firms will almost always require some information about the matters in the unsuitability assessment diagram.

RECOMMENDATION 5. Clarify in the Draft Approach that AFCA would expect financial firms to perform unsuitability assessments based upon verified income and expense figures.

RECOMMENDATION 6. Clarify in the Draft Approach that AFCA will first obtain relevant documents from the financial firm, and will only require complainants to provide further documents and information if necessary to assess the complaint.

RECOMMENDATION 7. Provide guidance and assistance to self-represented complainants to assist them in complying with AFCA document or information requests, and make them aware of the option to seek an extension for deadlines.

RECOMMENDATION 8. Clarify in the Draft Approach that if a financial firm has concluded that a complainant would cut back their spending to afford a credit product, the financial firm will be expected to provide evidence it discussed this with the complainant.

RECOMMENDATION 9. Provide more guidance on how AFCA will make findings where a complainant has not received the full (or any) benefit from a credit product, and provide firms more guidance on what is a reasonable inquiry to check if a customer may be experiencing family violence or financial elder abuse.

RECOMMENDATION 10. Provide more guidance on how AFCA will approach review of co-borrower situations, and whether this was the appropriate legal arrangement to reflect the requirements and objectives of each co-borrower.

RECOMMENDATION 11. Ensure that the body of the Draft Approach does not cause AFCA decision makers to take a restrictive view on when it may consider a complainant to receive a reduced benefit.

RECOMMENDATION 12. Specify in the Draft Approach that AFCA may find a consumer has received a reduced benefit under a credit contract used to purchase a secured asset if it can be reasonably established that the asset's true value was less than was paid at the time of the contract. Provide guidance for how this can be established in practice.

RECOMMENDATION 13. Clarify that in assessing consumer leases entered into after 12 June 2023, AFCA will ensure that the stated price of a leased good in the contract was reflective of its fair market value at that time.

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RECOMMENDATION 18. Explore whether AFCA could make it easier for complainants to respond to document requests by creating a tool or template for them to provide information.

RECOMMENDATION 19. Commit to providing references in determinations where key points of law are relied upon in a determination.

RECOMMENDATION 20. Clarify that if a credit contract should have been subject to the protections in the NCCP Act, AFCA will apply the process set out in its responsible lending approach document to resolving the dispute, even if the financial firm did not treat it as such when it entered the contract.

RECOMMENDATION 21. Provide more guidance about how AFCA will address unjust transactions.

RECOMMENDATION 22. AFCA should proactively offer to join member brokers or credit providers to a irresponsible lending complaint where it identifies that a self-represented complainant may have a claim against the member.

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