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**Community
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Credit law: Assisting clients experiencing mortgage stress

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What we'll cover

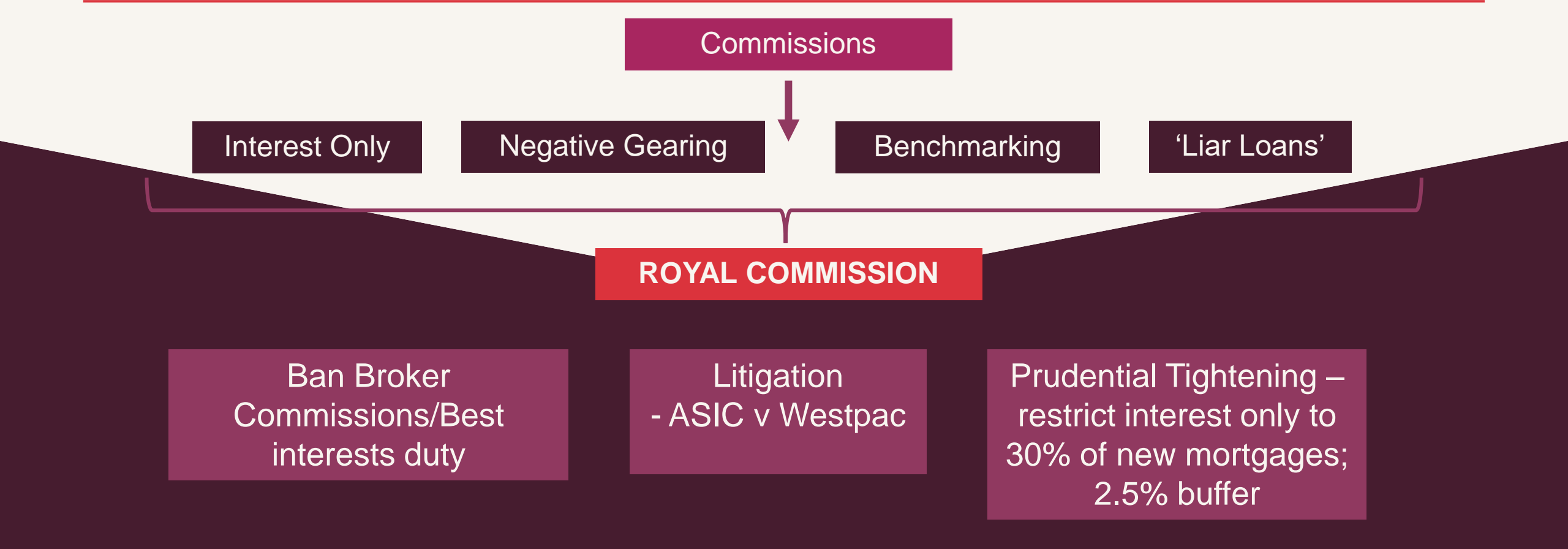
Over a decade of soaring property growth, generous tax incentives for property investors and record low interest rates has resulted in Australian households being among the most indebted in the world.

We will look at this problem in the context of unprecedented interest rates increases which will see thousands tipped from fixed to variable rates.

We will discuss borrowers rights under the [National Consumer Credit Protection Act 2009](#) (Cth) and explore the pros and cons of taking a complaint to the Australian Financial Complaints Authority (AFCA) as opposed to litigating.



Current setting and how we got here



Fixed rate mortgages end in mortgage stress

- The cash rate jumped from 0.1 per cent in May 2022 to 4.35 per cent as at April 2024.
- The RBA expected more than **800,000 households**¹ would fall off fixed rates on to more expensive variable rates in 2023.²
- Roughly **one in four home borrowers who took out mortgages at fixed rates**³ of around 2 per cent come off them and onto variable rates of 6-9 per cent.⁴
- For a household with average mortgage amount of \$600,000 that's an increase from \$2,200 per month to around \$4,000.
- Westpac warned that almost half of its \$471 billion in home loans were written using interest rate buffers that are set to be exceeded.⁵

Investors pass it on to renters

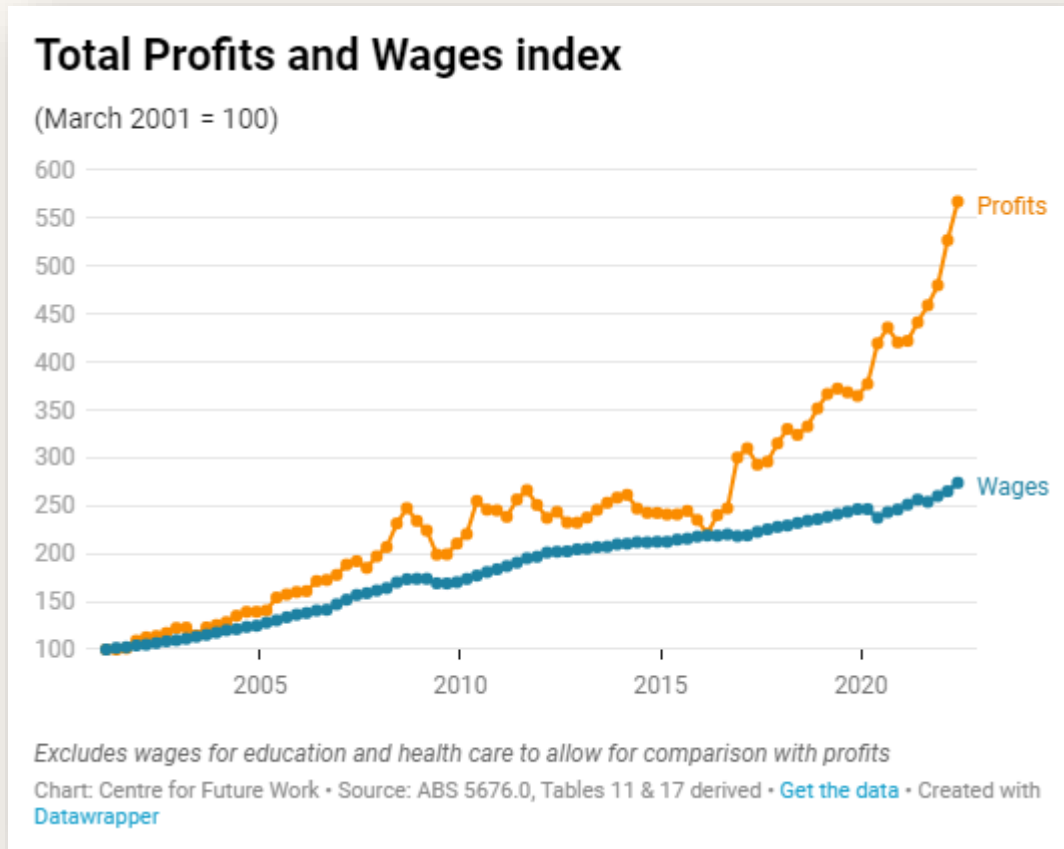
- Annual rent increases, which are calculated monthly, topped 10% in late 2022 and early 2023. The last time rents increased at such a pace was in 2007 during the global financial crisis, when peak annual rent growth reached 9.7%.
- Other factors:
 - shortages of building materials slowing down construction,
 - a lack of affordable and social housing,
 - increasing numbers of short-term rentals,
 - recent higher-income growth for some,
 - the trend towards smaller households; and
 - a fresh surge in migration.

Investors pass it on to renters

The report by property data firm PropTrack shows rental vacancy rates fell 0.14 percentage points in August 23 to hit a new low of **1.10%**, with the share of rental properties on the market now **54%** lower compared with pre-pandemic levels.



What's driving inflation?



Bureau of Statistics indicators show that over the 12 months to June 2023 total corporate profits rose **28.5%** while total wages paid rose just **6.8%**.

Other inflationary drivers: 2020 COVID early release? **\$38 billion** withdrawn, disproportionately by lower earners

National Consumer Credit Protection Act (NCCCP)

Background

After the Global Financial Crisis, the *National Consumer Credit Protection Act 2009* (Cth) (NCCCP Act), incorporating the National Credit Code (NCC), were put in place in order to:

- provide consumer protection,
- encourage prudent lending, and
- curtail undesirable market practices by lenders and intermediaries.

Intended to:

- ensure that credit providers, conduct appropriate inquiries of the consumer to ensure that the credit is provided responsibly; and
- enhance consumer protection by ensuring that credit providers did not provide credit to consumers who do not have the capacity to repay or is otherwise unsuitable.

National Consumer Credit Protection Act (NCCCP)

Key lending obligations

Section 128 provides that the licensee must not enter into a credit contract with a consumer, unless it has, within 90 days of entering into the contract (inter alia):

- made an assessment as to whether the contract will be unsuitable for the consumer;
- made reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract;
- made reasonable inquiries about the consumer's financial situation;
- taken reasonable steps to verify the consumer's financial situation;

National Consumer Credit Protection Act (NCCCP)

Key lending obligations

Section 131 provides that the licensee 'must assess' the credit contract as unsuitable for the consumer if, at the time of assessment, it is likely that:

- the consumer will be unable to comply with their financial obligations under the contract or could comply with those obligations only with substantial hardship; or
- the contract will not meet the consumer's requirements or objectives.

Pursuant to s131(3), it is presumed that the consumer will be under substantial hardship if they can only comply with their financial obligations under the contract by selling their principal place of residence, unless the contrary is proved.

National Consumer Credit Protection Act (NCCCP)

Key lending obligations

Section 132 states that consumers are entitled to copies of the assessment before and after entering into the credit contract.

A lender is prohibited from entering into an unsuitable contract with a consumer (s133(1)).

The fact that a mortgage broker has made a preliminary assessment in relation to a consumer does not relieve the lender of its obligation to make its own assessment.

This position has been confirmed in two cases where the lender's reliance on the broker's assessment was not sufficient, confirming lenders' direct responsibilities to assess customers' suitability themselves:

- *ASIC v The Cash Store* [\[2014\] FCA 926](#) [68];
- *Australian Securities and Investments Commission v Channic Pty Ltd (No. 4)* [\[2016\] FCA 1174](#) [1804]

National Consumer Credit Protection Act (NCCP)

Remedies & Time Limits

Pursuant to s178, the court may order the defendant to compensate the plaintiff for loss or damages suffered by the plaintiff if:

- the defendant has contravened a civil penalty provision or committed an offence against the NCCP Act (other than the Consumer Credit Code); and
- the loss or damage resulted from the contravention or commission of the offence.

The court may only make an order for compensation pursuant to s178 if the plaintiff applies **within six years** of the day the cause of action that relates to the contravention or commission of the offence accrued.

Explanatory Memorandum to the NCCP Bill 2009, 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.**

National Consumer Credit Protection Act (NCCCP)

AFCA Time Limits

B.4.2 Complaints to which the National Credit Code applies

B.4.2.1 Where a complaint relates to a **variation of a credit contract** as a result of financial hardship, an unjust transaction or unconscionable interest and other charges under the National Credit Code, AFCA will generally not consider the complaint unless it was submitted to AFCA before the later of the following time limits:

- a) within two years of the date when the credit contract is rescinded, discharged or otherwise comes to an end; or
- b) where, prior to lodging the complaint with AFCA, the Complainant was given an IDR Response in relation to the Complaint from the Financial Firm - within two years of the date of that IDR Response.

B.4.3 Other complaints

B.4.3.1 In other situations, AFCA will generally not consider a complaint unless it was submitted to AFCA before the earlier of the following time limits:

- a) within six years of the date when the Complainant first became aware (or should reasonably have become aware) that they suffered the loss; and
- b) where, prior to submitting the complaint to AFCA, the Complainant was given an IDR Response in relation to the complaint from the Financial Firm - within two years of the date of that IDR Response.

Scope of Losses (AFCA)

Can losses include investment loss on the property?

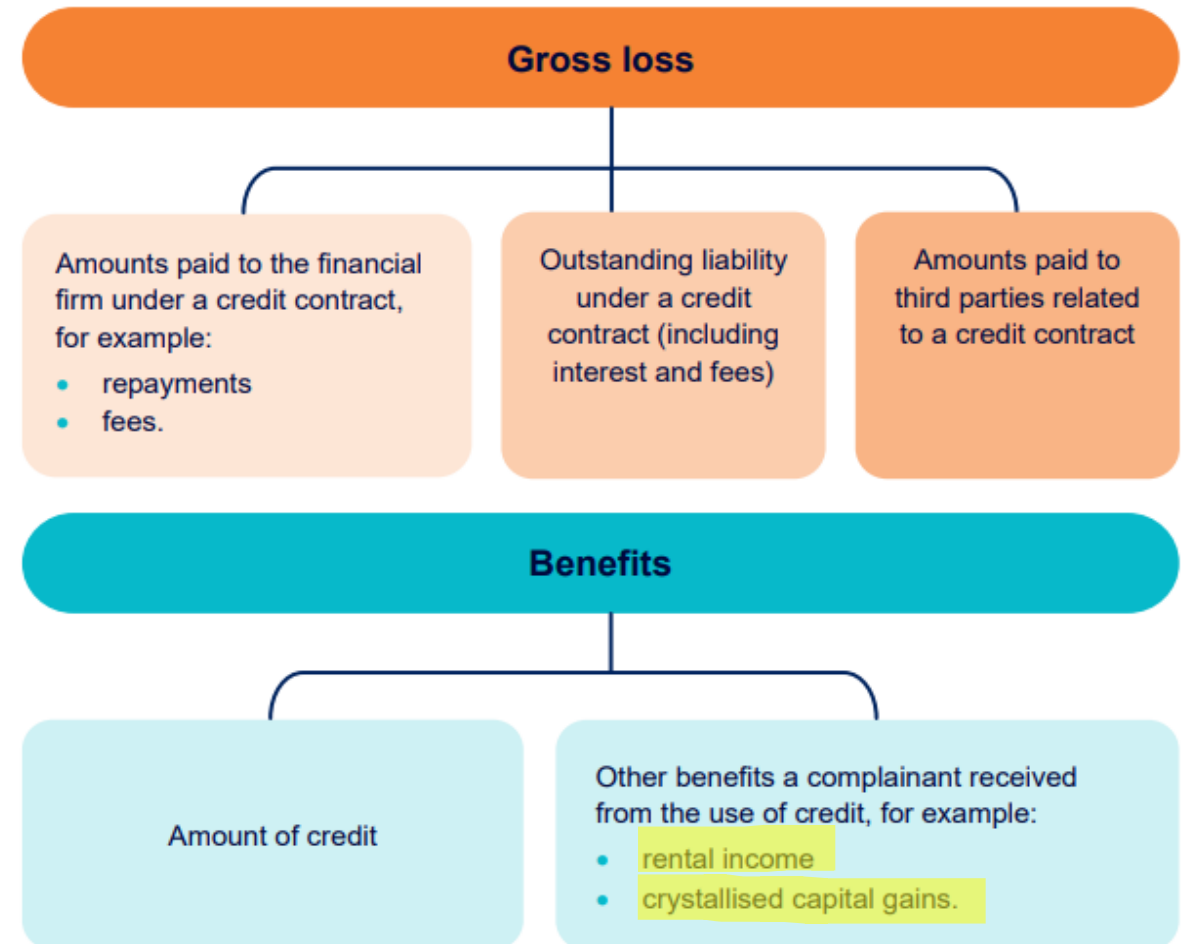
- Not according to AFCA:
 - ‘The consumer bears the risk of their investment choice, which may either increase or decrease in value over time. In those cases, the consumer’s loss is only the interest and fees they have paid to the FSP.’
(<https://www.afca.org.au/media/1764/download>)
 - ‘AFCA generally considers a complainant received a benefit from the full amount of credit used to purchase a residential investment property, even if they suffer a capital loss on resale of that property.’
- But AFCA do reduce damages by at least some investment gains. E.g. rental income and crystallised capital gain...



Scope of Losses (AFCA)

The AFCA Approach to Responsible Lending

- AFCA will generally require a financial firm to compensate a complainant for their 'net loss'.
- the complainant's net loss is their gross loss, less the benefit they received from the credit contract.



Scope of Losses (AFCA)

When complainants do not receive a benefit from a loan

In some cases, AFCA may determine:

- the complainant's benefit from the credit contract is less than the amount of credit the lender provided them
- the complainant received no benefit from the credit contract.

Some examples include where:

- the funds were applied for the benefit of, or misappropriated by, a third party
- there was a secured loan to purchase a personal asset that the complainant now agrees to surrender or sell, and that asset has declined in value so the complainant has suffered a capital loss.

Where loan funds are misappropriated by a third party, AFCA may consider the connection between the misappropriation and the financial firm's lending decision. This may involve AFCA **considering whether the financial firm was or should have been on notice that the funds may be misappropriated**. AFCA will consider all of the circumstances to determine whether it is fair for the financial firm or the complainant to bear the loss caused by the misappropriation.

Is that approach lawful?

We advocate for a ‘but for’ approach to losses.

Consistent with:

- s178 of the NCCP which allows for the payment of compensation for loss or damage which has resulted from the contravention of a civil penalty provision or offence.
- the Common Law where courts have interpreted similar provisions in other Acts to mean that the loss or damage which is caused by the contravening conduct can be recovered, and that the contravention of an Act only needs to be a cause of the loss or damage sustained, not the sole cause of the loss or damage.

Benchmarking tools

Used to assess affordability in around 80% of loans, the Household Expenditure Measure (HEM) benchmark **does not include:**

- Rent/lease payments;
- Mortgage payments/home purchase costs;
- HECS/HELP payments;
- School fees;
- Some medical charges, and counselling services;
- Some insurances, including life insurance, sickness insurance, personal accident insurance;
- Union and professional association fees; and
- Gambling.



‘HEM should not and cannot be used as a substitute for inquiries or verification, notwithstanding that it may have some utility in assessing whether or not a particular consumer is likely to experience substantial hardship as a result of meeting their obligation to repay a line of credit’.

- Commissioner Hayne

Benchmarking Tools

Royal Commission Recommendation 1.1

The NCCP Act should not be amended to alter the obligation to assess unsuitability.

Commissioner Hayne:

'If the court processes were to reveal some deficiency in the law's requirements to make reasonable inquiries about, and verify, the consumer's financial situation, amending legislation to fill in that gap should be enacted as soon as reasonably practicable.'

Westpac Judgement Handed down: 13 August 2019

The Federal Court has dismissed ASIC's responsible lending case against Westpac and ordered the regulator to pay the bank's costs.

Lender has no obligation to use declared expenses to assess affordability as they are an unreliable indicia for financial hardship:

"I may eat wagyu beef everyday washed down with the finest shiraz but, if I really want my new home, I can make do on much more modest fare."

Broker Remuneration

Royal Commission Recommendation 1.3

The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending.

Initial Govt. response

From 1 July 2020, the Government will prohibit for new loans the payment of trail commissions from lenders to mortgage brokers and aggregators.

Draft legislation - Mortgage broker best interests duty and remuneration reforms

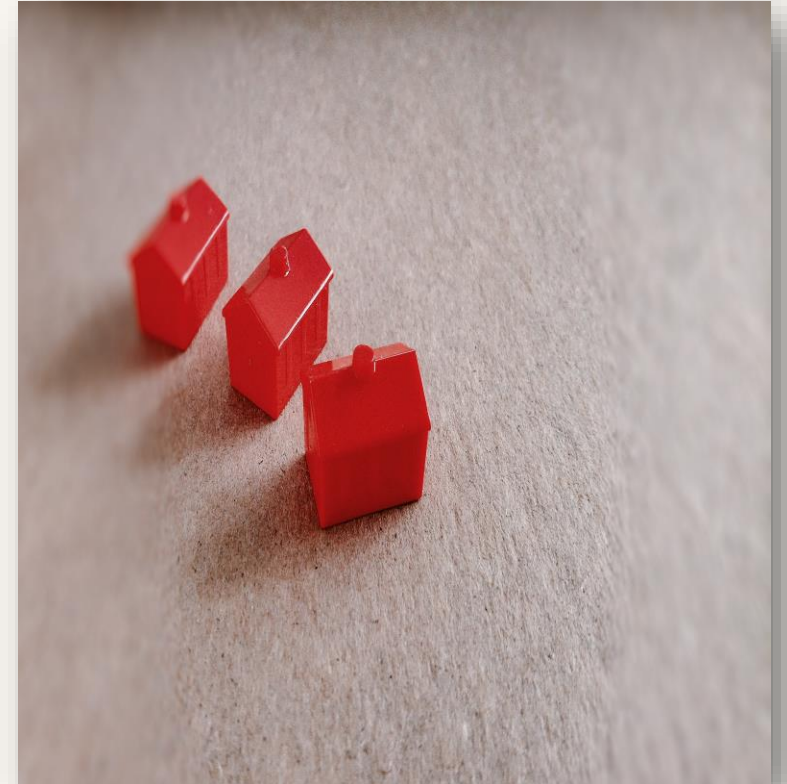
Does introduce best interest duty as per Rec 1.2

Does not ban commissions but caps them at % of amount drawn down rather than loan amount. Review in 3 years.

Capital Loss and Irresponsible Lending – a case study

The borrower (W) at the time of the loan:

- Indigenous woman in her mid 40s;
- Blue collar worker;
- Owned their residential property with a liability of approx. \$250,000;
- Wanted to invest in property to assist with retirement income and build wealth;
- Had no prior investment experience (aside from holding a superannuation account).



Capital Loss and Irresponsible Lending – a case study

The loan:

- Entered into a contract to build a new property in Central Queensland, during the mining boom (the IP);
- When entering into the loan, lender estimated value of the IP upon completion to be approx. \$480,000 (LVR approx. 120%);
- Was lent approx. \$575,000 for the purchase and construction of the IP, and the usual incidentals;
- Loan was crossed secured against their residential property;
- Following construction, IP value estimated at \$400,000 (LVR approx. 143%);
- Tenanted on fairly regular basis, but had difficulty maintaining repayments due to decreasing value and the end of the mining boom in Central Queensland;
- By 2021, IP estimated value was \$320,000.

Capital Loss and Irresponsible Lending – a case study

AFCA complaint:

- Lodged by W against the lender for breaches of the *NCCP*, on the basis it was not affordable, and not suitable;
- Lender offered to settle for approx. \$90,000, with loans to remain on foot;
- AFCA decisions in W's favour, with losses calculated at approx. \$120,000, comprised of interest paid and some incidentals;
- No losses awarded for significant capital loss that would be incurred if the IP sold, as AFCA are of the view that (paraphrased):
 - The choice to purchase one property over another is the decision of the borrower, not the lender;
 - The lender cannot therefore be held responsible for the investment decisions of the borrower.

Capital Loss and Irresponsible Lending – a case study

Litigation:

- W commenced litigation against the lender, claiming the usual heads of loss, plus capital losses which would be incurred if property sold;
- Capital loss head of damage sought under s178 *NCCP* pursuant to interpretations of similar provisions in other acts;
 - *Corporations Act 2001* (Cth) s 1041I; *Competition and Consumer Act 2010* (Cth) s 82, Schedule 2 s 236; *Australian Securities and Investments Commission Act 2001* (Cth) s12GF.
- During litigation, IP sold and capital loss realised, meaning their residential property at risk of recovery by the lender due to cross security;
- Litigated matter resolved on the basis that W could retain their residential property and owe no further funds with respect to IP (i.e. the loans were written off by the lender);
- By progressing through litigation Cf. AFCA, she was well over \$200,000 better off.

Bankruptcy and claims against lenders

Section 116 of the *Bankruptcy Act 1966* (Cth).

- Cause of action vests in creditors.
- Section 116(2)(g) excludes from property divisible among creditors “any right of the bankrupt to recover damages or compensation for personal injury or wrong done to the bankrupt” and any damages or compensation recovered in respect of such injury or wrong. The same phrase is used in s60(4).
- The question of what is a ‘wrong’ has been judicially considered, and cases indicate this will extend to claims arising from the person compared to claims arising from property interests: *Bourke v State Bank of NSW* [1995] FCA 1430 and *Holmes v Goodyear* (1984) 73 FLR 88.

Legal and Constitutional Affairs References Committee on Resolution of disputes with financial service providers within the justice system Recommendation 5:

Amend the *Bankruptcy Act 1966* to prevent causes of action relating to consumer credit protections from vesting in the trustee in bankruptcy.

Thank you.



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