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Lead Ombudsman – Banking and Finance
Australian Financial Complaints Authority
GPO Box 3
Melbourne VIC 3001

via email: consultation@afca.org.au

Re: AFCA Approach to Responsible Lending

We thank you for the opportunity to provide a written submission to this very important consultation piece. At the outset, we recognise that it is a particularly difficult area to provide rules and guidelines that can be consistently applied to provide fair outcomes for all parties.

Feedback from our members indicates that AFCA is not applying rules around responsible lending in a manner that is fair for all parties and that complainant bias remains an intractable obstacle.

While recent changes to the Rules hinted at the possibility that AFCA would have more power to shut down frivolous or vexatious complaints, those powers are exercised infrequently. It remains too easy for complainants to make unsubstantiated allegations of responsible lending breaches. Once made, financial firms are effectively required to provide a detailed defence to the complaint before any merit is even identified. Financial firms are still charged when baseless complaints are lodged, including where complaints are lodged against the wrong entity. Matters are still hurried through to conciliation under a conflicted fee structure whereby financial firms are charged significantly higher fees for matters that are progressed beyond registration.

It is encouraging that some of the published AFCA decisions indicate sensible application of reasoning by decision makers although the propensity to award amounts for non-financial loss remains too high. It should also be remembered that for every published decision that has found in favour of the financial firm, the firm has still incurred AFCA costs of many thousands of dollars alongside the costs of internal resources required to prepare responses to AFCA claims.

Members are generally of the view that AFCA remains an extremely unfair process where the financial firm loses even where they win. Such outcomes continue to put pressure on financial firms to compromise and make large concessions to baseless consumer complaints to avoid them being penalised by the AFCA process. AFCA members cannot fairly defend themselves from complaints that are trivial, unmeritorious or even fraudulent.

There are some high-level principles which run through AFCA's proposed approach to responsible lending that raise concerns.

AFCA's proposed approach is closely aligned with RG209. With the exception of a small number of Regulatory Guides that now carry enforceable provisions (and RG209 not being one of those), ASIC guidance is not law. Nor does it always demonstrate a correct application of the laws being administered.

The federal court decision of *Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial*) [2019] FCA 1244 ("the Westpac case") was the first Australian case to fully consider the responsible lending laws in a properly contested hearing.

The Westpac case dismissed ASIC guidance as wrong on most levels. ASIC has included a small number of selected extracts from the Westpac case but has not made any material changes to RG209. We believe it sits at odds with current judicial precedent.

The significance of the Westpac decision is not only that RG209 is wrong now, but that ASIC's approach to responsible lending enforcement, and as a corollary AFCA's approach to determining responsible lending complaints where it adopted an approach influenced by RG209 has always been wrong and is a misapplication of responsible lending laws.

In its administration of responsible lending laws over the years, ASIC has enforced its guidance rather than the law. We believe the AFCA's approach to determining responsible lending complaints should more closely apply the standards recognised by the Westpac case. RG 209 has no place in determining responsible lending disputes.

1. Do you consider our approach to assessing the reasonableness of inquiries and verification steps aligns with the guidance in ASIC RG 209?

We are concerned that AFCA continues to place too much weight on RG209

It is surprising that the consultation paper makes no reference at all to the significance of the federal court decisions which are the only federal court matters where responsible lending was considered in a properly contested trial where the lender had attempted to act in compliance with a rational and reasonable application of the responsible lending obligations. The two prior decisions of Channic and the Cash Store still quoted by ASIC in its regulatory guidance have been distinguished and have little merit. The Cash Store was an *ex parte* matter uncontested by an insolvent defendant and Channic was an outcome where the defendants had contravened basic obligations in the course of exploiting indigenous borrowers – a situation that every credible lender would recognise as indefensible. The first time a well-resourced entity sought judicial review of the responsible lending laws, the courts dismantled ASIC's conduct and its regulatory guidance.

AFCA's approach needs to align with position espoused by the federal court. Significant conclusions of the federal court include such matters as:

- The obligation to take reasonable steps to verify information do not require some forensic exercise resulting in perfection. "It would be surprising if s129(b) required every element of declared income or capital to be used in the process of assessing whether a loan was unsuitable".[1]
- A lender is not required to use the information provided by a consumer in their application for credit. As Justice Perram says in the primary judgement "Whilst I accept that the Act

[1] Perram J, para 64 - *Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial*) [2019] FCA 1244

requires a credit provider to ask the consumer about their financial situation (s130(1)(b))…..I do not accept that this has the further consequence that the credit provider must use the consumer's declared living expense in doing so".[2]

- It is reasonable to expect that a consumer will make changes to their spending after taking on new obligations – it is not a breach of responsible lending to extend credit to a person who fails to service a credit contract because of their own poor conduct.

We have always expressed concern with ASIC regulatory guidance being applied as though it is law. It is clearly no longer appropriate in the wake of the Westpac decisions. Unlike ASIC, which is a consumer protection agency and consumer advocate, AFCA must remain an impartial dispute resolution scheme for all parties. To adopt ASIC Regulatory Guidance is to advocate for the consumer.

This submission recognises that some provisions of some ASIC Regulatory Guidance are now enforceable provisions. We accept the language used around observing enforceable provisions of ASIC regulatory guidance may be different to that used around other ASIC guidance which has no legal effect. RG 209 does not contain enforceable provisions.

2. Do you have any other comments about our proposed approach to assessing the reasonableness of inquiries and verification steps?

The approach appears to be focussed on determining the truth of the consumer's situation and the adequacy of the inquiries made by the credit provider to verify the information. We submit that the objective of the approach should be to determine if the consumer appeared to be capable of servicing the credit provided to them.

Even where a review of the credit provider's assessment turns out to be incorrect, it does not follow that it has breached its responsible lending obligations or that it has put a complainant into an unsuitable loan.

Verification of Income

The AFCA Approach document at page 14 says:

AFCA may use information it obtains through further inquiries and verification steps to revise a financial firm's unsuitability assessment. AFCA will only revise a financial firm's unsuitability assessment if the financial firm:

• *used information in its unsuitability assessment that was incorrect or untrue*; **and**

• *could have obtained the correct information through reasonable inquiries and verification steps at the time it conducted its original unsuitability assessment, and*

• *would have been permitted to use the information in its unsuitability assessment at the time because:*

[2] Ibid para 4

> it is information about the complainant's financial situation or requirements and objectives, and

> the financial firm would have had reason to believe it was true if it had made reasonable inquiries or taken reasonable verification steps.

We will consider whether there were gaps or inconsistencies in the information available to a financial firm (often referred to as 'red flags') which should reasonably have caused it to make further inquiries or seek verification before making its unsuitability assessment.

The above list of matters where AFCA says it will revise a financial firm's unsuitability assessment should be cumulative. WE disagree the trigger for reviewing an assessment of unsuitability should be the accuracy or the truth of the information.

The AFCA document says it will "*revise a financial firms' unsuitability assessment where the information in its unsuitability assessment was incorrect or untrue".*

Considerable time and effort often goes into examining the information used by a financial firm in its assessment of unsuitability. It is not a breach of responsible lending to have mistakes in an assessment of unsuitability. The law does not demand that an assessment be perfect.

Complainants commonly assert that they did not want the finance or the amount of finance or the finance on the terms it was provided. Their conduct at the time of entering into the credit contract is usually inconsistent with such claims. Allegations of irresponsible lending are easy to make and are often supported by poor repayment history on the contract which prima facie appears to be evidence of the credit provider's breach. Once such a complaint is made, the financial firm is required to disprove it. Credit providers get drawn into arguments about whether the complainant chose not to meet repayments or was genuinely placed into a position of substantial hardship through the conduct of the credit provider. Some consumers will stop servicing a loan where they become disaffected, where they form a view they have paid enough or they become unhappy with the terms of their contract. Not making payments and not being able to make payments look very similar at the outset of a responsible lending complaint. This can result in responsible lending complaints becoming complex.

The Westpac case made it emphatically clear that a financial firm does not have to rely on any information provided to it by a consumer. Perram J at paragraph 80 states "one cannot say that s 129 requires that the declared living expenses be taken into account in performing an assessment of unsuitability". He goes on to say at para 82 "A credit provider may do what it wants in the assessment process, so far as I can see; what it cannot do is make unsuitable loans".

AFCA's approach appears to be at least partially directed at determining whether the information given to a credit provider when assessing a loan application was true. If not, the transaction may be reassessed.

The Westpac case says it may not matter whether the information given to the credit provider was true – because they are not required to rely on it. What is important is whether the credit provider reached a conclusion to offer a loan that was not unsuitable.

If the applicant provided information to a credit provider that was untrue, and the credit provider relied on that information, then the applicant has engaged in misleading and deceptive conduct and s154 of the National Credit Code applies. S154 of the Code says that a person must not make a false or misleading representation in relation to a matter that is material to entry into a credit contract.

It has never been a legal requirement under the NCCP Act that a credit provider verify the truth of all information given to it. The obligation has only ever been to take reasonable steps to *verify the financial situation* of the consumer (ss130(c)). ASIC through RG209 re-interpreted this requirement to turn it into a positive exercise to verify every piece of information and then went one step further to assert that any error, any inaccuracy in the information constituted a breach of the requirement to verify the information which in turn constituted a breach of responsible lending.

It does appear that AFCA has adopted this approach to responsible lending disputes and makes findings in favour of the consumer without necessarily making the connection between any information that was incorrect or untrue and any consumer any loss.

The Westpac case has comprehensively quashed any notion that accuracy of information is a requirement of responsible lending. What a credit provider must do is:

a) make reasonable inquiries into a consumer's requirements and objectives and financial situation; and

b) take reasonable steps to verify the consumer's **financial position**.

Given that the credit provider is not required to place reliance on the information supplied by the consumer, the correct approach to reviewing a responsible lending argument by AFCA should be to first look at the decision made by the credit provider.

Whether information provided to them was incorrect or untrue is not relevant at that point in time. We submit that a more appropriate approach would be to answer the following questions in order:

1. Did the credit provider's assessment appear reasonable on the information that it used (whether consumer derived or externally derived)?

   If the answer to this question is yes, then the finding should be in favour of the credit provider. Whether the information provided by the consumer was incorrect or untrue is not material to the decision – or should go against the consumer.

2. If the assessment was not reasonable, did the credit provider place any reliance on the information provided by the consumer?

   If yes, the consumer's complaint should not succeed. They mislead the credit provider into offering the loan.

3. Only beyond this point should there be any consideration about whether the credit provider should have made further inquiries.

It seems to us that AFCA begins at the wrong end of the decision chain. AFCA is not deciding whether the credit provider used correct information but whether it reached a reasonable conclusion that the decision to offer credit was not unsuitable. The definition of "not unsuitable" is not whether the information was correct or verified but rather, whether a person in the situation of the consumer should have been able to meet their financial commitments under the loan without substantial hardship. This includes a consideration of whether that person could be expected to make reasonable changes to their consumption to accommodate the loan (or in the words of Justice Perram, "trim the sails").

We are concerned that responsible lending obligations remain misunderstood. They are not about perfecting the information or uncovering every mistruth passed through by an applicant. Applicants often overstate income and understate expenses but these matters are capable of being verified. Income can be verified from bank statements. Reasonable expenses can be verified from bank statements and credit checks. Applicants do not forget matters such as the number of dependent children they have, or their primary sources of income or whether they are cohabiting. Verifying the truth of these matters is only relevant to whether an applicant has provided misleading information to the credit provider. It is our submission that Westpac case definitively puts the law on the side of credit providers to be protected from frivolous claims about breaching some higher standard that is a fabrication of over-regulation.

We contend that AFCA should modify its guidance in Chapter 3 of the position paper.

Changes the financial firm could reasonably have foreseen

See section 3.3, page 19: Changes the financial firm could reasonably have foreseen

3. Does our approach to considering a financial firm's assessment of reasonably foreseeable changes in a complainant's circumstances align with the guidance in ASIC RG 209?

The way in which this question is framed underscores our concern that AFCA's approach to determining responsible lending complaints is too closely aligned with RG 209.

The NCCP Act does not say that consumer must be 'likely' to comply with their financial obligations. S131(2) says a contract will be unsuitable if it is likely a consumer will be unable to comply.

We think it is important that AFCA adopt the correct terminology. A contract is unsuitable if it is likely the consumer cannot comply. The language of the legislation is deliberate. There is a different evidential threshold between "likely to comply" and "likely to be unable to comply" in the same way as the term "not unsuitable" does not mean "suitable".

Page 20 of the Paper says that AFCA may take into account whether a financial firm complied with its internal policies. In most situations we cannot see that this would be material for determining whether a complainant entered into a credit contract in circumstances where it was not unsuitable.

Whether a firm complied with an internal policy or not does not give rise to a consumer right for compensation.

AFCA is tasked with determining whether a financial firm complied with its responsible lending obligations in respect of the particular complainant. The question is whether the financial firm entered into an unsuitable loan with a consumer. Neither the evidence this is based upon nor the conclusion that AFCA must reach are based on whether a financial firm complied with internal policies. It is not a defence to a responsible lending complaint that a lender complied with its internal policies. Why then can it be a basis upon which AFCA might find in favour of a complainant?

Internal policies serve different purposes for different businesses. A financial firm may have policy settings that significantly exceed the responsible lending obligations. A financial firm may adopt a flexible interpretation of its policy parameters. No conclusion about compliance with legal obligations can be drawn from considering whether a firm followed internal policy. Even if a firm's policy directs them to act in a manner that is inconsistent with the law, it is the still the contravention of the law that gives rise to a claim and it is still the breach of the law that AFCA is ruling on.

A complainant asserting breach of responsible lending is not asserting a financial firm's breach of internal policy. They are seeking compensation for the consequence of having entering into an unsuitable loan.

Identifying an unsuitable loan is an objective decision based on empirical evidence. An unsuitable loan is one that does not meet the needs or objectives of the consumer or one where the consumer will be unlikely to be able to comply with their financial obligations under the contract without suffering significant hardship.

AFCA should revise this position to reflect the law.

Non-subscribers to a code

At the bottom of page 21 of the paper, AFCA states it may consider whether specific provisions of a code reflect good industry practice more broadly within a particular industry sector or sub-sector, beyond subscribers to the code.

There is no proper basis on which AFCA could assess the conduct of firms that are not subscribers to a particular code against that code. Codes usually adopt a higher standard than is required by the law.

We are concerned that AFCA is adopting an approach aimed at maximising avenues of compensatory redress rather than adjudicating whether a complainant has suffered loss because of a financial firm breaching its legal obligations. We maintain that it is not appropriate for an impartial dispute resolution scheme to assess code subscribers' conduct against the code. It is repugnant to suggest non-subscribers to a code could be subjected to adverse findings based on a determination that they failed to follow a code they were not bound by.

We do not support AFCA's position with respect to how it proposes to consider the impact of codes in consumer disputes.

4. Do you think it is it reasonable for AFCA to consider that where a borrower will likely reach retirement age during the loan term, the lender should, as part of its reasonable inquiries and verification steps assess how the borrower will repay the loan in retirement, and if it appears likely

the borrower will need to sell assets to repay the loan, make inquiries about whether the sale of those assets at that time meets the complainant's requirements and objectives?

This position is fraught with difficulties.

It is a difficult position to enforce through EDR where there is no clear legislated basis for it.

What is retirement age? The retirement window could be greater than 40 years with some people retiring in their fifties while others retiring decades later. Offering a loan to a person who may reach retirement age during the loan term is not a breach of responsible lending obligations per se.

It would be a poor outcome if a credit provider could be found to have breached responsible lending for not having a file note regarding an exit strategy for every borrower. Not having a file note could be characterised as a conduct breach or a record keeping breach depending on whether the lender spoke to the borrower about their exit strategy and then forgot to create a file note or misplaced it or never had the conversation at all. If the lender has a file note, how detailed must the note be?

This has the potential of leading to impractical behaviour whereby a 30 year old seeking a loan to buy a house in Sydney is required to provide the lender with a strategy on how they intend to repay the loan if they have not discharged the mortgage in 35 years' time. Is it a lender's legal obligation to ensure the borrower has a strategy? How far does this go? Must they demand life insurance to cover the debt, must it contemplate scenarios such as relationship breakdown (statistically greater than 50% chance), job loss, illness. Does a lender have to determine if any proposed strategy is realistic?

It is not currently a legal requirement that lenders must have a documented exit strategy for borrowers who may reach retirement age during the loan term. Embodying it in AFCA's rules will effectively make it a new legal obligation because it will be the standard lenders are measured against.

Any borrower taking out a loan and who knows they may cease work or retire before the end of their loan term must take responsibility for that. It cannot become a lender's liability if they fail to ask the question or fail to a make a file note that cannot be later recalled.

Borrowers need to be accountable for their decisions. They are adults and should be treated as adults. The risk of adopting this proposed approach is that an older borrower may obtain finance with the intention of taking risk for financial gain but where their investment goes against them they can turn to the lender seeking compensation merely by claiming the lender failed to consider their exit strategy. A lender finds themselves in EDR arguing over the existence or adequacy of a complainant's exit strategy rather than whether they lent money to a person who had capacity to repay at the time of seeking the loan. Such an approach without adequate qualification gives licence to older borrowers to offset risk against lender responsible lending obligations as interpreted by AFCA.

The example provided in AFCA's consultation paper at page 47 highlights this risk. In that example it appears a borrower close to retirement age sought a loan to acquire an adjoining property and build on it. This was likely intended to be a money-making venture. The borrower's plan did not come to fruition and faced with difficulty repaying the loan the complainant is able to exploit the consumer redress scheme by initiating a complaint through AFCA. The complainant will not have to adduce any evidence or prove a case. All they need to do is say the lender failed to inquire about the exit strategy. Or failing that, argue that they did not understand the ramifications of the discussion. If the lender cannot locate the file note, that simple failure will equate to a finding by AFCA that the lender has breached responsible lending by virtue of an internal AFCA rule. Such an outcome shifts all risk and accountability from the borrower to the lender.

If the difference between the outcome in this example being in favour of the lender rather than the consumer was simply whether the lender had a file note where the borrower claimed they intended to develop property B then sell Property A, this leaves the EDR scheme open to abuse.

5. Do you have any comments about our proposed approach to considering the reasonableness of applying interest rate buffers to loans?

At first instance AFCA needs to determine if what the financial firm has done is reasonable. Applying an interest rate buffer to a financial firm's assessment where that financial firm has not applied the same buffer will result in a different outcome. If AFCA determines fault or liability based on whether it reaches a different conclusion to the financial firm then it is merely setting up the financial firm for failure by applying a different buffer.

AFCA should apply the interest rate buffers used by the financial firm. In some industries, interest rate buffers are mandated by law such as the buffers mandated by APRA for ADIs. While we do not necessarily agree with these, they prescribe a course of conduct that is consistent across that cohort.

We do not consider it appropriate to apply interest rate buffers in other situations such as where the rates are fixed for the life of the loan.

For the most part, AFCA should be determining whether the approach adopted by the financial firm met the legal requirements. If it did, then there is no requirement for AFCA to apply any buffers.

Determining if a loan was unsuitable

See section 3.4: AFCA determines whether the loan was unsuitable

6. Do you have any comments about how we propose to seek and consider further information when we find a financial firm has made an error in its assessment?

There are many references in this section of the paper that in our view contradict the correct position as espoused by Perram J in the Westpac case.

As a starting position, AFCA must ensure the steps it takes to determine what "reasonable inquiries and verification steps" should have been made by a financial firm are aligned with the Westpac judgment and not RG209.   We think the AFCA paper should explicitly acknowledge that this is the approach that will be taken.

As stated earlier in the paper, the objective of responsible lending is to determine that a consumer ends up in a loan that is not unsuitable. Care needs to be taken not to confuse the requirement to take reasonable steps to verify the consumer's financial situation with some broader requirement to verify the truth of everything. Even the statutory requirement to verify the consumer's financial situation does not require the credit provider to verify the truth of what they have been given by the consumer.

The questions that must be asked are whether the credit provider offered a loan that was affordable and consistent with the consumer's requirements and objectives. AFCA should only consider extraneous information where that information should have been known at the time the credit provider made the offer, where the credit provider would have been obligated to take the information into account and whether the complainant made attempts to obscure the information or withhold it.

7. Do you have any comments about how we propose to use further information to determine whether the loan was unsuitable for the borrower?

We recognise that AFCA may need to seek further information in certain circumstances. We believe it must first answer the question whether the loan was unsuitable.

AFCA puts financial firms to an enormous amount to work collating records and information. Much of this is to plug gaps left by the dearth of information provided by many complainants.

Additional information requests should be focussed on answering questions relevant to determining whether the financial firm made a lending decision consistent with their responsible lending obligations. If the preliminary view is that they did, then seeking further information is not necessary.

For example, AFCA identifies that it may seek further information where it identifies a calculation error in an assessment. There is no legal requirement that an assessment be mathematically accurate. AFCA would need to form a view that the error has the potential to be so material that it would alter the outcome.

We are aware of what appears to be a recent focus on the financing of fees. There appears to be an increase in complaints that assert that the consumer only wanted finance for certain aspects of a transaction – for example the principal of a loan but not the fees. In many cases a financial firm's assessment of unsuitability focuses on the transaction and any specific requests of the consumer – but it does not separately identify a specific objective for a consumer to finance fees. Lenders often have no direct contact with borrowers before making an offer of finance. The borrower's needs and objectives are stated in their application. The lender reconfirms the borrower's requirements and objectives when making the offer of finance at which time the borrower has the opportunity to raise any further issues.

Fees are part of the offer of finance and the consumer's objective in most instances is to obtain finance to obtain the specific asset. Obtaining finance to cover all of the associated costs of acquiring the asset is entrenched in the request. Full disclosure of the fees and total amount financed is made in the financial table of the consumer contract as is required by the National Credit Code. This disclosure is made before the contract is signed.

Attempting to attack a loan on the basis that fees were financed in the loan is a sharp tactic intended to apply pressure to a lender to offer compensation to a consumer where they have done no wrong. We bring this to AFCA's attention and suggest AFCA should quickly close down such arguments to prevent the issue further escalating.

Section 4: How we determine fair outcomes and calculate complainant loss

Section 4 of the Approach explains how we will determine a fair outcome, including how we calculate loss. We have sought to align with legal principles and regulatory guidance, including ASIC Regulatory Guide (RG) 277.

8. Do you have any comments about the way we propose to assess a complainant's loss and benefit?

See section 4.2 Calculating responsible lending remedies, and Guide One.

We note the AFCA guidance makes reference in the example on page 32 to giving consideration to whether the complainant has contributed to the decline in the value of the asset. We encourage this and ask that it continue to be taken into account.

Is it not uncommon that a complainant has not taken reasonable care of an asset resulting in its accelerated devaluation and it remains important for AFCA to take that into consideration.

9. Do you have any comments about how we propose to assess loss and benefit for different types of loans?

See section 4.2, page 34 Assessing benefit from investment property loans and Guide One.

Does AFCA have a definition it uses for the term *substantial hardship*. We recognise that the threshold is lower than original example of substantial hardship which was having to sell the family home. There is a concern however that the threshold could be lowered too much. This is particularly an issue where AFCA can find that a consumer has suffered gross loss from a responsible lending breach even where they met their repayment obligations (page 39 of the CP).

Is AFCA able to elaborate more on what it considers to be substantial hardship?

Car Loans

We think there are errors in the approach relating to car loans.

In the table on p50 of the paper AFCA lists capital loss suffered from the sale of the vehicle under gross loss. Any vehicle purchaser understands when they acquire a vehicle that they are most likely to incur a capital loss. Leaving aside the irregular second-hand car market of the post-covid years where second hand vehicle prices appreciated to above the price of new cars, car owners expect capital loss. We do not believe it is appropriate in all instances for AFCA to include capital loss in the gross loss to the complainant. They would have incurred this loss regardless of whether they purchased the car using finance or without.

In the table under the column headed "Benefit", AFCA makes reference to the fact that it will take into account the true value of the car, noting this may be adjusted if the car was purchased for an **inflated value** or was **faulty.**

For lenders that are not linked credit providers this approach is not appropriate. The guidance needs to make this clear. Issues such as fair market value of the asset or whether it was faulty cannot be considered against financiers that have no legal obligation to consider them.

Asset financiers do not inspect the asset being financed and are not legally liable for their performance. Motor vehicles are covered by State legislation and roadworthy certification processes. There are State and Federal laws that apply to product vendors and suppliers and second hand motor vehicle dealers that have nothing at all to do with provision of finance.

Going further, AFCA should do considerably more to protect financiers that find themselves subject to bogus responsible lending complaints where the complainants' real issue is the performance of the vehicle they purchased. Such matters need to be raised by the State Fair Trading offices.

It should be extremely rare that AFCA needs to consider the value of the car in its deliberations and even rarer still that AFCA would make any adjustment. What a person chooses to pay for car is far more than the market guide. Factors such as lack of supply, rarity, timing of need and the specific proclivities of the purchaser all impact what a purchaser determines is the correct price to pay for a vehicle.

A financier should never be held financially accountable to re-price a vehicle after an individual has made a decision to purchase it for a specific price. The price paid is a matter between a vendor and purchaser. Perhaps if there are specific situations where AFCA believes it should take such action, it can more clearly identify this in the guidance.

The list of considerations provided on pages 50-51 send mixed messages.

- The second bullet point – whether a complainant has any specific vulnerabilities…requiring modifications to the car.
  AFCA should take into account whether the individuals with medical issues incurred any direct costs of vehicle modifications or whether the modifications were funded from the NDIS.

- Bullet points 4 and 5 do not demonstrate fairness for all parties to the dispute.
  AFCA says it will consider the complainant's capacity to secure another vehicle and the practical impact on a consumer of being without a vehicle.

  The remedy is not to keep the complainant in the car. The remedy is to restore the complainant to a financial position that reflects the costs they incurred less the benefit they obtained for the period they had the vehicle. If the financial firm and complainant can reach a mutually workable arrangement for the complainant to keep the car then such an outcome is reasonable. It is not reasonable if the complainant is permitted to retain the car where they cannot pay for it. In those situations, the vehicle should be surrendered – even where it is inconvenient for the complainant.

It is not an unfair outcome for a complainant to be restored to their proper position - even where that proper position isn't where they want to be.

Example – Complainant keeps the car

This is an example of AFCA advocating for the complainant and securing an unbalanced outcome against the financial firm.

The complainant acquired a car for $50,000. Presumably the lender didn't tell them they had to spend $50,000 on a car. They could have chosen a cheaper car.

The complainant would have received an offer of credit detailing the loan, the fees, the repayments and the total they would repay over the life of the loan. At the time of the offer they willingly accepted it. They serviced the loan. They enjoyed the use of the car.

Having made $70,000 of repayments towards the car before complaining, the complaint was not about responsible lending but the total price payable over the life of the contract. The complainant clearly felt they had paid enough. At worst it related to a change in circumstances which had nothing to do with the lending decision. The complainant could have traded the vehicle down for a cheaper car.

AFCA restored the complainant to the original amount funded under the loan by identifying repayments above the original amount funded as "excess" and also requiring a payment for non-financial loss.

In summary, the complainant got to purchase a car they couldn't afford, enjoyed driving it around for some years, became frustrated with some aspect of their own conduct and exploited the AFCA scheme. This is not how EDR should function. This is not demonstrative of a fair or impartial system.

10.Do you have any comments about how we propose to consider capital loss from investment property loans?

See section 4.2 Calculating responsible lending remedies, and Guide One.

We believe that AFCA should factor in the substantial taxation benefits as a benefit a complainant receives under an investment property loan.

The example provided on page 49 of the paper is worrying. This appears to be a case of a property investor making a bad investment decision and then using AFCA to underwrite their investment risk by exploiting a consumer redress scheme. Is it appropriate that an individual that has acquired four investment property loans in the space of six months avail themselves of a consumer redress scheme? A matter such as this should have been litigated in the courts.

11.We propose to determine how a complainant should repay any outstanding debt. This approach may allow a complainant to retain an asset and repay any outstanding debt over time if it is fair in the circumstances of the complaint. Do you have any comments about our flexible approach to

determining fair outcomes when an unsuitable loan is secured by an asset?
See section 4.2, especially page 36 Assessing how secured assets can be dealt with fairly and Guide One

The concept of "fair" comes into play significantly in this area. Much of the time AFCA's interpretation of fair is punitive against the financial firm and confers excessive advantage on the complainant. Housing is perhaps the most complex and requires a special approach.

We recognise that in some situations the best outcome will be to allow a complainant to retain an asset. We perceive that it is still too common that consumers retain the use of the asset for months or sometimes years as a dispute proceeds through AFCA. This benefit is not fairly recognised and often results in the subject asset being significantly devalued.

It is common for a consumer to be content to take the benefit of the subject loan while complaining it should not have been given in the first instance and seeking compensation for having been given it. Members report a growing number of complaints by consumers deciding they have paid "enough" under their loan for a particular asset or deciding they should be offered a better rate and who are using AFCA for leverage by lodging complaints alleging responsible lending breaches. These often morph into hardship complaints if the responsible lending angle does not gain traction. We continue to hear that AFCA appear to coaching complainants to introduce more grounds for consideration.

Consumers have a duty to mitigate their loss and AFCA should be encouraging complainants to take active steps to do so. If a complainant alleges they should not have been given a loan by a lender, they should be encouraged to consider dealing with the financed asset quickly to reduce the consumer's ongoing liability and to preserve value in the asset.

The scheme will continue to attract "strategic claims" aimed at securing repayment relief by consumers where there is no real underlying basis for lodging a complaint. It will help reduce these type of claims if complainants are required to give some indication to AFCA early on about how they intend to deal with the asset. In the case of motor vehicle finance, complainants are able to frustrate and drag out complaints to give them years of continuing use of a motor vehicle they should have surrendered.

Other feedback

12.Do you have any comments about our tool which has been developed to assist financial firms provide detail to us about their unsuitability assessment?
The tool is referenced on page 13 of the Approach, and a copy is attached to this consultation paper, see Appendix 1.

We refer to our earlier comments that a responsible lending assessment is not about achieving mathematical accuracy. It is about determining in all of the circumstances whether the consumer could afford repayments without substantial hardship, including making an allowance for reasonable changes in the consumer's discretionary expenditure and comparing the consumer's situation to what a reasonable person in their same situation may do.

It is important that AFCA not determine that a financial firm has breached responsible lending merely because it made errors in their assessments of unsuitability. Those errors must have been avoidable through making reasonable inquiries, not have been provided by the complainant either recklessly or indifferently and must be material to the decision to enter into the credit contract.

13.Do you have any feedback about the 'Quick reference guides' included in the Approach?

Our feedback is provided elsewhere throughout the submission. The QRGs must be accurate and balanced and we feel at the moment they carry a strong pro-consumer bias.

14.Do you have any other feedback about how the draft Approach meets our objectives?

We believe the draft approach needs to include more information regarding consumer/complainant responsibilities.

The document says very little about the obligations on a complainant to provide information truthfully – both to a lender during the application and to AFCA afterwards.

The information under the heading on page 22 of the Paper is incomplete. AFCA writes:

The parties' conduct may be relevant to the assessment

<u>When reviewing responsible lending complaints, AFCA focuses on the conduct of the financial firm. This is consistent with the National Credit Act</u>, which imposes positive conduct obligations on financial firms in relation to responsible lending.

The conduct of both parties is relevant. Consumers have as much of an obligation to provide truthful information as do lenders. It is imbalanced to suggest that the National Credit Act only focuses on the conduct of the financial firm. S154 of the Code makes all parties responsible. AFCA should explicitly address this assertion if it does not agree.

The subsequent paragraph suggests a complainant's conduct may be relevant where a complainant *knowingly provided* falsified documents to verify inaccurate information in a credit application. This does not go far enough and should not only be limited to situations where a consumer has engaged in fraud. A complainant should be liable where they provide inaccurate information in an application either in writing or verbally, where they are indifferent as to the veracity of information provided, where they fail to take reasonable care to check the information provided by them to the lender or where the lender has informed them of the lender's understanding of the information it is relying on and they do not check it.

As soon as a complaint is made, the financial firm is required to provide all documentation, answers to all questions put by AFCA even where a complainant has not adduced any evidence or responded to AFCA requests to them to provide information. It is too easy for a consumer to lodge a complaint of a few lines (the complaint itself not always truthful) which then kicks off an enormous amount of work on the financial firm. If the consumer fails to respond to further interaction, AFCA will quickly progress matters to conciliation conferences which trigger the next cost category for financial firms.

AFCA's discretion to exclude or close down complaints is welcome but still takes considerable time and resources of financial firms.

It is often the case that even where a financial firm has granted multiple hardship variations to a consumer, that a consumer will lodge a complaint claiming they have never had one – or when complaining about the refusal fail to inform AFCA that they have already had multiple previous variations. AFCA does not appear to require consumers to disclose what changes (if any) they have made to their spending habits to meet their contractual obligations. The Westpac case made it clear that this is a basic and necessary consideration.

Consumers need to be accountable for their conduct. The scheme remains unbalanced and continues to be exploited. Consumers (and their advocates/representatives) bring complaints alleging responsible lending breaches or failures to consider hardship variations in circumstances where their own conduct is the only issue in question. Members are reporting a staggering increase in the number of AFCA complaints relating to hardship decisions and credit inquiries.

In the current economic climate, an increase in hardship requests is not unsurprising of itself but members are incurring thousands of dollars defending AFCA claims where they have provided multiple hardship variations or the consumer is not adhering to the variations or where the financial firm's refusal is valid. Financial firms should not have to face the risk of AFCA intervention every time they do not give a consumer the outcome the consumer wants.

This still needs to get much better.

AFCA staff adding complexity to complaints

Members report that relatively simple complaints are being complicated by AFCA introducing additional considerations. In the Consultation paper AFCA writes:

Where the complaint raises concerns about a possible breach of responsible lending laws, it may also be necessary for AFCA to consider other relevant legal principles. For example, we may consider the implied warranty of due care and skill, unconscionable conduct, misleading or deceptive conduct, whether the contract includes unfair contract terms or was an unjust transaction.

Most of the "legal principles" referenced in this paragraph can be extremely obscure. Leaving aside cases where particular conduct is blatant, we do not consider it appropriate that AFCA should introduce concepts such as misleading and deceptive conduct or unconscionability into a simple consumer complaint framework at its own volition. Doing so makes matters more complex and makes them more difficult to defend. Consequently, it increases the likelihood of AFCA making some finding in favour of a complainant – even where the originating complaint had no proper basis (for example the consumer fails on the responsible lending complaint but AFCA finds an error in the communication and attributes it to misleading and deceptive conduct).

One significant frustration of the AFCA scheme is the propensity by AFCA case officers to introduce new claims and new heads of dispute on complainants' behalf. Many complainants are not alleging that a lender or financial firm breached its obligations to the complainant. At the time of lodging a complaint, many complainants merely want an outcome that is different to the one they have – whether this be for a financial firm to grant further hardship relief, to waive outstanding monies, to permit them to continue to use an asset they cannot afford or they want a valid credit inquiry to be removed from their credit file. What some complainants are doing is lodging a complaint and then using the AFCA process to be guided on how to construct a complaint to then try to fit their circumstances into a scenario where AFCA will entertain the complaint. This feels like a manipulation of the AFCA process.

A financial firm defending a claim of breaching responsible lending should not be having to consider defences against claims of unconscionability or misleading and deceptive conduct or other such issues in the ordinary course of a dispute. This is particularly so with the manner in which AFCA claims are conducted. Financial firms have to essentially prove innocence (or in the context of this point prove they did not engage in misleading and deceptive conduct etc) rather than the complaining party (or AFCA) having to fully make out a case to answer. Historically the bar for making a finding of unconscionability was extremely high. Now the term (and concept) appear to be thrown around very loosely.

Findings that a firm engaged in misleading and deceptive conduct must be based on more than whether a firm made an honest mistake. AFCA must take care that it does not demand perfection of financial firms and label every error, every mistake in a document to be potentially misleading or deceptive. It is also critical that a complainant demonstrate some detrimental reliance on any matter where misleading and deceptive conduct is considered a cause of action. We are concerned to hear of outcomes where pressure is applied to financial firms to offer consumer compensation for mistakes made but where the consumer has been largely oblivious to those mistakes (they are identified by AFCA and not the complainant) and the mistakes have had no material impact on the outcome.

Matters involving misleading and deceptive conduct and unconscionability are heavily evidence dependent and turn on the factual situation of every instance. We consider it very dangerous for AFCA to have an appetite to deliberate on such matters, particularly where there is no procedural fairness, the laws of evidence do not apply and determinations are not appealable. By lowering the bar to make findings against such nuanced heads of action in a consumer redress scheme, the likely outcome is that many incorrect and/or incomplete decisions are made that fall in favour of the complainant and where the financial firm has no rights. Firms have no right to object, no right to require a properly articulated case to respond to or defend, no rules of evidence, no reliance on legal precedent and are subject to the decision maker having unfettered power to apply any frame of reference they choose for reaching a determination. This includes being able to make adverse findings against financial firms where a decision maker considers the financial firm should have acted differently even where it was under no legal obligation to do so. The result is that firms have difficulty defending themselves because the standards against which their conduct will be assessed can change every time.

Ultimately the legal framework that has been created to influence the conduct of financial firm should be the most relevant measure of whether a financial firm has erred and caused a consumer compensable loss. What we see in practice is that AFCA still appears to have a bias towards finding an outcome that gives something to the consumer. If it cannot order compensation for actionable breach it awards a payment to the consumer for frustration or disappointment via an award for non-financial loss. If it cannot find fault in the financial firms' conduct it recommends the firm apply an interest rate reduction as a matter of "good industry practice". If the firm has correctly declined to offer hardship, AFCA frequently orders a further hardship variation (i.e. "gives the complainant one more shot").

A very high percentage of consumer complaints are resolved before they get to AFCA. Many times, financial firms are making significant concessions to complainants to try to resolve complaints in the knowledge that the costs of AFCA will eclipse any benefit from defending a complaint.

The Scheme is still being exploited and we would like to see more effective cost control whereby financial firms can defend frivolous complaints without incurring large fees. A financial firm of any reasonable size will quickly exhaust their 5 "free" matters each year. We continue to support a push for further changes that would include a "no fault, no cost" approach where financial firms are not charged where they are found to have acted appropriately and a cost ceiling where the AFCA fees cannot exceed the amount in dispute. This is particularly important for complaints involving privacy breaches and credit inquiries.

Yours faithfully

Peter J White AM MAICD
Managing Director

Life Member – FBAA
Life Member – Order of Australia Association

Advisory Board Member – Small Business Association of Australia (SBAA)
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