Mortgage Stress Victoria

WEstjustice

18 September 2023

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

By email only: consultation@afca.org.au

To the Lead Ombudsman – Banking and Finance,

Re: Submission to AFCA Approach to Responsible Lending – Draft – July 2023

This submission is structured according to the headings of the AFCA Approach to Responsible Lending – Draft – July 2023 (Draft Approach).

3.1 How does AFCA assess whether the financial firm met its obligations?

Some contracts are presumed to be unsuitable

The clear explanation of AFCA's expectations on rebuttable presumptions regarding small amount credit contracts (SACCs) is helpful. However, this portion of the Draft Approach refers to the *National Consumer Credit Protection Act 2009* (Cth) (*National Credit Act*) obligations prior to 12 June 2023 only.

- **Recommendation 1:** Add a section in the Draft Approach referencing the *National Credit Act* SACC obligations which came into effect on 12 June 2023, and clearly setting out which obligations will apply depending on the date on which a SACC was entered.

3.2 AFCA considers whether inquiries and verification steps were reasonable

Reasonable inquiries and verification by financial firms

Generally, the drafted approach for how AFCA considers the reasonableness of inquiries and verification by financial firms is suitable and consistent with ASIC Regulatory Guide

209 on credit licensing and responsible lending conduct. However, it can go further to help consumers by setting a minimum standard in terms of what is expected of financial firms.

In our responsible lending casework at Mortgage Stress Victoria (MSV) and Westjustice, we regularly see the harm caused to consumers experiencing financial hardship and vulnerability by financial firms that have granted unsuitable loans, often applied for by brokers. The following are some common examples of lack of inquiry and verification:

- Taking loan application documents on face value, requiring little to no pay slips and bank transaction statements to verify income and expenses or documentation evidencing assets.
- Not requiring tax returns or notices of assessment to verify income and expenses.
- Not obtaining comprehensive credit reporting information to verify liabilities.
- Conducting suitability assessments with HEM benchmark calculations without inquiring about expenses specific to the consumer.
- Estimating figures for assets (household furniture and appliances, vehicles) without an actual inventory of belongings, which has the effect of inflating a consumer's asset position.
- Not listing key information about the consumer relevant to their expenditure including dependents, other debts, or repayment obligations outside of essential expenses. In some cases where consumers have informed the financial firm of their dependents or expenses, the financial firm has instructed the consumer not to include this information in the loan application.
- Not making inquiries with the employers of consumers (with their express permission) to verify income, employment status and role, and reliability of pay slips.
- Not inquiring whether the consumer understands an exit strategy, its implications, and whether the exit strategy is realistic for them considering their circumstances.
- Not inquiring whether the consumer understands an unusual but significant obligation of a loan contract such as a balloon payment at the end.
- Failing to suggest or arrange an interpreter where inquiry and verification (particularly regarding objectives of borrowing) is needed from a consumer who has lower levels of written or spoken English.
- Not making direct inquiries as to requirements and objectives with the consumer when it is an investment loan.
- Not making direct inquiries as to requirements and objectives of the loan when the consumer is a co-borrower.

We agree with page 12 of the Draft Approach specifically listing "what benefit (if any) the consumer will receive from the credit product and how it will meet their requirements and objectives" as a factor relevant to the inquiry and verification steps a financial firm must take. A recurring issue in our casework is lending (both secured and unsecured) in circumstances of family violence and economic abuse where the victim-survivor takes on

liability (either joint or individual) for a loan from which the perpetrator receives sole benefit.

While we appreciate the Draft Approach noting that "a higher risk of harm could exist" in such circumstances, it would be beneficial to clearly articulate how AFCA expects a financial firm to assess what if any benefit a consumer will receive, and how this interacts with the suitability assessment obligation in respect of requirements and objectives.

The AFCA Approach to joint facilities and family violence provides that "a financial firm should not accept a customer as a borrower for a credit facility if it is aware that the customer will not benefit from the facility… If the customer will not benefit from the funds advanced, then they cannot be regarded as a borrower or co-borrower and should instead be treated as a guarantor".

Our case study below highlights the limitations of relying on 'red flags' of family violence in application documents as the trigger for further inquiries and verification as to whether a consumer will benefit from the loan.

Case Study 1: Alma[2]

Alma and Derrick had been in a relationship for several years, over which time Alma had experienced family violence perpetuated against her by Derrick. Derrick, who is unemployed, wished to purchase a secondhand car but was advised by a broker that he would be unable to obtain a loan based on his current financial circumstances.

Derrick coerces Alma, who is employed on a middle income, to apply for the loan jointly with him so that he can secure finance. Derrick promises that he will make all the loan repayments – he just needs Alma to be included in the application so that the loan can be advanced. Alma is fearful of Derrick so agrees to avoid angering him. The loan is secured against the vehicle purchased, which is registered to Derrick.

The loan application is prepared by a broker, who deals only with Derrick. Derrick provides evidence of Alma's income as well as his own Centrelink income to the broker. The broker uses this information to prepare the loan application, listing the purpose of the loan as 'purchase of car'. Alma and Derrick's financial documents appear relatively 'normal' – with no significant 'red flags' of family violence apparent on the face of the documents. The financial firm approves the loan without making further inquiries, as it assesses the loan as affordable, given Alma's income.

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[1] The AFCA Approach to jo nt fac t es and fam y v o ence, page 7.

[2] Due to the h gh degree of conf dent a ty re ated to fam y v o ence matters, we note that the above case study does not re ate to a s ng e spec f c Westjust ce c ent, but rather s made up of a compos te of var ous c ent stor es.

Six months later, the family violence experienced by Alma reaches a level of severity where Alma is forced to flee the home to ensure her safety. She leaves the car with Derrick, who has the only set of car keys and has not allowed Alma to drive it since the purchase.

Alma contacts the financial firm and explains that she would like to be removed from the joint loan as she derived no benefit from it but does not have access to the secured vehicle to surrender. She is also fearful that if she tells the financial firm that she would be content for the vehicle to be taken from Derrick, that this may result in an escalation of violence. She is aware that Derrick rarely makes loan repayments on time, and she is worried about the impact this is having on her credit record.

The financial firm declines to cease recovery activity against Alma or remove her from the loan contract. The financial firm refers to its suitability assessment, and claims that the application demonstrates the loan was clearly affordable and that there were no 'red flags' of family violence in the application which would give rise to a remedy.

To properly meet the positive obligation to make inquiries and verification, it is insufficient for financial firms to rely on the stated requirements and objectives on application documents alone. This is particularly pertinent in relation to joint facilities and where applications have been submitted online or through a broker (meaning that the financial firm has not had direct contact with the consumer regarding requirements and objectives).

While the veracity of declared income and expenditure may be interrogated by examining supporting documentation such as bank transaction statements, there is no equivalent documentation provided to support representations as to a consumer's requirements and objectives.

Had the financial firm in the above case study directly contacted each co-borrower individually, it may have ascertained that the reason Alma was included in the loan application was because Derrick had been unable to obtain a loan on his own and that Alma was not likely to obtain any benefit from the loan, which was for the purchase of a vehicle for Derrick's use.

- **Recommendation 2:** On pages 11 and 12, add in examples of minimum standards of reasonable inquiries and verification, including but not limited to:
  - Requiring at least three months of pay slips and six months of bank transaction statements if available.
  - Requiring tax returns or notices of assessment when either pay slips or bank transaction statements cannot be provided.
  - Always requesting comprehensive credit reporting information.
  - Requiring an inventory of belongings if estimating figures for assets.
  - Mandatory inquiries with consumers and their employers with express permission from the consumer when: income is either inconsistent or cannot

be verified when comparing pay slips, bank transaction statements, tax returns and notices of assessment; and employment status and role has not been verified directly with the consumer.
    - Mandatory inquiries with the consumer to confirm understanding when there are unusual features to a loan contract such as an exit strategy or balloon payment at the end.
    - Mandatory inquiries as to requirements and objectives directly with the consumer when it is an investment loan.
    - Mandatory inquiries as to requirements and objectives by an appropriately trained representative of the financial firm directly with each consumer separately when they are co-borrowers (unless the inquiries may place the consumer at risk of family violence, then sensitively making this option of inquiry known to the consumer and how this can occur discretely).
    - In digital loan applications using an online portal for submissions, requiring additional verification steps including attachment of written or recorded correspondence with each consumer evidencing their understanding of the application and agreement with the information provided in the application.
    - In interactions with the consumer, a requirement to document that the consumer could understand the application and agreement in English or, if not, how this was facilitated by way of translation or interpreting services.

- **Recommendation 3:** On page 12, add into the first dot point list:
    - "the consumer's employment situation and proof of income provided"; and
    - "where the consumer's source of income is insecure, i.e. not a full-time salaried wage".

- **Recommendation 4:** In section 3.2, add in an example or further explanation as to how AFCA expects financial firms to verify requirements and objectives where a loan is otherwise assessed as suitable (i.e., affordable), with reference to where a consumer may derive no benefit in circumstances of economic abuse.

Requesting information from complainants

Requesting information that the financial firm did not obtain or consider in its assessment from complainants in the first instance can be onerous and difficult. Complainants are likely not to understand the relevant responsible lending laws or what a financial firm is required to do in terms of reasonable inquiries and verification unless this is clearly explained to them by AFCA.

This can put the complainant at a disadvantage early in the complaint process if they do not provide the right information, particularly where AFCA is not put on notice of a possible or probable breach of responsible lending obligations.

- **Recommendation 5:** On page 13 in the first sentence under this heading, change the word "will" to "may".

- **Recommendation 6:** On page 13 under this heading, add in that at the beginning of the complaints process AFCA will provide to the complainant a list of examples of information that the financial firm could obtain or consider in its assessment.

Requesting additional information

- **Recommendation 7:** In the "verification of income" and "taking further reasonable steps" examples on pages 14 and 15, add in further examples of what the financial firm could have done to verify the consumer's income, e.g. obtain updated pay slips and/or contact the consumer's employer with express permission from the consumer to confirm the changing income.

3.3 Reviewing unsuitability assessments

Reviewing use of benchmarks as verification tools

We agree with the indication in the Draft Approach that AFCA expects use of benchmarks to be limited to verification of the reasonableness of a consumer's own declared living expenses, and not be used as a substitutable figure.

However, AFCA should clarify that comparison of a consumer's declared expenses with a benchmark alone will not be sufficient to verify actual expenditure, and that other methods of verification (such as reviewing bank transaction statements) are also required regardless of whether a consumer's declared expenditure is higher, lower, or roughly equivalent to a benchmark.

- **Recommendation 8:** On pages 17 and 18 under the heading "Reviewing use of benchmarks as verification tools", add in that comparison of a consumer's declared expenses with a benchmark alone will not be sufficient to verify actual expenditure, and that other methods of verification (such as reviewing bank transaction statements) are also required regardless of whether a consumer's declared expenditure is higher, lower, or roughly equivalent to a benchmark.

Changes the financial firm could reasonably have foreseen

In our MSV and Westjustice casework, we often see loans approved for consumers when they were on a fixed-term employment contract which had a clear end date in the near future with no confirmed plan as to further employment provided by the consumer or asked for by the financial firm. In this situation, the financial firm should be required to make further inquiries and verification as to whether and how the consumer will be able to comply with their financial obligations under the loan contract following the expiration of their fixed-term employment contract.

Further examples include changes in family make-up such as a consumer being pregnant at the time of the loan application, or a change in social security income where a child living at home reaches a certain age or stops studying and Centrelink payments cease as a result.

In Victoria, financial firms have also relied on WorkCover or Transport Accident Commission (TAC) payments as an indication of income going forward, in circumstances where no further inquiries were made about how much longer those payments were going to continue or about the realistic prospects of the consumer returning to work once those payments ceased.

- **Recommendation 9:** On page 20, add into the diagram as examples of reasonably foreseeable changes:
    - "Fixed-term employment contract coming to an end in the near future with no confirmed plan as to further employment".
    - "The upcoming birth of a child".
    - "Centrelink benefits ceasing due to children reaching a certain age".
    - "Workplace injury or road accident compensation payments ceasing".

Where a broker is involved in the loan application

Where brokers have been involved in applying for unsuitable loans in our casework, we are not aware of any occasion where our clients have been given the opportunity to review the loan application documents for accuracy and to correct any errors.

While the Draft Approach includes 'red flag' examples such as the consumer not agreeing with or understanding representations the broker made on their behalf, or not being aware of certain information in the loan application form, it does not make clear under what circumstances a financial firm is expected to have a conversation with a consumer eliciting this information. It is our experience that financial firms rarely if ever directly contact consumers to verify information provided by a broker, unless other red flag matters are obvious (and even then, such contact is rare).

We consider that some measure of direct contact by financial firms to consumers is particularly important in respect of verifying consumers' requirements and objectives where a broker has completed an application. As highlighted by Case Study 1: Alma above, while financial firms might be able to meaningfully compare income and expenditure figures provided by brokers against supporting documents like bank transaction statements, there is no equivalent documentation provided to support representations as to a consumer's requirements and objectives. As noted in Alma's case, this could be as straightforward as the financial firm contacting each co-borrower and confirming they wish to proceed with an application.

It would be helpful for AFCA to include an example demonstrating how a financial firm may fail to comply with its independent inquiry and verification obligations by relying

inappropriately on broker information, particularly where requirements and objectives have been inaccurately recorded by a broker.

- **Recommendation 10:** On page 23 under the heading "Where a broker is involved in the loan application", add in an example demonstrating how a financial firm should verify a consumer's requirements and objectives when a broker has submitted the loan application.

3.4 AFCA determines whether the loan was unsuitable

What a complainant would have provided on request

- **Recommendation 11:** On page 25, change the wording in the two dot points from "we are unlikely to…" to "we will not…", so that it is clear that AFCA will not be making any unfounded, negative assumptions about what complainants would have provided.

4.1 Overview of AFCA's approach to determining fair outcomes

The AFCA Rules and delivering fair outcomes

The dot point list of remedies that AFCA may provide in responsible lending complaints on page 27 of the Draft Approach does not currently include all the possibilities in practice and in the *National Credit Act*. The list can be improved with further additions.

- **Recommendation 12:** On page 27, make the following changes to the dot point list of remedies:
  - Add in "the return of property" (consistent with section 179 of the *National Credit Act*).
  - Add in "the supply of specified services" (consistent with section 179 of the *National Credit Act*).
  - Add in "the closure of an account" (consistent with section 179 of the *National Credit Act*).
  - Add in "a financial firm to withdraw a default notice issued or apply to a court to have judgment set aside".
  - Add in "a financial firm to make a change, addition or correction to a credit report".
  - Edit the fifth dot point to read "the reinstatement, variation, rectification, or setting aside of a contract, deed or arrangement" (consistent with section 179 of the *National Credit Act*).
  - Edit the sixth dot point to read "a financial firm refraining from taking further enforcement action, including enforcing a default notice or default judgment".

Dealing with secured assets fairly in the circumstances

The Draft Approach states that its principles have been developed considering ASIC Regulatory Guide 277 on consumer remediation.

RG277.62 and RG277.74 state that the guiding principle for all remediations and determining compensation is to return consumers, as closely as possible, to the position they would have been in had the misconduct or other failure not occurred. To achieve this, licensees must account specifically for interest the consumer would not have incurred but for the misconduct or other failure.

Additionally, RG277.150 states that a key principle of conducting a remediation is that it should minimize complexity and consumer action. Accordingly, asking an affected or potentially affected consumer to take any action (i.e. a 'call to action') should be rare and should not be used to ask affected consumers who are likely to fall within scope (to a reasonable degree of certainty) to opt in to a remediation.

Lastly, the above principles are supported by RG277.68 which states that where a loan is secured or involves goods subject to a consumer lease, allowing the consumer to retain the underlying asset if appropriate for the consumer is an appropriate remedy when remediating an unsuitable loan.

There is no suggestion in ASIC Regulatory Guide 277 requiring a complainant to mitigate their future loss by selling assets.

Given the above and AFCA's fairness jurisdiction, there is opportunity for the Draft Approach to better align with the regulatory guidance.

We do not consider it fair to require complainants to take action such as selling assets to mitigate their future loss as a result of a responsible lending complaint outcome, unless the complainant has expressed a prior desire to sell assets. This is adding complexity and a call to action on the complainant in order to remediate what is a failure of the financial firm's legal obligation to ensure that it lends responsibly.

Emotional connection to the home and local community, upheaval of families, the immense difficulty in selling a home and relocating elsewhere, lack of financial literacy, poor condition and wear and tear of the home, negative property market conditions, family violence and economic abuse, and mental health issues are just some of the common barriers to complainants realistically being able to sell their home. We see complex combinations of these factors in our responsible lending casework.

It is a fair outcome for a complainant to keep a secured asset obtained through an unsuitable loan whilst repaying to the financial firm the principal benefit they have received as an adjusted debt. Generally, a financial firm should not be able to profit from its irresponsible lending by being allowed to charge future interest on an adjusted debt. The loss in value to the financial firm of an adjusted debt being repaid by the complainant

over time should be the financial firm's loss to bear as a result of it not meeting its legal obligation to lend responsibly. Otherwise, this loss unfairly falls on the complainant.

AFCA should take the same approach to applying interest to secured adjusted debts as it does to unsecured adjusted debts.

- **Recommendation 13:** Edit pages 28 and 29 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

4.2 Calculating responsible lending remedies

AFCA calculates the complainant's net loss

Since AFCA's inception, its approach to calculating remedies and loss has caused much complainant frustration and harm, particularly when complainants experiencing vulnerability have been left with no option but to sell their home.

The lack of specificity, consistency in approach, and intent on keeping complainants in their homes between different case managers and conciliators has meant that there is little surety or predictability in terms of a likely and/or positive outcome to a complaint. This inconsistency has often derailed the positive trajectory of complaints, where complainants and financial firms may have been able to reach a resolution together had AFCA's approach been clear and consistent.

As stated above, we do not consider it to be a fair result if a complainant must sell their home to remediate their loss from an unsuitable loan. The end goal of remediating the irresponsible lending should be to keep the complainant in their home. Therefore, should "compensating the complainant for their net loss" be the only way for AFCA to define its approach to calculating responsible lending remedies?

AFCA should adopt a two-tiered approach to calculating responsible lending remedies, with the first tier being "compensating the complainant for their net loss" and then introducing a second tier being "making repayment of the adjusted debt balance affordable to the complainant".

- **Recommendation 14:** Edit page 30 and section 4 of the Draft Approach more broadly to introduce a two-tiered approach to calculating responsible lending remedies which aims to compensate complainants for their net loss and make repayment of the adjusted debt balance affordable to the complainant.

How we calculate net loss

In the diagram on page 31, it is unclear whether "outstanding liability under a credit contract" under the definition of "gross loss" includes principal and future interest or only principal.

- ➢ **Recommendation 15:** On page 31, make it explicit in the diagram whether outstanding liability includes future interest or not.

The definition of "benefit" in the diagram should only include what the complainant has received. A capital gains amount should only be included in the calculation if it has been received by the complainant, e.g., a property has been sold and the complainant has received the benefit of the capital gain, as opposed to a rise in market value of a property without realising the equity. This should be made clear in the wording of the diagram.

- ➢ **Recommendation 16:** On page 31 in the diagram, add in the words "when an asset is sold" after the words "capital gains".

When complainants do not receive a benefit from the loan

The example in this section is helpful. We frequently assist consumers who have purchased a defective secondhand motor vehicle secured by an unsuitable loan that was irresponsibly lent.

These matters have been historically difficult for us to resolve in circumstances where the financial firm is not able to recover a significant sum from the sale of the defective vehicle due to its condition, or where the financial firm elects to release its security for the vehicle rather than accept surrender of the vehicle as anticipated sale costs exceed anticipated returns. The status of these loans cannot be resolved in court or tribunal proceedings for the defective vehicle under the Australian Consumer Law, apart from an extremely limited class of linked credit contracts.

It is our experience that in consumer guarantees disputes with motor vehicle traders involving defective vehicles, traders rarely if ever concede that either latent or manifest defects existed in vehicles at the time of sale, rely on roadworthiness certificates issued prior to sale in defence of this position, and frequently attempt to shift the blame to the consumer for any mechanical issues. Expert reports obtained by consumers in these cases typically cost more than $2,500 and are prohibitively expensive for many consumers in financial hardship to obtain.

- ➢ **Recommendation 17:** On pages 31 and 32, add into the approach and/or example that if a secured asset such as a vehicle has depreciated in value and the financial firm seeks to attribute that depreciation to the consumer, that the onus would fall on the financial firm to establish this with evidence and that a roadworthiness certificate issued prior to sale alone would be insufficient for this purpose.

- ➢ **Recommendation 18:** On pages 31 and 32, add in how AFCA would approach matters where a secured vehicle cannot be surrendered, for example, where it is in the possession of a perpetrator of family violence and the victim-survivor borrower does not consider it safe to authorise the financial firm to progress with repossession.

Benefits other than the loan funds

Generally, we do not consider it appropriate to use assumptions to include hypothetical rent avoided as a benefit the complainant received.

RG277.73 in ASIC Regulatory Guide 277 states that a partial monetary remedy may be appropriate in limited circumstances, but only if the consumer has received a legitimate and demonstrable financial benefit in return.

RG277.73 goes on to state that if making assumptions about a consumer's financial benefit, licensees should apply the guidance at RG 277.113–RG 277.141. This guidance makes numerous references that licensees should only use assumptions in a remediation if they are beneficial to consumers. Further, RG 277.125 states that if the outcome of using assumptions appears to commercially benefit the licensee over the consumer, it may indicate that the assumptions are not beneficial to the consumer.

Including hypothetical rent avoided in loss calculations is not beneficial to consumers and commercially benefits licensees over the consumer.

At the very least, any avoided rent benefit that AFCA applies to loss calculations must be offset by hypothetical time value of money benefits that the consumer has missed out on due to using their money on mortgage repayments, such as generating income through an interest-bearing savings account. The Draft Approach must also specify in what circumstances AFCA would consider rent avoided as a benefit and how AFCA calculates rent avoided.

- **Recommendation 19:** Edit page 34 to remove the paragraph referencing making assumptions about avoided rent.

- **Recommendation 20:** If keeping the paragraph on page 34 referencing making assumptions about avoided rent, add in:
  - That assumed benefits such as avoided rent must be offset by assumed benefits that the consumer has missed out on such as generating income through an interest-bearing savings account.
  - What circumstances AFCA would consider rent avoided as a benefit.
  - How AFCA calculates rent avoided.

Determining how the adjusted debt should be repaid and assessing how secured assets can be dealt with fairly

- **Recommendation 21:** Consistent with Recommendation 13 above, edit page 36 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

Applying interest to secured adjusted debts

- **Recommendation 22:** Consistent with Recommendations 13 and 21 above, edit pages 37 and 38 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

Loss may end when a debt is refinanced with a responsible loan

In practice, AFCA has generally considered that there has been no loss suffered when the interest rate of a refinanced secured unsuitable loan is lower than the interest rate of the previous loan that it paid out. Further, AFCA has considered that if the interest rate is higher, then the loss should be limited to the difference in interest between the old and new loans.

We do not agree with these principles in certain circumstances – such as:

- When an old debt is refinanced to an increased amount with a lower interest rate the consumer can suffer a loss due to the compounding interest causing higher interest repayments overall.
- When an unsuitable loan consolidates other unsuitable debts (secured and unsecured), where it could be assumed the other unsuitable debts may have been resolved had the complainant received the opportunity and may have become interest free as a result of a remediation.
- When one unsuitable loan of available funds is taken out to make interest-only repayments toward another unsuitable loan rather than paying it out entirely.

These principles have not effectively accounted for the diverse range and complexity of scenarios involving refinanced unsuitable loans.

Case Study 2: [redacted]

Our client, [redacted], had an approximate balance of $1,000 outstanding on her home loan when she informed the financial firm that she wanted to pay out her home loan. The financial firm discouraged [redacted] from paying out her home loan and convinced her to keep the balance at $1,000.

[redacted] then moved overseas and fell victim to a perpetrator of violence and economic abuse. The perpetrator forced [redacted] to draw down approximately $75,000 on her home loan for his benefit. The drawdown attracted an additional $55,000 in interest.

When [redacted] moved back to Australia as a survivor of the violence and economic abuse, she applied to the financial firm for a refinance of the approximate $131,000 balance outstanding. The financial firm convinced [redacted] to borrow $300,000 on interest-only repayments, which was much more than she needed for the refinance. The lend of $300,000 was subsequently assessed as being unsuitable.

paid $290,000 of the $300,000 in funds back into the loan account, leaving a balance outstanding of $10,000. then additionally drew down approximately $155,000 on the loan account to use for her benefit, which attracted interest.

then applied to the financial firm for a business loan, which was approved. The business loan was subsequently assessed as being unsuitable. The funds from the business loan were used to make the interest-only repayments on the $155,000 home loan.

lodged an AFCA complaint alleging irresponsible lending. The two loans were assessed as being unsuitable; however, the loss calculation was inaccurate and did not consider some of the facts of complex scenario. did not accept the Determination because she could not obtain pro bono legal advice regarding the confusing loss calculation within the required time frame.

If AFCA is proposing to change its past principles above through the last paragraph under this heading on page 39 of the Draft Approach, then it needs to include more detail and examples of what loss it considers a complainant could suffer across different scenarios of refinancing.

- **Recommendation 23:** On page 39, add in more detail and examples of what loss AFCA considers a complainant could suffer across different scenarios of refinancing like the ones mentioned above.

Contracts that are affordable but do not meet requirements and objectives

It would be helpful to provide more detail in this section of the Draft Approach, particularly in relation to where loan contracts do not meet requirements and objectives for a complainant because they derive no benefit from the loan, as in Case Study 1: Alma.

In Alma's case, a fair outcome would be:

- Varying the loan contract to remove Alma as a borrower;
- Requiring the financial firm to suppress or remove any defaults or other negative credit reporting information, including missed payments;
- Refunding Alma all amounts paid by her in service of the loan; and
- Refunding Alma for all third-party expenses paid by her in relation to the loan, including deposit paid for the purchase of the vehicle and any insurance and registration payments.

- **Recommendation 24:** On pages 39 and 40 under the heading "Contracts that are affordable but do not meet requirements and objectives", add an example which sets out how AFCA will determine a fair outcome where a loan is affordable but does not meet requirements and objectives because the complainant derived no benefit.

Reducing compensation due to complainant conduct

When reducing compensation by a certain percentage due to complainant conduct, AFCA should explain how it has reached its percentage in the interests of transparency in decision-making.

- **Recommendation 25:** On pages 40 and 41, particularly in the "complainant conduct reduces compensation" example, add in more specific detail on how AFCA calculates its percentage when deciding to reduce a complainant's compensation.

In the final paragraph regarding brokers under this heading on page 41, it should be made clear that the test for a financial firm reasonably relying on information provided by a broker is the same as reasonably relying on information provided directly by a consumer without a broker. There should be no difference between the standard of a financial firm's verification of information from a broker versus a consumer. A financial firm must have its responsible lending obligations read down or absolved because a broker provided the information.

- **Recommendation 26:** On page 41, add in a sentence at the end of the final paragraph under the heading "reducing compensation due to complainant conduct" which states that the test for a financial firm reasonably relying on information provided by a broker is the same as reasonably relying on information provided directly by a consumer without a broker.

<u>Guide one: Calculating loss from different credit products</u>

Home loans

- **Recommendation 27:** Consistent with Recommendation 15 above, edit page 45 to make it explicit in the diagram whether "amount they remain liable for" includes future interest or not.

- **Recommendation 28:** On page 45, add into the diagram real estate agent, conveyancer, and legal fees as examples of acquisition and holding costs.

- **Recommendation 29:** Consistent with Recommendations 13, 21 and 22 above, edit pages 45 and 46 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

The considerations for how AFCA will determine an adjusted debt should be repaid on pages 45 and 46 are mostly helpful. There is an opportunity to provide more consistency and surety about the outcome for a responsible lending complaint by setting expected standards for as many scenarios as possible (like the helpful standard that an elderly person can repay the adjusted debt when they pass away or move to another home).

- **Recommendation 30:** On pages 45 and 46, add in more detail and examples that are beneficial to consumers regarding how an adjusted debt can be repaid, like an elderly person repaying the adjusted debt when they pass away or move to another home.

Car loans

- **Recommendation 31:** On page 50, add into the diagram insurance and registration fees as examples of fees and charges paid to the financial firm or any third party.

<u>Guide two: Information we may request from financial firms</u>

Additional information we may request if relevant

- **Recommendation 32:** On page 58 in the table at "loan was for construction", add in "documentation in relation to progress payments and approvals for such payments toward a build".

<u>Other issues</u>

The Draft Approach does not have a section dealing with when other causes of action overlap with responsible lending provisions in the *National Credit Act* such as unjust transactions in the *National Credit Code* or unconscionable conduct in the *Australian Securities and Investments Commission Act 2001* (Cth). There needs to be consideration for how these causes of action are applied to a complainant's circumstances and how overlaps can affect the calculation of remedies.

In our experience, AFCA has tended to take a one-size-fits-all approach and only considers responsible lending causes of action and remedies but not the others above.

If the Draft Approach is not amended to include detail about alternative causes of action which can result in remediation, AFCA should consider creating separate approach documents addressing these causes of action.

- **Recommendation 33:** Add a section in the Draft Approach stating AFCA's approach to other relevant causes of action and remedies that overlap with responsible lending conduct and remedies or create separate approach documents addressing these causes of action.

Yours sincerely,

Mortgage Stress Victoria and Economic Justice Program
Westjustice

<u>List of Recommendations</u>

- **Recommendation 1:** Add a section in the Draft Approach referencing the *National Credit Act* SACC obligations which came into effect on 12 June 2023, and clearly setting out which obligations will apply depending on the date on which a SACC was entered.

- **Recommendation 2:** On pages 11 and 12, add in examples of minimum standards of reasonable inquiries and verification, including but not limited to:
    - Requiring at least three months of pay slips and six months of bank transaction statements if available.
    - Requiring tax returns or notices of assessment when either pay slips or bank transaction statements cannot be provided.
    - Always requesting comprehensive credit reporting information.
    - Requiring an inventory of belongings if estimating figures for assets.
    - Mandatory inquiries with consumers and their employers with express permission from the consumer when: income is either inconsistent or cannot be verified when comparing pay slips, bank transaction statements, tax returns and notices of assessment; and employment status and role has not been verified directly with the consumer.
    - Mandatory inquiries with the consumer to confirm understanding when there are unusual features to a loan contract such as an exit strategy or balloon payment at the end.
    - Mandatory inquiries as to requirements and objectives directly with the consumer when it is an investment loan.
    - Mandatory inquiries as to requirements and objectives by an appropriately trained representative of the financial firm directly with each consumer separately when they are co-borrowers (unless the inquiries may place the consumer at risk of family violence, then sensitively making this option of inquiry known to the consumer and how this can occur discretely).
    - In digital loan applications using an online portal for submissions, requiring additional verification steps including attachment of written or recorded correspondence with each consumer evidencing their understanding of the application and agreement with the information provided in the application. In interactions with the consumer, a requirement to document that the consumer could understand the application and agreement in English or, if not, how this was facilitated by way of translation or interpreting services.

- **Recommendation 3:** On page 12, add into the first dot point list:
    - "the consumer's employment situation and proof of income provided"; and
    - "where the consumer's source of income is insecure, i.e. not a full-time salaried wage".

- **Recommendation 4:** In section 3.2, add in an example or further explanation as to how AFCA expects financial firms to verify requirements and objectives where a loan is otherwise assessed as suitable (i.e., affordable), with reference to where a consumer may derive no benefit in circumstances of economic abuse.

- **Recommendation 5:** On page 13 in the first sentence under this heading, change the word "will" to "may".

- **Recommendation 6:** On page 13 under this heading, add in that at the beginning of the complaints process AFCA will provide to the complainant a list of examples of information that the financial firm could obtain or consider in its assessment.

- **Recommendation 7:** In the "verification of income" and "taking further reasonable steps" examples on pages 14 and 15, add in further examples of what the financial firm could have done to verify the consumer's income, e.g. obtain updated pay slips and/or contact the consumer's employer with express permission from the consumer to confirm the changing income.

- **Recommendation 8:** On pages 17 and 18 under the heading "Reviewing use of benchmarks as verification tools", add in that comparison of a consumer's declared expenses with a benchmark alone will not be sufficient to verify actual expenditure, and that other methods of verification (such as reviewing bank transaction statements) are also required regardless of whether a consumer's declared expenditure is higher, lower, or roughly equivalent to a benchmark.

- **Recommendation 9:** On page 20, add into the diagram as examples of reasonably foreseeable changes:
    - "Fixed-term employment contract coming to an end in the near future with no confirmed plan as to further employment".
    - "The upcoming birth of a child".
    - "Centrelink benefits ceasing due to children reaching a certain age".
    - "Workplace injury or road accident compensation payments ceasing".

- **Recommendation 10:** On page 23 under the heading "Where a broker is involved in the loan application", add in an example demonstrating how a financial firm should verify a consumer's requirements and objectives when a broker has submitted the loan application.

- **Recommendation 11:** On page 25, change the wording in the two dot points from "we are unlikely to…" to "we will not…", so that it is clear that AFCA will not be making any unfounded, negative assumptions about what complainants would have provided.

- **Recommendation 12:** On page 27, make the following changes to the dot point list of remedies:
  - Add in "the return of property" (consistent with section 179 of the *National Credit Act*).
  - Add in "the supply of specified services" (consistent with section 179 of the *National Credit Act*).
  - Add in "the closure of an account" (consistent with section 179 of the *National Credit Act*).
  - Add in "a financial firm to withdraw a default notice issued or apply to a court to have judgment set aside".
  - Add in "a financial firm to make a change, addition or correction to a credit report".
  - Edit the fifth dot point to read "the reinstatement, variation, rectification, or setting aside of a contract, deed or arrangement" (consistent with section 179 of the *National Credit Act*).
  - Edit the sixth dot point to read "a financial firm refraining from taking further enforcement action, including enforcing a default notice or default judgment".

- **Recommendation 13:** Edit pages 28 and 29 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

- **Recommendation 14:** Edit page 30 and section 4 of the Draft Approach more broadly to introduce a two-tiered approach to calculating responsible lending remedies which aims to compensate complainants for their net loss and make repayment of the adjusted debt balance affordable to the complainant.

- **Recommendation 15:** On page 31, make it explicit in the diagram whether outstanding liability includes future interest or not.

- **Recommendation 16:** On page 31 in the diagram, add in the words "when an asset is sold" after the words "capital gains".

- **Recommendation 17:** On pages 31 and 32, add into the approach and/or example that if a secured asset such as a vehicle has depreciated in value and the financial firm seeks to attribute that depreciation to the consumer, that the onus would fall on the financial firm to establish this with evidence and that a roadworthiness certificate issued prior to sale alone would be insufficient for this purpose.

- **Recommendation 18:** On pages 31 and 32, add in how AFCA would approach matters where a secured vehicle cannot be surrendered, for example, where it is in the possession of a perpetrator of family violence and the victim-survivor borrower does not consider it safe to authorise the financial firm to progress with repossession.

- **Recommendation 19:** Edit page 34 to remove the paragraph referencing making assumptions about avoided rent.

- **Recommendation 20:** If keeping the paragraph on page 34 referencing making assumptions about avoided rent, add in:
    - That assumed benefits such as avoided rent must be offset by assumed benefits that the consumer has missed out on such as generating income through an interest-bearing savings account.
    - What circumstances AFCA would consider rent avoided as a benefit.
    - How AFCA calculates rent avoided.

- **Recommendation 21:** Consistent with Recommendation 13 above, edit page 36 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

- **Recommendation 22:** Consistent with Recommendations 13 and 21 above, edit pages 37 and 38 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

- **Recommendation 23:** On page 39, add in more detail and examples of what loss AFCA considers a complainant could suffer across different scenarios of refinancing like the ones mentioned above.

- **Recommendation 24:** On pages 39 and 40 under the heading "Contracts that are affordable but do not meet requirements and objectives", add an example which sets out how AFCA will determine a fair outcome where a loan is affordable but does not meet requirements and objectives because the complainant derived no benefit.

- **Recommendation 25:** On pages 40 and 41, particularly in the "complainant conduct reduces compensation" example, add in more specific detail on how AFCA calculates its percentage when deciding to reduce a complainant's compensation.

- **Recommendation 26:** On page 41, add in a sentence at the end of the final paragraph under the heading "reducing compensation due to complainant conduct" which states that the test for a financial firm reasonably relying on information provided by a broker is the same as reasonably relying on information provided directly by a consumer without a broker.

- **Recommendation 27:** Consistent with Recommendation 15 above, edit page 45 to make it explicit in the diagram whether "amount they remain liable for" includes future

interest or not.

- **Recommendation 28:** On page 45, add into the diagram real estate agent, conveyancer, and legal fees as examples of acquisition and holding costs.

- **Recommendation 29:** Consistent with Recommendations 13, 21 and 22 above, edit pages 45 and 46 to remove references to requiring complainants to sell assets to mitigate their future loss and allowing financial firms to charge future interest on adjusted debts.

- **Recommendation 30:** On pages 45 and 46, add in more detail and examples that are beneficial to consumers regarding how an adjusted debt can be repaid, like an elderly person repaying the adjusted debt when they pass away or move to another home.

- **Recommendation 31:** On page 50, add into the diagram insurance and registration fees as examples of fees and charges paid to the financial firm or any third party.

- **Recommendation 32:** On page 58 in the table at "loan was for construction", add in "documentation in relation to progress payments and approvals for such payments toward a build".

- **Recommendation 33:** Add a section in the Draft Approach stating AFCA's approach to other relevant causes of action and remedies that overlap with responsible lending conduct and remedies or create separate approach documents addressing these causes of action.