

# Submissions to the Review of the Australian Financial Complaints Authority

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My name is Anita Shannon. I am a consumer advocate, a strong supporter of Responsible Lending laws and currently studying to become a Financial Counsellor.

Accessing 'alternative' dispute mechanisms is vitally important to banking and insurance customers, as most do not have the money, nor resources and knowledge to take their complaints to the Courts.

As a part of financial counselling services, financial counsellors can (and often do) assist their clients in making complaints to AFCA.

There has been a long history in Australian law which has attempted to ensure lenders do not lend money to people who can not repay it under the terms of the contract or not without substantial hardship. (See various (now repealed) State Consumer Credit Codes S.70 (also known as the **UCCC**) (1996) (now **NCC** (S.76)) and the National Consumer Credit Protection Act (Cwth) (**NCCP Act**) – Responsible Lending obligations.

These laws also provide compensation provisions, equitable relief and amendments / changes to loan amounts and contract terms.

The NCCP Act was revolutionary as it was the first Federal piece of legislation that made 'reasonable enquiries' into a borrowers ability to repay a loan an 'obligation' under law, with civil penalties for breaches and compensation provisions for borrowers who were placed into 'unaffordable' loans from the outset.

My concern is that AFCA are not currently making determinations based upon Parliaments intentions regarding compensation for loss and damage under the NCCP Act. While I understand AFCA are not a Court, they have a legal and contractual obligation to apply the law as it stands.

I write these submissions from the perspective of an AFCA determination that 'irresponsible lending' had occurred and AFCA's current approach to providing consumer compensation for 'loss or damage' and whether this approach is 'fair, efficient, timely and independent'.

1. Is AFCA meeting its statutory objective of resolving complaints in a way that is **fair**, efficient, timely and independent?

- 1.1. Is AFCA's dispute resolution approach and capability producing consistent, predictable and **quality** outcomes?

## **National Consumer Credit Protection Bill - EXPLANATORY MEMORANDUM**

<https://www.legislation.gov.au/Details/C2009B00148/Explanatory%20Memorandum/Text>

Referring to the Explanatory Memorandum to the National Consumer Credit Protection Bill (Cwth) (2009) the approach to 'Irresponsible Lending' and 'compensation for loss and damage' is stated as follows:

### **Compensation orders for loss or damage**

**4.79** Where a licensee has contravened a civil penalty or committed an offence, and a consumer has suffered loss or damage from that contravention, the consumer can seek compensation in two ways:

- through a specific order for a compensation amount for loss and damage [Part 4-2, Division 2, section 178]; or
- through a general order to compensate loss or damage or prevent or reduce the loss or damage suffered or is likely to suffer, through a broader range of remedies [Part 4-2, Division 2, section 179].

**4.80** ASIC may make an application on behalf of the consumer with their consent for both types of orders.

**4.81** The primary reason for the two separate orders is to enable access to streamlined court procedures in section 199 for straightforward compensation matters. It is recognised that more complex claims warrant a more formal assessment under the law. However, straightforward and small claims could be addressed in simpler court proceedings. Consequently, a separate remedy for only monetary compensation is provided in section 178.

**4.82** If the amount of compensation sought under section 178 is less than \$40,000, a consumer can 'opt-in' to a streamlined court procedure at their local court, Magistrate's Court, or the Federal Magistrates Court. This procedure permits more streamlined and informal proceedings, including not having to regard legal forms and technicalities and a presumption against legal representation (see below).

**4.83** An order can be made under this provision; whether or not a declaration of contravention under section 166 has been made.

**4.84** Both types of compensation orders are limited to offences or contraventions of the Credit Bill other than the Code. This is because the Code contains self-contained civil remedies that are currently known to industry and consumers. These provisions would likely be in conflict with provisions in the Code.

**4.85** The compensation orders may only be made within six years of the day the cause of action (that is, the loss or damage to the consumer) that relates to the contravention or offence accrued.

This is to capture the situation where the contravention (for example, putting a consumer into an unsuitable contract) does not result in loss or damage to the consumer until a later time.

**4.86** Section 179 is modelled on section 1325 of the Corporation Act.

**4.87** A court may make an order as it thinks appropriate to compensate a consumer or any other affected party (the plaintiff), or prevent or reduce that loss or damage suffered where the loss or damage is the result of a contravention of a civil penalty provision or a commission of an offence under the Credit Bill [Part 4-2, Division 2, subsection 179(1)]. The defendant is the person who committed the contravention or offence [Part 4-2, Division 2, paragraph 179(1)(b)].

**4.88** The type of orders the court can make include:

- voiding or partially voiding the contract, deed or arrangement;
- varying the contract, deed or arrangement;
- refusing to enforce some or all of the terms of such a contract, deed or arrangement; and/or
- directing the contravener to pay an amount of compensation.

**4.89** This remedy is particularly important where precise restitution or compensation is not possible. It enables the court to do what is practically or equitably just between the parties.

**4.90** The flexibility given to the courts to rewrite the credit contract is due to the way in which credit contracts operate. The consumer may have utilised the credit in a way that does not allow the court to void the contract (for example, due to the purchase of a home or where the principal is used to purchase goods or services that cannot be sold, such as travel).

**4.91** An award of money may not be the most effective way of providing compensation, compared with varying the terms of the contract. Cancelling the contract (rescission) may also give a consumer an unfair benefit in the use of the principal of the loan.

#### **Example 4.2: Responsible lending**

Samuel was an electrician who earned \$1,200 a week. He spent \$600 a week on expenses. He went to a lender to get a home loan of \$200,000. Samuel needed a loan with an average interest rate that he could pay off over the medium term. Instead, he was offered a loan for \$500,000 with a high fixed interest rate and therefore repayments that he could not readily afford.

As he was experiencing hardship, Samuel sought an injunction against the lender collecting his mortgage repayments. Samuel then sought compensation for the loss and damage he had suffered for being put into an unsuitable loan. The court, under section 179, ordered the lender to **reduce the overall debt Samuel owed to the lender commensurate with what he would have owed if he had been provided with a loan that was not unsuitable** minus:

- the amount he had already paid to the lender; and
- the amount in compensation for any loss and damages he suffered as a result of getting the unsuitable product.

This recognised that Samuel received a benefit from the initial credit provided, but that he experienced loss and damage from being put into the unsuitable loan.

**4.92** Any compensation to a consumer or an order in relation to loss or damage can be mitigated (including limiting the amount of compensation) if the consumer has made a false or misleading representations in order to obtain the credit. This is to take into account what is practically just in the circumstances.

**Example 4.3 Consumer False and Misleading Representation**

In order to obtain a credit card with a \$3,000 limit, Flower claimed that she had an income of \$50,000 and had one personal loan valued at \$5,000. In fact, Flower only had an income of \$18,000 and also had another personal loan of \$3,000 plus a credit card with a credit limit of \$4,000 from other credit providers.

The credit provider offered her the credit card.

The credit provider relied on the information provided by Flower and made some reasonable steps to verify her financial circumstances in order to provide the loan. However, the credit provider did not suitably verify her income. If the credit provider had known of her true financial circumstances, they would not have offered her the credit.

When Flower could no longer meet the repayments, she sought compensation for being placed into an unsuitable credit contract.

In this instance, the court considered that Flower was entitled to a lower amount compensation for loss and damage, even if the credit provider did not suitably verify her income. This is because she made false and misleading representations to the credit provider about her financial circumstances.

**Preference for compensation**

**4.93** A person who contravenes the Credit Bill may be required to both pay a fine and compensate those who have suffered loss or damage as a result of the contravention. Where the person who has contravened the Credit Bill has insufficient financial resources for both, section 181 will require the court to give preference to making a compensation order to compensate those who have suffered loss or damage. [Part 4-2, Division 2, section 181]

**4.94** This is not directed at allowing the court to waive or reduce the fine where it considers that the defendant does not have sufficient financial resources, thereby allowing the defendant to avoid punishment. The court may still impose a fine. The provision allows the court to order that a person who has suffered loss or damage will be compensated first, that is, before the fine is paid into consolidated revenue. Where a fine is not paid, proceedings for enforcement and recovery may be commenced.

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## Fair and Practical Outcomes for the Example in 4.2

So, with regard to the Electrician example (or Sam the Sparky as I like to call him) which comes straight out of the Explanatory Memorandum Sam would:

1. have had his principle loan amount reduced from \$500,000 to \$200,000 (debt reduction)
2. the \$200,000 would have been reduced further by:
  1. the amount of interest / principal payments Sam had already made to the lender, and,
  2. the amount Sam paid for legal / disbursement / loan application fees / etc

This result would be a **fair** and **equitable** outcome for Sam, and a suitable consequence for the lender for breaching the 'responsible lending' laws, which includes a loss of principal.

Under this outcome it would be more probable that based upon the reduced loan amount, Sam:

1. would be able to make affordable repayments going forward, and,
2. would not lose his home.

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## AFCA's current approach to 'Irresponsible Lending'.

Currently, AFCA's approach to 'Irresponsible Lending' does not reflect the approach contained in the Explanatory Memorandum as stated above.

Once AFCA identifies that the lender has engaged in 'irresponsible lending' (a breach of the law) AFCA's starting position is 'what amount did the person borrow?' (no debt reduction) and then works through calculations of loss and damage from that point, while also adding a rental amount the borrower must 'pay' to the lender for living in their own property.

**Note:** I do not know the following borrowers. I downloaded this case from AFCA's own website using key search words such as 'home loan' + 'irresponsible lending' + '2019'

Example:

### AFCA Case Number 604211 – Bank: St George

Publicly available at <https://service02.afca.org.au/CaseFiles/FOSSIC/604211.pdf>

In January 2018, the borrowers obtained from the financial firm (bank) a loan for \$1,197,000 (loan) to purchase a property (property), which was taken as security.

The borrowers complained to AFCA that the bank breached their legal obligations under the NCCP Act and engaged in 'irresponsible lending'.

AFCA **agreed** with the borrowers that the Bank did indeed lend irresponsibly and therefore broke the law.

AFCA's approach to Irresponsible Lending ...

## **What is an appropriate outcome to this complaint?**

In accordance with AFCA's approach to irresponsible lending, the bank has to reimburse interest and fees to the loan. If the complainants sell the property, the bank must reduce the loan further to reimburse the complainants for purchase and holding costs. The bank is responsible for sale costs. If the complainants refinance and retain the property, they are not entitled to reimbursement of stamp duty and holding costs. The complainant has to account for the benefit received from living in the property.

AFCA considers both loss and benefit incurred from investment lending.

Where we decide it was inappropriate for a financial firm to lend funds, it has to reimburse interest and fees on the irresponsibly lent amount. We also consider what loss the complainant suffered because of the lending being provided. To do this, we consider the purpose of the loan, any benefit the complainant gained from it, and any additional costs the complainant incurred.

### **Loss if the complainants have to sell the property.**

If the complainants have to sell the property, their loss comprises:

- costs related to the purchase (for example, legal/conveyancing expenses)
- repayments made to the loan
- "holding costs" –i.e. costs of maintaining the asset (for example, council rates)
- costs of sale

### **Loss if the complainants refinance and retain the property**

If the complainants refinance the loan and keep the property, their loss comprises repayments to the loan, solicitor's fees and loan and registration fees; and solicitor's fees only.

They are not entitled to reimbursement of stamp duty and holding costs. This is because if the loan had not been advanced, the complainants would not have the property.

The holding costs and stamp duty are costs the complainants would always have had to incur to own the property and live in it; and are not costs that they will be charged by any new lender on refinance. If these costs were reimbursed and the complainants kept the property, rather than compensating them for loss from the irresponsible lend, they would be unjustly enriched –i.e. they would get a windfall.

On the other hand, the complainants are entitled to reimbursement of loan and registration fees; and solicitor's fees, since they may have to incur such costs again on refinance, so this is a loss to them. From either of these calculations of loss, we subtract the value of any use the complainant derived from the asset.

This includes rental income received from an investment property, and any tax benefits received. In this case, it includes the **benefit the complainants got from living in the property, rather than paying rent elsewhere** (this is appropriate and fair whether the complainants sell or retain the property, as they are getting the repayments to the loan reimbursed).

Where a complainant uses funds for investment purposes, such as to purchase an investment property, the complainant is liable for any shortfall after the sale of the property. This is because the bank is not liable to the complainant for the investment risk. The investment risk rests with the complainant (and also the investment reward if there is a surplus after sale).

The complainants received a benefit from living in the property. The complainants' stated intention when they applied for the loan, was to rent out the property. The complainants say that due to unforeseen circumstances, they could not rent the property out and elected to live in it, so it would not sit vacant.

**The complainants therefore had the benefit of living in the property, without paying rent to live in a comparable property.** The bank has provided a valuation which states the property had an estimated rental value of about \$820 per week. The complainants have provided two rental appraisals stating the rental value of the property is about \$700 to \$750 per week.

Generally, AFCA accepts the estimate of a licensed valuer over that of a rental appraisal, unless there is reason to vary from this approach. In the circumstances, it is appropriate to adopt the higher end of the complainants' rental appraisal (being \$750 per week), because:

The complainants provided two rental appraisals from different real-estate agencies which provide a consistent estimate of the rental value of the property. This adds weight to the estimate in the rental appraisals.

The complainants' rental appraisal was obtained in July 2019 while they were living in the property. It is therefore a more accurate estimate of the rental benefit the complainants received whereas the bank's valuation was obtained about six months before settlement.

It is unlikely the property depreciated in rental value by 15% within one year (being the difference between \$820 and \$700). In the circumstances it is fairer to adopt the higher figure of \$750, because it represents a conservative estimate which is between the bank's valuation and the lower figure in the rental appraisals.

The complainants therefore received a benefit from the property of about \$68,250 from 12 January 2018 to 15 October 2019, **being the amount of rent they saved.** The complainants incurred a financial loss due to the irresponsibly lent loan.

The account statements show that as at 11 October 2019, the complainants owed \$1,190,507 on the loan.

Considering the benefit the complainants received, AFCA has calculated a revised debt owing:

**of \$1,112,102** as at 11 October 2019 if the complainants sell the property.

**of \$1,177,053** as at 11 October 2019 if the complainants refinance and retain the property.

This means as at 11 October 2019, the complainants have incurred a loss due to the loan being provided:

of **\$84,186** if they sell the property (\$1,196,288 less \$1,112,102)

of **\$19,235** if they refinance and retain the property (\$1,196,288 less \$1,177,053)

The complainants must repay one of the alternative final revised debt amounts to the bank within 180 days of their acceptance of this determination (whether by sale of the property or refinance).

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So in breach of the Explanatory Memorandum, AFCA provided no debt reduction of the principal amount, added 'rental costs' to the borrowers debt for living in their own property and 180 days to finalise the debt in full, with the Bank.

I can not see in this determination an option that would allow the borrowers to make payments on an amount that was affordable, nor an option that instructs the Bank to continue in the contract at that affordable rate.

These borrowers were not even in 'default' under the terms of the contract when they made this complaint. (Page 3).

What this approach also does not consider is the possibility that borrowers may have had to borrow money from family members or obtain further credit from other sources in order to meet their repayments obligations under a 'irresponsible loan'.

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### **What should have happened?**

Inputting the financial details of these two borrowers (found on page 9 of the AFCA determination) into the St George Banks own calculator the results were these two borrowers had the capacity to borrow an amount of:

**\$280,033**

**St George Bank – How much can I borrow calculator.**

<https://www.stgeorge.com.au/personal/home-loans/home-loan-calculators/mortgage-calculator>

**However the loan amount approved by the Bank was \$1,197,000**

Using the Explanatory Memorandums example under **Example 4.2: Responsible lending** the consumers would have been required to repay \$280,033 (the affordable loan amount) less the repayments already made, less the costs of acquiring the loan.

I'm sure these borrowers would have been able to make arrangements with the Bank to make the reduced payments going forward without having to sell or refinance the home.



The Bank would need to take the hit on principal (as per the law) as they engaged in irresponsible lending.

As you can see – these two approaches (AFCA v Explanatory Memorandum) to irresponsible lending create very different outcomes for consumers.

As AFCA is required to ‘put consumers first’, a real review of the current AFCA approach to compensation calculations for customers who have experienced irresponsible lending MUST occur!

**AFCA must be made to follow the intentions of Parliament when it passed the National Consumer Credit Protection Act (Cwth) regarding irresponsible lending, compensation provisions.**

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### **Meeting with the CEO of AFCA**

On 5 April 2019 I attending the UWA, Business School Event -Banking - What is next? breakfast event in Perth wherein Mr Locke, the CEO of AFCA was guest speaker. It was just after the Royal Commission and he was speaking to Industry participants and also Consumer Advocates about the newly formed AFCA and what it could do.

After the event I approached Mr Locke personally and asked him why AFCA were not providing ‘debt reductions’ for irresponsible lending, and explained to him what was contained in the Explanatory Memorandum (ie Parliaments intentions), aka Sam the Sparky example.

To be fair to Mr Locke, he was in a hurry to leave as he needed to catch a plane so we didn’t speak for long, however he did say that if Labor were elected into office, Ms Clare O’Neil, the then shadow Finance Minister, would ensure debt reduction was available under AFCA’s rules and guidance, however it was not to be included as an option under the Liberal / National Government.

As it is not currently the AFCA standard approach to adhere to the Explanatory Memorandum Irresponsible Lending provisions / intention regarding debt waiver / compensation provisions I can only assume this is a political decision by the Liberal / National Government and does not, in my opinion reflect a fair approach to compensation to customers for Irresponsible Lending in AFCA.

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### **My Recommendations**

**As AFCA was established under the ‘Putting Consumers First’ legislation:**

1. Ensure that AFCA are applying the ‘debt reduction’ provisions under the NCCP Act as per the Explanatory Memorandum and using that amount as its base amount for calculating further loss or damage, not basing calculations upon the ‘full amount loaned’.

2. Ensure that AFCA removes the current additional cost (as an implied benefit) of 'rent' in its consideration for compensation. This is not something that was considered under the legislation, nor can I find any 'case law' that would support the additional payment of 'rent'.

3. Ensure that under an AFCA determination it is **imperative** that considerable consideration is given to options that would allow a consumer being able to remain in their home, and not be pressured into refinancing or selling if the reduced amount of the loan can be repaid under the terms of the contract, at no interest, (even if the loan term has to be extended).

This is also in the Public Interest in so far as tax payers and not for profit charities should not be left to clean up this mess by having to assist now (potentially) homeless people access housing and other essential services such as mental health services and counselling.

It would be much fairer to ensure that lenders and AFCA are doing everything they can to ensure Australians are not becoming homeless through irresponsible lending.

4. Enquire of AFCA:

1. how it's current approach to compensation provisions / calculations for irresponsible lending was established?
2. who it consulted with when establishing this approach?
3. whether or not it believes this approach is consistent with the intention of parliament when it passed the NCCP Act and therefore is consistent with the law?
4. whether or not (and if so when) AFCA obtained legal advice regarding the current approach?
5. whether or not AFCA provides complainants with an opportunity to argue a position against unjust enrichment? Ie ... 'change in position'.

5. Ensure that ALL irresponsible lending breaches are reported to ASIC, as they have a responsibility under the Act to apply for civil penalties against lenders who breach the law.

6. Establish a system where complaints regarding the 'approach' by AFCA can be challenged and assessed by an independent adjudicator to ensure AFCA's approach is consistent with the law.

Thank you for considering my submissions.

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