



11 September 2023

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

By email: consultation@afca.org.au

Dear Lead Ombudsman

SUBMISSION TO AFCA CONSULTATION ON RESPONSIBLE LENDING APPROACH

1. This submission has been prepared by the Australian Consumer Law Committee of the Law Council of Australia's Legal Practice Section. The Committee welcomes the opportunity to make a submission to the Lead Ombudsman in relation to AFCA's consultation on the draft Responsible Lending Approach.
2. We provide feedback on AFCA's draft Approach to Responsible Lending (**Approach**) in response to both specific questions posed in AFCA's consultation paper and to particular sections of the Approach. We reference our responses accordingly.

1.4 About responsible lending complaints

3. The Approach does not appear to include some complaints, including:
 - (a) complaints about contracts not regulated or purporting not to be regulated by the *National Consumer Credit Protection Act 2009* (Cth) (the **National Credit Act**); and
 - (b) systemic issues complaints.

Non-regulated loans

4. We foresee that excluding non-regulated contracts could cause vulnerable consumers to be excluded from being able to rely on this Approach and, consequently, the award of compensation for any harm caused.
5. For example:

A young woman is encouraged by her partner to obtain an ABN. Her partner was rejected for a loan and given she has a paid employment and a clean credit report he gets her to enter into a car contract for the purchase of a vehicle. They attend the dealership together and the loan is obtained. The vehicle is registered in his name and he uses it.
6. In this example, it is open to AFCA to find that the lender knew or ought to have known that the credit was provided wholly or predominantly for personal, domestic or

household purposes. In our view, it would be fair in these circumstances for AFCA to apply the Approach despite the contract appearing at first instance to relate to an unregulated loan.

7. Accordingly, we submit that:
 - (a) the Approach be amended to make it clear that it applies to loans that have in AFCA's view been wrongly treated as non-regulated; and
 - (b) if not, that AFCA provide additional guidance about its approach to dealing with complaints about non-regulated loans.

Systemic issues complaints

8. In addition, we submit that the Approach include specific reference to how it deals with systemic issues complaints, including the consequences where breaches are found to have occurred.

2.1 Complaints AFCA can consider

9. The Approach does not expressly state that it will deal with complaints about financial hardship and responsible lending concurrently despite its general practice of doing so. Given the substance of a financial firm's responsible lending obligations, it is common for a person making a responsible lending complaint to be struggling with repayments.
10. Accordingly, we submit that:
 - (a) the Approach be amended to expressly state that it will deal with complaints about financial hardship and responsible lending concurrently; and
 - (b) provide clear guidance on:
 - (1) whether consumers should continue to make loan repayments for the life of the complaint; and
 - (2) the impact of making or not making loan repayments for the life of the complaint, including on a consumer's credit report and whether repayments will be refunded in the event of a successful complaint.

2.2 Complaints not considered

11. The Approach provides that AFCA will not consider complaints about brokers and other credit assistance providers. So as not to exclude consumers who have suffered harm caused by brokers and other credit assistance providers, we submit that:
 - (a) the Approach be amended to include guidance on dealing with complaints about brokers and other credit assistance providers; and
 - (b) if not, that AFCA provide additional guidance on its approach to dealing with complaints about brokers and other credit assistance providers .

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

Referring to laws, codes, good industry practice and past decisions [Page 10]

12. The Approach provides that AFCA may consider provisions of “applicable industry codes” and “good industry practice” in its consideration of what is fair in all the circumstances of a responsible lending complaint. This is appropriate. We submit that reference should also be made to “applicable industry guidelines” that are related to industry codes which explicitly set out and detail good industry practice. These can include financial abuse and family and domestic violence guidelines, vulnerability guidelines, and guidelines covering other topic areas that may be relevant.

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

Other legal principles and obligations may be relevant [Page 10]

13. The Approach provides that it will consider whether the loan contract was an unjust transaction where necessary. This is appropriate.
14. We submit that the Approach should provide additional guidance on its approach to dealing with claims of unjustness, including that:
 - (a) AFCA acknowledges that the factual circumstances of consumers entering into loan contracts can be complex and many laws can apply to offer consumers remediation;
 - (b) AFCA acknowledges that claims of unjustness are separate to claims of responsible lending and are dealt with accordingly;
 - (c) AFCA acknowledges that even where a consumer may be out of time to make a responsible lending complaint, the consumer may not be out of time to make a claim of unjustness;
 - (d) AFCA will deal with whether a financial firm entered into an unjust transaction where it is raised on the facts, even when it is not specifically raised by the consumer;
 - (e) AFCA will consider matters including those set out in section 76(2) of the National Credit Code;
 - (f) AFCA will consider other legislative provisions relating to unjustness where relevant, including state laws (i.e., *Contracts Review Act 1980* (NSW)) and other federal laws (i.e., *Australian Securities and Investments Commission Act 2001* (Cth)); and
 - (g) AFCA acknowledges that claims of unjustness may be raised in relation to loan contracts not regulated by the National Credit Act.
15. In the alternative, we submit that AFCA should prepare separate guidance on its approach to dealing with claims of unjustness.

3.2 Requesting information from financial firms

16. The Approach does not make it clear whether AFCA is proposing that the information requested from financial firms is to be exchanged with consumers. Given the fundamental principle of procedural fairness, we submit that this exchange should occur and be expressly stated in the Approach.

3.3 Reviewing unsuitability assessments

Assessing capacity to repay without substantial hardship [Page 16]

17. The Approach provides that, in reviewing a financial firm's serviceability assessment, AFCA may "Where relevant, consider whether the financial firm has assessed the complainant could reasonably reduce their outgoings without substantial hardship" (page 17). As part of AFCA's approach to assessing the reasonableness of inquiries made, we would expect that in any situation where a loan has been assessed as suitable on the assumption that identifiable discretionary expenditures will be eliminated, the financial firm should have to demonstrate having communicated this to the consumer, ideally with specific identification of these expenditures. This is consistent with the record-keeping expectations in ASIC Regulatory Guide (RG) 209 at 209.263.

3.3 Reviewing unsuitability assessments

Reviewing use of benchmarks as verification tools [Page 17]

18. We submit that the Approach should make clear that:
- (a) benchmarking should not be used as a default verification tool or as a replacement for a financial firm's responsible lending obligations to make reasonable inquiries and verification steps in relation to a consumer's financial situation; and
 - (b) benchmarks bear no relation to a consumer's actual expenses, consistent with RG 209.134.

3.3 Reviewing unsuitability assessments

Changes the financial firm could reasonably have foreseen [Page 19]

Question 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?*

19. Yes. This approach is also consistent with RG 209.64. We submit further that a financial firm simply asking the consumer whether they expect to retire within the term of a prospective loan contract and documenting their response should not be considered adequate compliance with this section. Many people are overly optimistic about how much autonomy they have in deciding the timing of their retirement and the matter is, quite often, beyond their control. RG 209.64 provides guidance that a

financial firm should inquire about a consumer's 'exit-strategy': i.e., how that prospective loan contract will be serviced in the event that such foreseeable circumstance actually occurs. And, consistent with the record-keeping expectations of RG 209.263, that this inquiry should also be documented.

20. In our view this approach should also be taken in circumstances where the sale of the principal place of residence is the only way that the debt may be repaid.
21. We submit that the Approach should be amended to reflect that AFCA will also consider the financial firm's record-keeping in these circumstances.

3.4 AFCA determines whether the loan was unsuitable

AFCA considers whether the credit contract was unsuitable [Page 25]

22. In the Approach, there is a suggestion that it is only if and when the loan contract is determined to be unsuitable for the consumer that a breach of the responsible lending obligations occurs. On the contrary, the law contains the separate obligations of making reasonable inquiries into the consumer's requirements and objectives and into their financial situation and taking reasonable steps to verify the consumer's financial situation, where a failure to comply with any of these obligations will constitute a breach of the law. It is correct to say that breaches of these obligations in the circumstance where the loan contract is not unsuitable may not lead to the consumer suffering loss (see Also the discussion at pages 39–40 of the Approach). However, this does not mean that the financial firm is not in breach of its obligations; it does mean that the financial firm is in a position to improve its practices and systems to achieve compliance and reduce the risk of consumer harm.
23. We submit that the language in the Approach should be amended accordingly.

4.1 Overview of AFCA's approach to determining fair outcomes

The AFCA Rules and delivering fair outcomes [page 27]

24. Where the Approach presents the compensation for the different types of loss as an "either/or" list, we submit that it should be an "and/or" list to cover situations where there may be more than one form of loss present.
25. We also submit that there should be definitions and/or cross references and examples for the different types of loss, for example, to guide consumers in this section of the Approach.

4.2 Calculating responsible lending remedies

How we calculate net loss [Page 30]

26. We submit that the Approach should include details of the approach AFCA takes to depreciating an asset in calculating remedies and loss. This would provide greater transparency and predictability in forecasting loss.

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

27. We also submit that the Approach should consider the current position at law for calculating loss, and ensure that its approach is consistent with general legal principles.
28. Even where an investment loan contract is unsuitable, AFCA generally considers that investment risk rests with the consumer borrower. AFCA will only consider capital loss in exceptional circumstances (pages 34 and 35).
29. We note that the position at law is not limited in this way. While there is minimal authority regarding the principles of causation and assessment of damages under section 178 of the National Credit Act, in our view, the principles in respect of the standard damages provisions under other Commonwealth legislation (for example, *Corporations Act 2001 (Cth)* and *Competition and Consumer Act 2010 (Cth)* which includes the Australian Consumer Law) are relevant. They include:
 - (a) the question is not what was the sole cause of the loss or damage that has been sustained; it is enough to demonstrate that contravention of the Act was a cause of the loss or damage sustained;
 - (b) it may be sufficient if the contravening conduct materially contributed to the loss or damage;
 - (c) the approach to be adopted in determining whether loss was suffered by contravening conduct must be flexible and “best adapted to give the injured claimant an amount which will fairly compensate for the wrong suffered”¹ provided no injustice thereby results;
 - (d) in a ‘no transaction case’, where *restitutio in integrum* is not possible, if the Court finds for the injured party it must then calculate a monetary sum, as damages, to put the party in the position that the party would have been in had the transaction not occurred.
30. Further, RG 277 lists the possible remedies and considerations for misconduct related to consumer lease or credit contracts (page 29), including “accounting for any capital losses that have been incurred as a result of the loan”.
31. In these circumstances, we encourage AFCA to reconsider its approach to capital losses. In general, the most appropriate counterfactual when assessing responsible lending complaints is the ‘no transaction’ counterfactual (i.e., what the consumer’s position would have been had they not entered into the loan contract). Therefore, the Approach’s starting point should be to compensate consumers for capital losses, as the consumer would not have suffered these losses if they had not entered the loan.
32. In other words, if the financial firm had not breached its responsible lending obligations and provided the credit, for example, the consumer would not have entered a transaction to purchase the asset which ultimately made the loss. It is not simply a case of the consumer accepting an investment risk. If not for the financial firm’s breach, there would have been no exposure to risk. If there is to be any departure from that approach, it should be in response to the particular circumstances of the

¹ Legg, M., ‘Class action settlement distribution in Australia: Compensation on the merits or rough justice’, *Macquarie Law Journal*, Vol 16, 90-104, at [97].

case, assessed on a case-by-case basis, and not by reference to any circumscribed criteria.

33. Adopting a less restrictive approach would be more aligned with the legal principles regarding damages assessment, as well as the consumer-protection purpose of the responsible lending obligations.

4.2 Calculating responsible lending remedies

Assessing how secured assets can be dealt with fairly [Page 36]

Question 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?

34. It is appropriate that there should be no constraints on what flexibility AFCA can apply to determine remedies.
35. For example, where an unsuitable loan contract jeopardises a consumer's capacity to remain in their principal place of residence, particularly where it was an existing asset, then everything possible should be considered to ensure that consumer retains their right of residency. In such instances, the remedy may involve one or a combination of the following:
- (a) a life tenancy in appropriate cases (such as where the person is very elderly or there are no other housing options, or where there are other compassionate grounds); and/or
 - (b) having the term of any repayments on the adjusted debt extended to such length that repayments can be serviced.
36. The Committee would welcome the opportunity to discuss this submission with the Department. In the first instance, please contact Ben Slade, Committee Chair, on bslade@williamforster.com.

Yours sincerely



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Chair, Legal Practice Section