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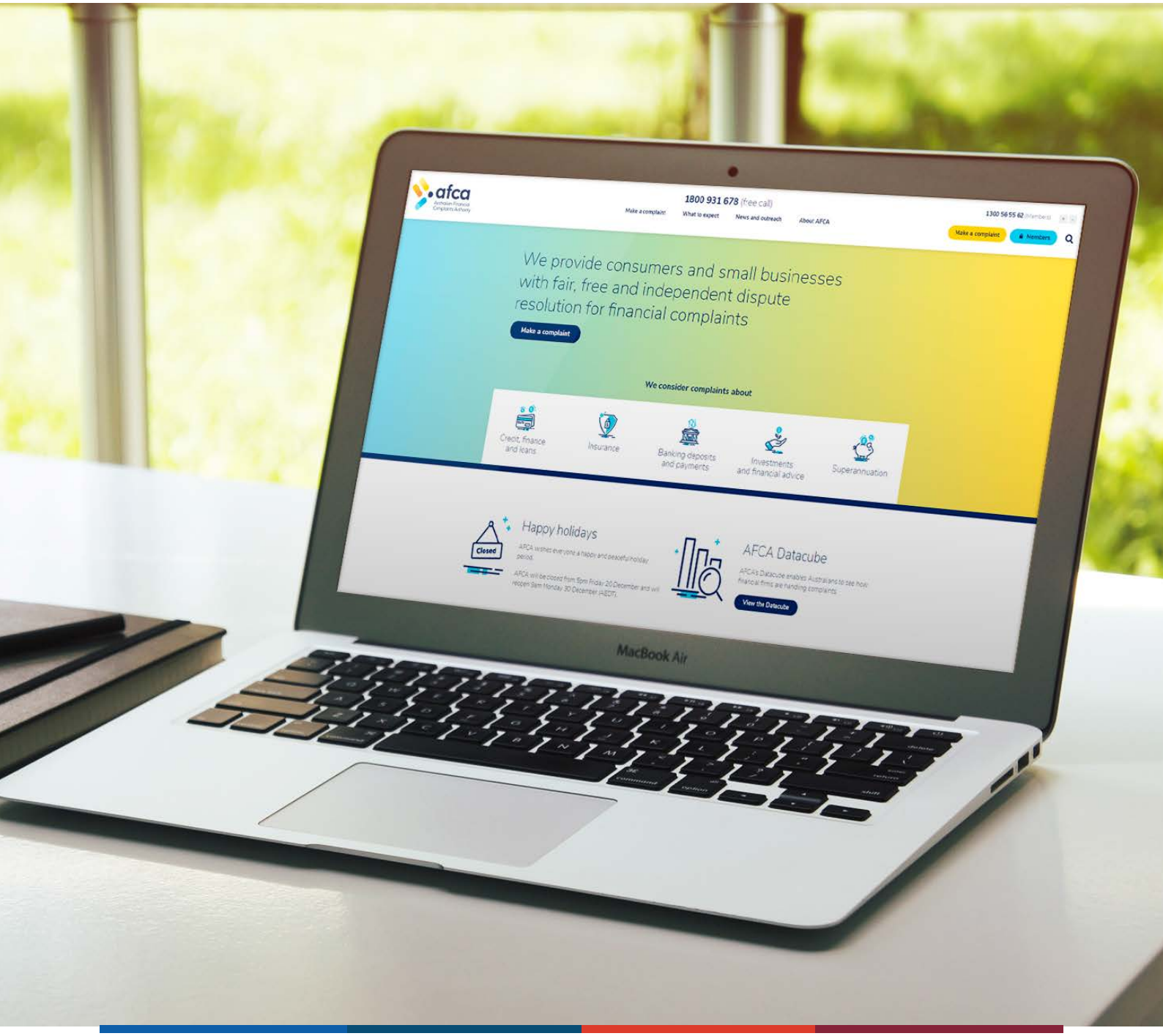


AFCA (AN OVERVIEW)

A PAPER SUMMARISING THE PRESENTATION GIVEN BY NADIA SABAINI AND CHARLIE YOUNG AT THE PRIVATE LENDERS FORUM 2019 HELD ON 14 NOVEMBER 2019.

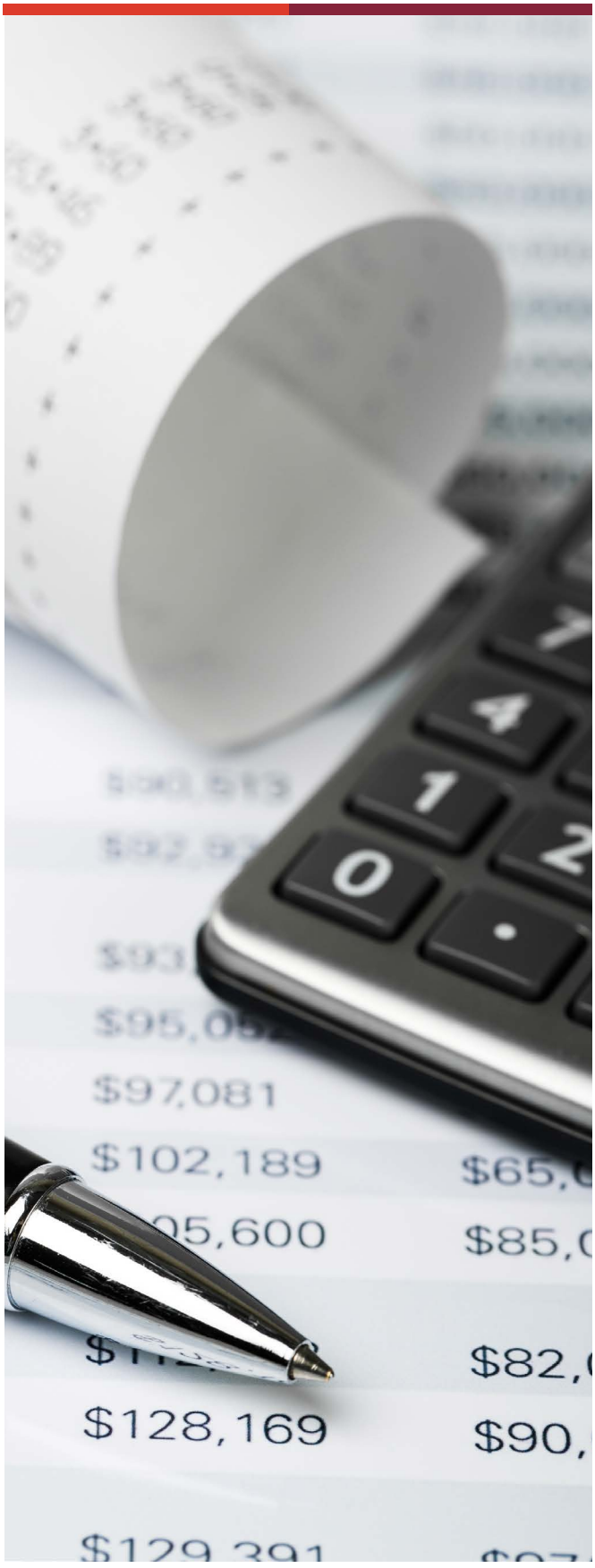
ABOUT AFCA

The Australian Financial Complaints Authority (AFCA) was established on 1 November 2018 and replaces the three previous external dispute resolution schemes: Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (STC).

AFCA is now the single new mandatory external dispute resolution scheme (EDR) for complaints regarding credit facilities, insurance, banking payments and transactions, investments and financial advice, and superannuation.

All credit licensees and financial services licensees must apply for membership of AFCA when their Australian Credit Licence or Australian Financial Services Licence is issued.

In addition to its EDR function, AFCA also reports on system issues, serious breaches and collects data for legislative purposes. However, in this paper, we will only look at AFCA's EDR function and only in respect of credit complaints.



AFCA JURISDICTION – CREDIT COMPLAINTS

To make a complaint to AFCA, a complainant must be an 'Eligible Person', which means:

A consumer
(individuals)

A small business
(sole trader, partnership, company or club/association with less than 100 employees)

A strata title body corporate

A registered charity

The complaint must be about a 'Financial Firm' that is an AFCA member, that is, in the context of credit complaints, a credit provider, broker or other business who holds an Australian Credit Licence or Australian Financial Services Licence.

The complaint must meet two important threshold requirements:

1. Time limit – AFCA will not consider:
    a. For certain specific complaints under the National Credit Code (eg. hardship), complaints made after the later of 2 years from termination of the credit contract or 2 years from an internal dispute resolution decision of the Financial Firm;
    b. For other general credit complaints, complaints made after the earlier of 6 years from the complainant becoming aware or 2 years from an internal dispute resolution decision of the Financial Firm.

2. Monetary limit – AFCA will not consider:
    a. For individuals, claims exceeding $1m (unless regarding a guarantee supported by a mortgage on the guarantor's home – in which case there is no monetary limit);
    b. For small businesses, complaints regarding facilities exceeding $5m

AFCA JURISDICTION – CREDIT COMPLAINTS

The complaint must also not be an excluded complaint. Excluded complaints include:

a. complaints about the quantum of fees, interest rates (except regarding non-disclosure);

b. complaints about a non-financial service or product;

c. complaints solely about investment performance;

d. complaints previously dealt with by AFCA; and

e. complaints already dealt with by a Court (with some exceptions).

Reference should be made to AFCA's Rules and Guidelines for additional and more technical requirements, which may depend on the nature of the complaint.

It is important to note that AFCA's credit complaints jurisdiction is not limited to Credit Code loans. AFCA will determine a complaint regarding a non-code facility if:

a. the Financial Firm is an AFCA member (ie. holds an Australian Credit Licence or Australian Financial Services Licence); and

b. the complaint meets the remaining jurisdictional requirements.

The remedies that AFCA can grant include:

a. a release from the security or debt (including not enforcing a default judgement obtained); and

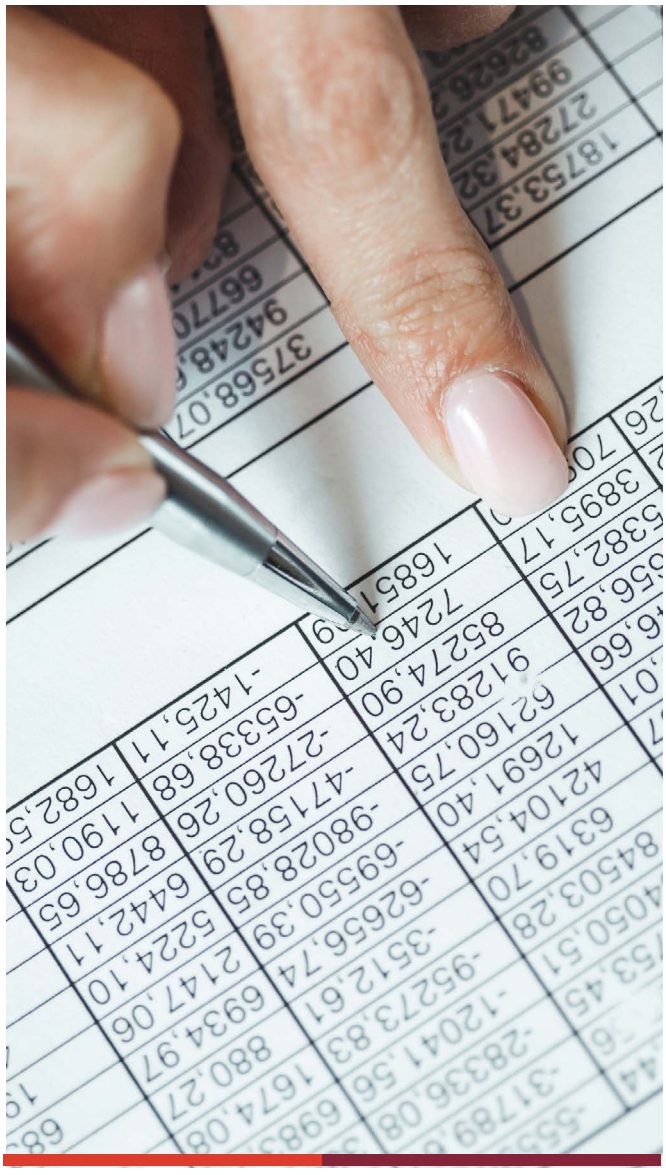
b. damages (including interest on damages).

There are some damages caps, which for credit complaints are generally:

a. Individuals - $500,000

b. Small businesses - $1m (primary producers $2m)

c. Guarantors – unlimited.



COMPLAINT PROCEDURE

Consumers are not required to utilise AFCA's EDR process and are at liberty to file proceedings in Court, should they want to do so. However, making a complaint is free and there is no requirement for legal representation. Complaints may be filed online, through an online form submission.

AFCA will notify the Financial Firm on receipt of a complaint and allow a set time for the Financial Firm to attempt to resolve the complaint unless AFCA considers it appropriate to investigate immediately.

Once a complaint is on foot, the Financial Firm is generally prohibited from taking further action against the complainant, for example, the Financial Firm:

a. must not take any action to recover the debt, or protect the assets secured, and may not begin proceedings against the borrower or guarantor;

b. must not continue any previously commenced proceedings (eg. to obtain default judgement) other than to protect its legal rights;

c. must not assign the debt; or

d. must not list a default on the complainant's credit file.

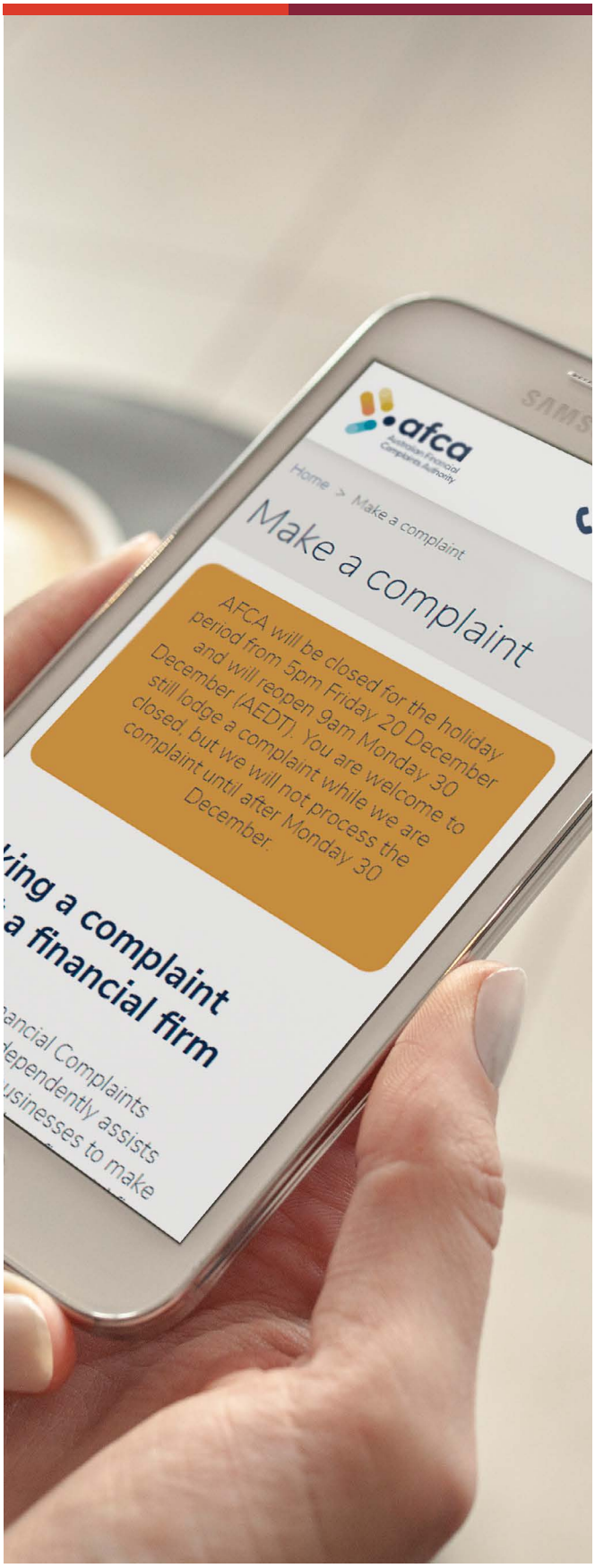
AFCA may consent to the Financial Firm taking certain actions in certain cases, for example:

a. to begin proceedings if a limitation period is about to expire or to run as a test case;

b. to freeze, preserve or sell assets in certain cases;

c. to continue proceedings where complainant took steps to defend by more than merely filing a defence; or

d. to enforce a default judgement already obtained.



COMPLAINT PROCEDURE

THE EDR PROCESS ITSELF MAY BE SUMMARISED AS A THREE-STEP PROCESS:

STEP 1
Conciliation Conference

STEP 2
Preliminary Assessment or Recommendation

(to which each party may make submission)

STEP 3
Final Determination

Determinations will be made by the Chief Ombudsman, an Adjudicator or a panel.

Each party must comply with all information requests and all information collected will generally be shared with both parties, subject to certain exemptions that may be granted for sensitive information.

The EDR process is confidential and without prejudice, so information cannot be used in any court proceedings. However, it should be noted that AFCA determinations are publicly available, and from October 2019, AFCA will name Financial Firms in its determinations.

An AFCA determination is final and binding if accepted by the complainant within 30 days of receipt. The complainant may choose not to accept the determination and both parties are released. However, if the complainant accepts, then 'final and binding' means there is no right of appeal to a Court by the Financial Firm. The Financial Firm will need to abide by whatever decision is made, including forgiveness of the debt, release of the security or payment of damages. It is therefore important to look closely at how AFCA decisions are made.

ATTITUDES AND RECENT DECISIONS

AFCA's publicly available statistics indicate that consumers are very aware of the ability to file a complaint with AFCA, and AFCA has been very diligent in taking up complaints and dealing with them fairly rapidly. Our research indicates that AFCA receives some 200 complaints per day (on average) and most complaints are accepted. Just over 33% of complaints relate to consumer loans, business finance and housing finance.

Over the past 12 months, AFCA has heard 73,000 complaints for a reported $185 million in compensation awarded. Lenders and other Financial Firms who hold an Australian Credit Licence or Australian Financial Services Licence should thus be very aware of AFCA's presence and the likelihood of having to defend a complaint.

It is absolutely important that lenders appreciate that, if a complaint goes before AFCA, simply being able to demonstrate that the lender followed the law, will not always be enough. This is because AFCA bases its decisions on what it considers to be fair in the particular circumstances and this involves more than the law.

In making a decision, AFCA will have regard to:

1. legal principles (although AFCA is not strictly required to strictly apply them);
2. applicable codes (although AFCA is not strictly bound by any minimum standard set by a Code);
3. 'good industry practice' (or at least what AFCA considers that to be); and
4. previous determinations (although AFCA is not bound to follow a previous decision).

Given AFCA's discretion, it can be extremely difficult to predict the outcome of a complaint.

Lenders must not deal with AFCA complaints half-heartedly, nor treat them in the same manner they might treat a strictly legal dispute. To do so could be disastrous.

Due to the subtleties associated with AFCA's decision-making process, it is vital that lenders obtain legal advice before responding to a complaint. This is for two main reasons:

1. The lender needs to be aware of all the potential issues that AFCA might consider important in the relevant case, based on the particular facts. Do not expect all of those issues to be mentioned in the complaint, as AFCA will draw its own conclusions so it is necessary to think beyond what is strictly listed in the complaint.
2. The lender needs to know what legal argument can or should be made, and what evidence should be produced, to address those issues. This is however also not limited by rules of evidence, and additional information or evidence may be admissible and considered by AFCA, so it is important to not only identify the issues at play and the law, but also research and gather supporting information on the question of fairness and the circumstances of a complaint.

By way of example, we will consider two AFCA determinations of common complaints we see made against lenders on the following pages.

ATTITUDES AND RECENT DECISIONS

EXAMPLE 1: 'THE MORTGAGEE SOLD MY HOUSE BELOW MARKET VALUE' [CASE NO.605672]

The complainant had several loans with a lender secured by a mortgage on the complainant's residence. A default arose and the lender exercised power of sale, selling the home for $92,000. The complainant complained that the lender breached its obligation to sell at market value noting that the Council's earlier rateable value of the property was $160,000.

The lender's independent appraisals for the property had the property in the range of $110,000 to $135,000. However, the lender's independent valuation gave the property a value of $80,000 to $90,000. On the face of it, one might be led to think the lender was safe. However, that is not enough.

ACFA'S DECISION:

Section 85 of the Property Law Act 1974 (Qld) states that a mortgagee is under a duty to take reasonable care to ensure the property is sold at market value. For a residence, this requires the mortgagee to:

a. Obtain reliable evidence of value;

b. Adequately advertise;

c. Maintain the property and undertake reasonable repairs; and

d. Sell by public auction, unless appropriate to sell another way.

Furthermore, AFCA stated that it also expected FF to:

a. Act in good faith without wilfully or recklessly sacrificing the mortgagor's interests; and

b. Follow 'good industry practice' (such as not to unreasonably delay auction, to set the reserve after obtaining a valuation, etc).

Although AFCA ultimately found in favour of the lender, AFCA assessed the lender's conduct in considerable detail. This highlights that, to avoid an adverse finding, a credit provider is expected to go above and beyond what the law strictly requires. A failure by a lender to apply 'good industry practice' in this type of situation could potentially have lead to the lender to provide compensation in connection with the sale, despite having adhered to the letter of the law.

EXAMPLE 2: 'I WAS MISLED ABOUT THE GUARANTEE AND PRESSURED INTO SIGNING' [CASE NO. 615032]

The complainant's son needed finance to buy a business. The complainant (mother) agreed to act as guarantor and offer her residence as security. A company was established as the vehicle to purchase the business, with both the mother and son as directors and shareholders. They contacted a broker who arranged two loans from a lender. In an email to the broker, a representative of the lender erroneously stated that only one loan ($80,000) was secured by the mortgage over the guarantor's residence and the other ($170,000) was not. This is despite the fact that the guarantee clearly stated that it secured the sum of $250,000 plus interest and costs.

In her AFCA complaint, the guarantor claimed that the lender had misled her and that she thought her liability was limited to $80,000, despite what the guarantee said. She said the broker told her what was in the email from the lender and she proceeded on the faith of this. She also claimed she had been pressured into signing by her son and should not be liable. No legal advice certificate was obtained by the lender.

In response to the complaint, the lender submitted that the guarantee's terms were clear on the face of the guarantee and that, as a director and shareholder of the borrower company, the complainant would have known the structure of the loans in dispute and her responsibilities.

ACFA'S DECISION:

AFCA did not agree. AFCA determined that being a director of the company did not mean that the guarantor was acquainted with the knowledge of the company's affairs, which appears contrary to the position of, say, the ATO. Furthermore, AFCA determined that the lender mislead the complainant (by virtue of the email to the broker) and that the guarantee was totally unenforceable, meaning no part of the debt was secured, including the $80k which the complainant said she understood she was liable for.

This determination highlights the fact that lenders must be very careful taking guarantees from any parent or spouse of a borrower, or any other person who could argue that they were at a special disadvantage. Furthermore, lenders cannot assume that a director of a company has inherent knowledge and it is important to obtain a legal advice certificate, which in this case may have assisted to bring the misunderstanding to light or go some length to counter the alleged misrepresentation.

OBSERVATIONS AND RECOMMENDATIONS

The nature of AFCA's external dispute resolution raises some serious concerns for Financial Firms. Whilst the creation of a body to give consumers greater access to fair justice is commendable, if lenders are forced to ascribe to a process without appeal, which is based on seemingly subjective standards, this raises a serious question of procedural fairness for the lender.

We have a concern that this system could lead to more non-bank lenders abandoning their credit licence and further alienating themselves from the regulatory system, rather than being encouraged to become part of it. Ultimately, however, whilst there may be questions of legal reform to be taken up by the industry, lenders must be aware of the current system and do their best to adapt to it.

We make the following recommendations to lenders who hold an Australian Credit Licence:

1. Never proceed without a legal advice certificate. AFCA will invariably give complainants the benefit of the doubt, therefore proceeding without a legal advice certificate places the lender at significant risk and makes it considerably more difficult to defend the lender's position.

2. Simply following the letter of the law is not enough. AFCA has additional expectations of lenders based on good industry practice and fairness. Lenders need to consider customer expectations and what additional steps can be taken to ensure the borrower/guarantors are afforded the outmost fairness.

3. Lenders should bring their documentation and procedures up to Credit Code and Banking Code standard even for non-code non-bank loans. AFCA will refer to these Codes as guidance of good industry practice so consider meeting the standard set by the Codes even when not required by law. A few easy-to-include procedures that will help raise your loan standards include:

    a. Emailing guarantee documents to a guarantor directly, not to the borrower (see Credit Code);

    b. The signature page of documentation containing some form of warning statement (see Credit Code); and

    c. Guarantors being afforded a cooling off period of 1-3 days before the loan is advanced to the borrower (see Banking Code of Practice).

4. Never dismiss a complaint, but seek legal advice immediately. Given the non-appealable nature of AFCA decisions and the fact that AFCA now publishes the name of Financial Firms in its decisions, a complaint needs to be treated seriously. Even if the lender is afforded a period to carry out internal dispute resolution, the lender should still seek advice at this time on the best manner of conducting that process so it has the best chances of resulting in a mutually acceptable solution. Ignoring the complaint or downplaying the complainant's concerns could result in the complaint proceeding to an AFCA decision that is adverse and cannot be appealed.

5. If a complaint proceeds to a preliminary assessment or recommendation, lenders should seek advice on the legal argument but also research and dig hard for factual evidence that surrounds and supports the lender's position. Traditional rules of evidence do not apply, so there could be useful information in the lender's records, the broker's records or available through public searches and enquiries, that could help paint a different picture from that outlined in the complaint.

We recommend to all lenders to engage the services of solicitors who specialise in the area of credit law and are familiar with industry requirements, industry practice and the challenges faced by non-bank lenders for the purpose of preparing loan documentation and undertaking debt recovery. Furthermore, when responding to an AFCA complaint, it pays to seek the advices of a solicitor who has previously advised in AFCA complaint matters and is familiar with its procedures and prior decisions.

COMMENTS FOR NON-LICENSED LENDERS

A final point to be raised is, for those lenders who do not hold an Australian Credit Licence and are not subject to the AFCA external dispute resolution system, it is good to remain informed of the obligations of Australian Credit Licensees as consumer credit laws may be extended to other forms of credit at some point in future, whether wholly or in part, depending on future law reform.

Additionally, whilst non-licensed credit facilities will not be the subject of AFCA's jurisdiction, non-licensee lenders should bear in mind that:

1. The Courts will still consider issues of misrepresentation if a claim for recovery is defended by the debtor, so it is still important for the lender's documentation to be clear and the lender's procedures to meet the highest standards, regardless.

2. Having a higher standard of business may not necessarily reduce frivolous complaints or defaults on high risk facilities, but it should reduce disputes based on misunderstandings and result in a better relationship with customers as well as cheaper and faster recovery of the loan (if required).

3. All States and Territories have mandatory mortgagee sale requirements that apply to all land mortgages, so it is important to seek legal advice when a default arises, as failing to meet the requirements may leave the lender exposed to injunction proceedings or a damages claim.

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