Australian Banking Association

11 September 2023

Ms Natalie Cameron
Lead Ombudsman, Banking & Finance
Australian Financial Complaints Authority

By Email: Consultation@afca.org.au

Dear Ms Cameron

Approach to Responsible Lending

The Australian Banking Association (**ABA**) welcomes the opportunity to comment on the Australian Financial Complaints Authority's (**AFCA**) proposed Responsible Lending Approach.

Our position

We support AFCA's intent to publish its approach to responsible lending complaints. During the 2021 Independent Review of AFCA, the ABA requested the authority's responsible lending approach to be made more transparent.[1] We are pleased to see that this recommendation has been taken up.

The ABA acknowledges the guidance that AFCA provides to financial firms, consumers, and small businesses regarding its approach to resolving key issues in the complaints it deals with. The approach documents that AFCA has published are helpful resources that facilitate a common understanding of all parties' rights and obligations.

Banks take their obligations under responsible lending laws and regulations seriously, and have established frameworks, policies and procedures to ensure these obligations are embedded across their operations. Where compliance difficulties are identified, banks are committed to working with AFCA to address those issues promptly and effectively.

Key recommendations

A key purpose of AFCA's approach guidance is to enhance a consistent understanding of the requirements imposed by financial regulators and the Government, as well as those agreed in relevant industry standards and codes. We consider that the approach document could be improved in the following ways to better explain and accord with existing legislation, regulation and practice:

1. **Recommendation 1:** It is important to recognise the flexibility inherent in responsible lending requirements regarding the inquiries and steps that banks can take. For example, commentary relating to the use of benchmarks and analysis of bank statements should be amended to better reflect the Federal Court's position in *Australian Securities and Investments Commission v Westpac Banking Corporation* (2020) 277 FCR 343 ('*ASIC v Westpac*').
2. **Recommendation 2:** Over the past few years, there has been significant technological changes in the provision of credit, including the expansion of the Comprehensive Credit Reporting (CCR) regime and Open Banking. Credit applications are now predominantly made digitally, with one major bank reporting that 94 per cent of credit cards are opened digitally and other banks reporting that four in five home loan applications are processed on a digital origination platform.[2] The examples in the approach document mostly rely upon the use of older assessment practices, e.g.,

[1] ABA, *Submission to the Review of AFCA*, March 2021, p. 2.
[2] Data sourced from Annual Reports of the major banks.

Australian Banking Association

customer declarations and transaction statements. The approach should recognise that responsible lending obligations are not static—what is 'reasonable' can and will change depending on technological innovation and other factors.

3. **Recommendation 3:** The draft approach document does not explicitly acknowledge that scalability is a key element of the responsible lending framework. We suggest that this omission may mislead complainants about the level of verification that was required for their credit application. This is particularly the case given that many of the examples in the approach document deal with smaller amounts of credit. We request that AFCA explicitly reference the concept of scalability and explain how it is incorporated in its consideration of complaints.
4. **Recommendation 4:** The ABA supports the proposed definition of good industry practice in the approach document. However, we ask for additional context to be included that AFCA will assess the substance of a complaint against what was good industry practice *at the time the credit was provided.*
5. **Recommendation 5:** AFCA has proposed several remedies throughout the document that appear to be out of line with good industry practice. We support an approach to remediation that aligns with the principles articulated in RG 277, including the aim to return affected consumers as closely as possible to the position they would have otherwise been in had the misconduct or other failure not occurred. The ABA asks AFCA to approach remedies in a balanced manner that considers the responsibilities of customers as well as commercial costs to banks.

The ABA has provided more detail in our response to the AFCA consultation questions in Appendix 1. We thank you for the opportunity to provide our feedback and look forward to continued engagement.

Kind regards

Jess Boddington
Policy Director, Australian Banking Association

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

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Appendix 1: Response to AFCA Consultation Questions

Assessing reasonableness of inquiries and verification steps

1. Do you consider our approach to assessing the reasonableness of inquiries and verification steps aligns with the guidance in ASIC RG 209?

Use of benchmarks

AFCA provides significant guidance in the draft approach document regarding the appropriate use of benchmarks as income/expense verification tools. For example, it states that:

> We are unlikely to presume a complainant would have agreed that significantly reducing their discretionary spending met their requirements and objectives, if the financial firm did not ask during the assessment (unless the information suggests otherwise).[3]

This statement is illustrated in the example of 'inconsistent information about living expenses' on page 19. In the example, the financial firm is found deficient because it applied the relevant Household Expenditure Measure (HEM) benchmark instead of using the customer's total net expenditure from the last month of their bank statements.

The proposed approach to income expense benchmarks is out of step with the responsible lending obligations as they have been applied by the Federal Court of Australia. In *ASIC v Westpac*, Gleeson J found that the *National Consumer Credit Protection Act 2009* (Cth) (NCCP) did not possess a high degree of prescription as to how reasonable inquiries must be carried out.[4] The full Federal Court upheld the decision by Perram J that a customer's declared expenses were not determinative of their ability to repay a loan – and therefore, of its suitability for them – in the absence of further information indicating that the customer could not reduce those living expenses.

At paragraph 58 of the judgement, Perram J described ASIC's argument as follows:

> …a credit provider who assessed a loan's suitability based only on the HEM benchmark would not have carried out the assessment required by s 129(b). The critical part of ASIC's case is not that Westpac must not use the HEM benchmark—ASIC accepts that it may—but that it must take into account the individual financial position of the consumer in doing so and that the HEM benchmark, by itself, will not satisfy that requirement.[5]

In other words, ASIC argued that Westpac breached responsible lending obligations because it did not use information regarding the customer's actual expenses, in assessing suitability. That view was however expressly rejected by Perram J (at 60):

> The policy of the statute that unsuitable loans should not be made is explicitly and directly given force by ss 131 and 133. Given that statutory fact, what purpose can be served by prescribing how a credit provider goes about the assessment process? Sections 131 and 133 make that the problem of the credit provider**.**
>
> A credit provider may do what it wants in the assessment process, so far as I can see; what it cannot do is make unsuitable loans. ASIC's argument creates a whole new range of implied rules which appear altogether unnecessary in light of ss 131 and 133…
>
> On one view, seeking to determine circumstances of objective hardship by reference to actual household expenditure may be quite misconceived. With knowledge of the consumer's declared living expenses, one may well be able to discern that a consumer will have to trim their sails if the loan proceeds. But there is arguably a conceptual gulf between a trimming of sails and poverty…[6]

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[3] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 25.
[4] *Australian Securities and Investments Commission v Westpac Banking Corporation* 277 FCR 343 [141] *('ASIC v Westpac')*.
[5] *ASIC v Westpac* [58].
[6] *ASIC v Westpac* [60].

Australian Banking Association

The views expressed by the Federal Court are in direct opposition to the views expressed by AFCA in its draft approach document. The court found that the lender was permitted to presume that a customer could (if required) reduce expenses to the HEM level to meet repayments. If a lender can assume living expenses could be reduced to HEM, then there does not seem to be utility in using the 'total net expenditure' as per the example on page 19. Further, it can be argued that the borrowers' declaration of their living expenses in the loan application at an amount lower than the benchmark shows the borrowers' future intentions for their levels of spending.

The ABA recommends that the commentary relating to the use of benchmarks is substantially amended to recognise the flexibility inherent in the legislative requirements.

Bank statements and transactional information

The Quick Reference Guide contains a list of information that AFCA may request financial firms provide for responsible lending complaints including, for example:

- information about the steps a financial firm took to verify the complainant's income, along with all verification documents obtained (such as pay slips, tax returns, Centrelink statements, **account statements**, letter from employer), and
- for customers that say their living expenses are higher than usual or that they spend money on gambling - **statements for all accounts** the complainant had with the Bank for the six-month period prior to credit approval.[7]

Account statements are not always obtained by a credit provider as part of a credit assessment process. Even where they are, we would query whether it is reasonable to require the forensic examination of statements to show 'reasonable' verifications have been completed. If statements are obtained for one purpose (e.g., to verify income) and the bank is checking the customer's financial position (including expenses) with other reasonable automated tools, the bank should not be required to review the statements to validate the applicant's expense position.

While analysis of bank statements may disclose 'red flags' (such as undisclosed fixed commitment and liabilities), it is extremely difficult to draw meaningful conclusions about the level of the customer's ongoing expenses through analysing bank statements or transactional information. This is because:

- the financial firm may not have information for all the applicant's transactional accounts;
- categorisation of transactions is highly uncertain (for example, how do you treat cash withdrawals? Does a David Jones or Kmart expenditure relate to general living expenses such as clothing or is it a one-off expense?); and
- expenditure can vary considerably during a year for a variety of reasons (for example, in the lead up to Christmas or during vacation periods).

The ABA considers that an (explicit or inferred) requirement for banks to obtain and analyse bank statements or transactional information is out of step with the responsible lending obligations as they have been applied in *ASIC v Westpac* and RG 209. While lenders remain liable if the contract is ultimately found to be unsuitable, it is important that the proposed approach clearly consider the implications of this case and not seek to add in additional requirements where they are not required by either law or RG 209.

Technological neutrality

In RG 209, ASIC notes that the responsible lending "obligations are not static—what is 'reasonable' will be affected by the broader professional and regulatory environment in which you operate. For example, legislative developments (e.g., open banking and comprehensive credit reporting) and other developments and innovations adopted by the credit industry will affect the measures you could reasonably be expected to undertake."[8]

[7] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, pp 57-59.
[8] ASIC, *Regulatory Guide RG 209 – Credit licensing: Responsible lending conduct*, December 2019, p 9.

The case studies that are provided in the approach document heavily rely upon customer declarations and the subsequent forensic examination of transaction statements. While there are a few references to credit reporting as a valid means of checking a customer's existing liabilities, there is no reference to open banking. The ABA submits that the approach document should refer to the fact that verification practices may reasonably change over time as the financial landscape changes.

Scalability of assessments

RG 209 acknowledges that responsible lending is subject to scalability, whereby the level of inquiries and steps that are reasonable differ depending on the individual circumstances. It lists the following circumstances as examples:

- *Risk of consumer harm*: Further inquiries may be required if there is a higher risk of harm due to a consumer's actual inability to meet new financial obligations. In contrast, if it is apparent that the amount of credit and new financial obligations do not comprise a material amount of the consumer's available income, it may be less likely that a mistake or oversight in the estimate will mean the credit product is unsuitable. In this situation, fewer steps may be reasonable.
- *Kind of credit product:* The complexity of the credit product could also dictate the level of inquiries and verification required. In the absence of indicators or red flags that the consumer may be in a financial situation involving a higher risk of harm, it may be reasonable to obtain less information or take fewer steps to verify information. For example, this may be relevant in relation to personal loans and credit cards, as opposed to larger, longer-term loans.[9]

The draft approach document does not explicitly acknowledge that scalability is a key element of the responsible lending framework. We suggest that this omission may mislead complainants about the level of verification that should have been undertaken for their credit application. This is particularly important to draw out given that many of the examples in the approach document deal with smaller amounts of credit. For example, we note the example on page 19 refers to a $3,000 personal loan and then suggests the financial firm should have undertaken a detailed manual examination of the customer's bank statements. Generally, it is only economically viable for banks to provide smaller amounts of credit where this credit can be assessed and approved on a fully automated basis. The ABA suggests AFCA should adopt a cautious approach on this issue, as requiring manual scrutiny in all cases would have the effect of denying credit to many applicants.

We request that AFCA explicitly reference the concept of scalability and explain how it is incorporated in its consideration of complaints. For instance, the following circumstances could be listed as examples where less inquiries and steps may be reasonable:

a) the bank is aware the consumer has previously had a credit product of a similar kind and amount, and they used it in a way that was consistent with their requirements and objectives;

b) the consumer is a strata corporation seeking a kind of credit product commonly obtained by such entities (e.g., credit for renovations or correction of defects of the strata property);

c) the consumer is an existing customer with the bank and their financial history indicates that they have an appropriate level of experience or understanding in relation to financial matters (e.g., a financial institution may deal with clients in relation to their savings and investments and form a reasonable view about their ability to articulate their requirements and objectives in relation to a credit product and understand their obligations under that product);

d) the amount of credit does not comprise a material amount of the customer's available income;

e) the credit was provided during an emergency where the funds were needed urgently but it was difficult for the customer to access or provide verification documentation, e.g., following a natural disaster or in situations of family and domestic violence; or

[9] ASIC, *Regulatory Guide RG 209 – Credit licensing: Responsible lending conduct*, December 2019, pp 31-34.

f) the customer is locked into a home loan with a bank at an interest rate that is higher than current available market rates or has rolled off a lower fixed interest rate and is seeking to refinance on to better terms.

2. Do you have any other comments about our proposed approach to assessing the reasonableness of inquiries and verification steps?

Relationship between law, good industry practice and 'fair in all the circumstances'

The executive summary in the approach leaves considerable uncertainty as to the relationship between the law on responsible lending, good industry practice and AFCA's 'fair in all the circumstances' jurisdiction. The ABA suggests this uncertainty could by reduced through an acknowledgement that:

- in determining whether a breach of responsible lending requirements has occurred, AFCA will give priority to the law;
- 'good industry practice' will be applied by AFCA primarily to the issue of the 'reasonableness' requirements of the law; and
- 'fair[ness] in all the circumstances' is in most circumstances achieved through financial firms complying with their legal requirements, although AFCA retains a discretion in unusual circumstances.

Good industry practice

The ABA supports the following definition of good industry practice in the approach document:

> AFCA recognises that there are a range of practices within different sectors of the credit industry that may be sufficient to comply with the law, each of which may meet the standard of 'good industry practice'. Equally, AFCA recognises the fact that while certain practices are adopted by industry participants at particular points in time (i.e. a practice may have been 'standard industry practice'), it does not mean that practice is necessarily 'good industry practice' or compliant with the law.
>
> We do not assess the conduct of financial firms against *best* industry practice. Where some market participants make commitments or develop practices that go above and beyond their obligations, we may determine those commitments or practices are 'best industry practice' rather than 'good industry practice'.[10]

However, we ask for additional context to be included that AFCA will assess the substance of a complaint against what was good industry practice *at the time the credit was provided.*

In some circumstances, the good industry practice jurisdiction has appeared to be used by AFCA to apply current standards retrospectively to historical loan decisions, and to take the benefit of hindsight to rule in favour of customers when banks would not have that information at the time. For example:

- AFCA have used tax returns that were not available to the bank at the time to determine that the loan was unsuitable. This determination was justified on the basis that good industry practice would have been to consider those tax returns when making the decision.
- Buffers are used on historical loans pre-dating the responsible lending regime (i.e., pre-2011). AFCA has deemed buffers at specific rates as being good industry practice for historical loans, even though there was no wide practice of using that metric.

Type of expense benchmark

AFCA has provided the following guidance:

> If a financial firm uses a benchmark as a verification tool, it is generally reasonable for the firm to use the benchmark data that provides the most accurate and reliable comparison to the consumer's situation. For example, where the financial firm relies on the Household Expenditure

[10] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 22.

Australian Banking Association

Measure (HEM) dataset, it should use the income and location-adjusted data and select the data appropriate to the complainant's family size.[11]

The Melbourne Institute (MI) publishes national and regional-based HEM tables for various household/income configurations in response to their Household Expenditure Surveys (HES), but not the raw underlying data. When done on a regional basis, some of the combinations (e.g., a family with three children and a gross household income of between $120,000 to $140,000 in regional Victoria) become small data sets. In fact, the sample size could be so small as to be statistically insignificant. We understand the MI's view is that, in some cases, the HES sample is too small to provide HEMs by income class, geographical region, or both. As a result, statistical techniques are applied to smooth these results to get predicted expense values.

Use of income and location-adjusted data also produces anomalies when applied to some consumer's situations. For example, where 'regional' versus 'metro' figures are significantly different for a particular state, similar families living close to each other (even on opposite sides of a street) but across the 'regional' and 'metro' boundary may have similar circumstances but a significantly different regional-based HEM. Similarly, we understand locations such as Wollongong may be treated as regional, despite its proximity to Sydney. Individual circumstances vary so greatly that it is not the case that any HEM measure is a 'better fit' for a particular customer. State and territory data also suffers from the inaccuracy created by smaller sample sizes, particularly if metro and regional splits are attempted.

Overall, a credit provider that uses the HEM dataset should not be compelled to use income and location-adjusted data to comply with its obligations. The use of other HEM data does not produce a result that is inaccurate or unfair in comparison. Moreover, the ABA notes that this guidance has not been specifically required by the financial regulators, ASIC or APRA. We caution AFCA from creating new requirements above and beyond the existing guidance provided by financial regulators.

Serviceability assessments based on assets rather than income

AFCA should acknowledge that serviceability assessments based wholly or partially on consideration of the customers' assets may be appropriate in a range of circumstances, including for:

- bridging loans,
- reverse mortgages,
- customers likely to retire in the near future,
- customers expecting or planning a short-term reduction in income (e.g., a customer planning parental leave where they have savings sufficient to cover the period of reduced income), and
- customers expecting or planning a period of increased expenses (e.g., planned renovations or the last 6 months of private schooling where the customer has savings sufficient to cover the period of heightened expenditure).

Undisclosed debts

On page 16 of the approach, there is an example where it appears that AFCA expects banks to take extra steps to identify undisclosed debts that may not appear on a credit report (or may not be otherwise disclosed by the customer). For example, to review an applicant's statement to see if there are additional unexplained withdrawals. We question whether this view goes too far and whether it would be reasonable for a credit provider to rely on a credit report when combined with the use of alternative verification means and appropriate buffers and other margins in the responsible lending assessment.

Funds to complete settlement

On page 21 of the approach, AFCA sets out its expectations for confirming funds to complete a property settlement. It highlights the risk that an applicant might get the funds from another loan that was not disclosed/considered as part of the bank's responsible lending assessment because it was taken out after the bank conducted the assessment. We consider that this goes too far as it would

[11] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 18.

practically mean that financial service providers would need to conduct a second credit check/verification task just before settlement. The responsible lending obligations apply as at certain points in time under legislation for a reason and it is unreasonable to expect financial services providers to continually re-verify a customer's financial position up to settlement.

Unsuitability

On page 17, AFCA has suggested that it may:

> confirm that any necessary adjustments to the figures [in the serviceability assessment] have been made to reflect the complainant's actual financial situation (e.g., including deductions shown on payslips or adjustments in rental income to account for holding costs).

The ABA notes that some income adjustments are voluntary and thus may be able to be reasonably added back, such as voluntary additional super payments or purchased leave. We ask for AFCA to include the caveat of 'relevant deductions' in this sentence.

Changes the financial firm could have reasonably foreseen

3. Does our approach to considering a financial firm's assessment of reasonably foreseeable changes in a complainant's circumstances align with the guidance in ASIC RG 209?

AFCA has provided the following guidance:

> The responsible lending obligations require a financial firm to assess whether a complainant 'will be likely' to be able to comply with their financial obligations under a credit contract. This requires the financial firm to consider changes which are reasonably foreseeable **over the term of the credit contract** at the time it conducts its unsuitability assessment.[12]

The ABA submits that it is difficult for banks and other lenders to assess and incorporate all 'reasonably foreseeable' risks that may manifest over a longer time, such as for a 30-year home loan. For example, the bank may forecast that interest rates could increase significantly over a longer-term period. However, positive economic changes may also be possible, such as an increase to wages, and indeed there may be a link between the two.

Instead, we suggest that AFCA should acknowledge that serviceability assessments are essentially conducted at 'a snapshot in time', and that financial firms have limited ability to foresee changes that may occur in the economy or for the individual customer over the long term. We suggest that, instead of referring to changes which are reasonably foreseeable 'over the term of the credit contract, the focus should be on risks that are reasonably foreseeable within the short to medium term (e.g., up to 5 years in the future).

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?

The ABA considers that this guidance does not reflect existing good industry practice, nor regulation or legislation. For example, RG 209 provides that:

[12] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 19.

Australian Banking Association

> If a consumer is approaching retirement and will still be making repayments on the credit product after their expected retirement age, you will need to determine whether this event is likely to change their income, and information about the amount that is expected to be available.[13]

Banks will generally engage with customers that are nearing retirement at the time of applying for a loan. However, there is no requirement or necessity to have this conversation with customers that are more than 5 or 10 years away from their retirement, given customers are rarely able to foresee that far into the future, and such a conversation would hold limited value for both lenders and borrowers.

As currently worded, the AFCA approach would require banks to discuss retirement plans with any individual older than their late 30s that was applying for a standard 30-year term home loan. This also extends further than RG 209, where ASIC states that a reasonably foreseeable change to income/outgoings is when the customer is "approaching retirement." We suggest that the approach document should be revised to accord with the intent of RG 209 on this matter.

5. Do you have any comments about our proposed approach to considering the reasonableness of applying interest rate buffers to loans?

APRA guidance on interest rate buffers

For prudentially regulated institutions, such as banks, we understand that AFCA's approach will be to assess reasonable interest rate buffers for home loans as being those that accord with APRA's guidance at the time the credit was made. The ABA notes that this approach should incorporate an understanding that the interest rate buffers recommended by APRA need to be considered within a whole of institution risk management framework, which envisages that it is appropriate to apply credit overrides in some cases.

In addition, we consider it is suitable for AFCA to apply the same buffers to non-prudentially regulated firms, as they represent good industry practice. A decision not to apply the same buffers would lead to adverse competitive effects in the market, as well as worse consumer outcomes.

Fixed rate loans

The approach document notes that AFCA generally considers it is appropriate for a financial firm to apply buffers to both a complainant's 'new and existing fixed and variable interest rate debt'. It does not carve out loans that remain fixed for the entire term, such as a fixed rate personal loan. By applying AFCA's proposed approach to fixed rate loans that remain static for the duration of the loan, these loans could fail servicing using incorrect figures. We request that AFCA clarify that the requirement to apply buffers does not apply where a loan remains fixed for the entire loan term.

Buffers for credit cards

We note that requirements imposed by *ASIC Credit (Unsuitability-Credit Cards) Instrument 2018/753* under sections 131(3AA) and 160F(1) of the NCCP Act introduces a considerable buffer into serviceability assessments for credit cards, and where the same treatment is applied to existing credit cards held by an applicant applying for new credit. We suggest AFCA treat these requirements as constituting a sufficient buffer for credit card debt.

Determining if a loan is unsuitable

6. Do you have any comments about how we propose to seek and consider further information when we find a financial firm has made an error in its assessment?

The approach document says that AFCA may consider more detailed verification may be reasonable, even if a small surplus is calculated, in cases where the revised serviceability assessment indicates there was likely to be little or no uncommitted income available.[14] We note that surpluses can be eroded

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[13] ASIC, *Regulatory Guide RG 209 – Credit licensing: Responsible lending conduct*, December 2019, p 22.
[14] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 25.

by lenders using more conservative buffers and other margins in their serviceability assessment – i.e., by applying 'best industry practice'.

Instead of focusing on the individual elements of the unsuitability assessment, it would be better to focus on the outcome that was achieved. Ideally, the same outcome should be reached in a complaint about loan affordability against any given credit provider, based on a particular borrower's financial position and the loan amount. This is despite credit providers applying slightly different buffers and considerations to each element of the serviceability test. The ABA asks for AFCA to clarify that its assessment will be conducted holistically, i.e., smaller margins or other 'errors' may be balanced out by more generous treatment in other areas of the assessment process.

7. Do you have any comments about how we propose to use further information to determine whether the loan was unsuitable for the borrower?

N/A.

How AFCA determines fair outcomes and calculates complainant loss

8. Do you have any comments about the way we propose to assess a complainant's loss and benefit?

Approach to determining remedies

AFCA has proposed several remedies throughout the document that appear to be out of line with good industry practice. We support an approach to remediation that aligns with the principles articulated in RG 277, including the aim to return affected consumers as closely as possible to the position they would have otherwise been in had the misconduct or other failure not occurred. The ABA asks AFCA to approach remedies in a balanced manner that considers the responsibilities of customers as well as commercial costs to banks. We have called out specific examples in questions 9 and 10.

Lack of benefit found to the customer

AFCA flags potentially including amounts paid from the loan funds to a third party as part of a customer's gross loss due to lack of a direct benefit. We consider that there needs to be further context added to this point, to the effect that financial firms are liable only if they were or ought reasonably to have been aware of the lack of benefit.

If AFCA's intention is that the application of this principle is limited to family violence situations, we would encourage AFCA to make this clear. We are concerned that this principle is potentially open-ended. For instance, complainants that have gambled with loan proceeds, or lost them in an investment scam, may also claim that a third party has instead had the benefit of the loan funds. In most cases, if there has been no other contribution by the credit provider, the situations in these examples do not provide grounds to prevent a credit provider recovering the loan principal.

Fees and charges paid to the financial firm

The tables in Guide One for the different loan types state that fees and charges paid to the financial firm may be considered as a separate item in the calculation of gross loss. However, where the complainant's total repayments and the outstanding loan balance are already considered as items in the gross loss calculation, it seems to be double counting to again include the financial firm's fees and charges as a separate item. This is because any fees and charges that were applied to the loan account would already be accounted for in the gross loss calculation as components of either the total repayments or the current balance.

9. Do you have any comments about how we propose to assess loss and benefit for different types of loans?

Investor property loans

- AFCA provides examples of circumstances where it may not require sale of the investment property.[15] This may include where “the complainant has sold other assets (for example their home or other investment properties) because of their financial difficulty and the property is now their only asset”. It is unclear to the ABA why this approach would be justified if the complainant is not living in the property. We ask for AFCA to remove this point as a potential mitigating factor.
- AFCA’s current approach is to include tax benefits of negative gearing as a complainant ‘benefit’ in the loss calculation. We note that this is not mentioned in the approach. We ask for AFCA to address whether they are no longer regarding this as a benefit, and if so, why.

Car loans

- FOS/AFCA until now have treated the depreciation of a car’s value as representing the complainant’s ‘benefit’ from use of the car. AFCA is now proposing to reverse this and treat depreciation as part of the customer’s ‘loss’. We do not think this an appropriate approach when consumers, with a few exceptions, will buy a vehicle for use and enjoyment and with knowledge it will depreciate. This is different from consumer expectations when purchasing residential property.
- In the examples provided on pages 32 and 52, AFCA’s proposed remedy appears to allow the complainant to have had free use of the vehicle for the period they were in possession of it. This is because any repayments and purchase fees are refunded, and any shortfall was waived after sale of the vehicle. We do not consider that this remediation approach adequately returns the affected consumers to the position they would have otherwise been in had the misconduct or other failure not occurred, given that they will have received a benefit from use of the vehicle. We note that AFCA is currently consulting on its draft Approach to Appropriate Lending. The proposed remedy for an inappropriate commercial lease includes a ‘fair amount for benefit of use’ (pages 37-38). This represents a fairer approach.
- The ABA queries how refinance and trade-ins will be treated under AFCA’s proposed approach.

Personal loans

- In circumstances where a portion of an unsuitable variable rate personal loan was used to refinance a previous interest-bearing debt (or where a credit limit increase was unsuitable), AFCA proposes to apply interest at the lower of the interest rate on the new loan and the interest rate on the refinanced loan, varied after the date of the contract in line with the Reserve Bank of Australia cash rate.[16] The ABA does not consider it is appropriate for AFCA to pin the interest rate to the cash rate. If the financial firm has refinanced existing debt at a lower interest rate, the financial firm’s contract rate should be applied to reflect the benefit of lower interest received by the customer.

Owner occupied loans

- The table in Guide One suggests the current market value of home may be complainant’s ‘benefit’ if they surrender the property. How would market value be determined? Would AFCA require the financial firm to obtain a valuation?
- AFCA says it may only consider ‘rent avoided’ when purchasing a new home as a benefit to the complainant in some circumstances. We note that this has previously been a standard inclusion in the AFCA remedy for owner-occupier home loans.

  AFCA’s new approach indicates that it will now likely only include rent avoided as a benefit if the borrower was likely to have paid rent if the loan had not been approved. We take this to mean, for example, that AFCA will not apply rent avoided where the borrower was previously a homeowner rather than a renter. However, if AFCA refunds all the complainant’s repayments and does not offset a corresponding benefit, this will appear to result in an unfair windfall for a complainant who was paying home loan repayments before they obtained the home loan in dispute.

  If the borrower would have been otherwise paying home loan repayments, we consider this should be reflected as a benefit in the loss calculation. For example, if the complainant previously had a

[15] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 48.
[16] AFCA, *The AFCA Approach to Responsible Lending - Draft*, July 2023, p 53.

smaller loan, then an amount reflecting the lower repayments applicable to that earlier loan could be applied as a benefit in the loss calculation.

- We note the possibility that AFCA may award life tenancy type arrangements in exceptional circumstances. Life tenancies are significant undertakings and can also be complex if a joint borrower is involved. Life tenancies would only be appropriate in very limited circumstances. If a life tenancy is awarded, financial firms will likely need to work with a deceased estate in future. In these circumstances, would AFCA's determinations include provisions stating that the financial firm can require a Deed from the complainant that sets out the terms of the life tenancy?

Credit cards

- Would welcome guidance on the proposed remedy where the complainant disputes the approval of a credit card and multiple credit limit increases, but AFCA only finds that the later limit increases were unsuitable. Our previous experience is that AFCA has sometimes applied an old approach from the Banking & Financial Services Ombudsman that is not appropriate to a revolving credit facility, and especially one that has been on foot for some time. Instead, financial firms should be able to retain interest charged on the appropriate and affordable credit limit throughout the life of the facility. For example, if the credit card was approved with a limit of $10,000 that was responsible, but a later limit increase to $20,000 was found not to be responsible, the financial firm should be able to charge interest on the balance below $10,000.

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

N/A.

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?

With regard to residential mortgage lending, if AFCA determines that a customer can retain the property and keep repaying an adjusted debt, it suggests that capital gain will not be considered as a benefit. In these circumstances, if the customer receives the benefit of capital gains indefinitely into the future, there is an argument that it is fair and reasonable for the financial firm to charge interest at the contract rate.

Instead, AFCA proposes charging a non-commercial rate such as RBA's cash rate. We consider this does not adequately factor in the benefit received by customers in these circumstances. Application of the RBA cash rate would also require significant manual monitoring and long-term implementation. In addition, it does not reflect the cost of funding to banks, given they have a diverse funding mix that includes wholesale sources.

We consider that, in many cases, a more reasonable approach would be to allow the customer a period (e.g., 6 months) to sell or refinance the property at a reduced or 0% interest rate. If the customer wishes to remain in the property, normal customer rates would apply. This approach can then be amended to suit specific individual circumstances, i.e., if the resident is elderly or requires accessible accommodation on an ongoing basis.

In addition, in the example on page 47, if the financial firm is only entitled to take possession of the property if the complainant moved to another property or passed away, then there would appear to be no consequences for complainant not making repayments. We suggest that this should be clarified.

Other feedback

12. Do you have any comments about our tool which has been developed to assist financial firms provide detail to us about their unsuitability assessment? The tool is referenced on page 13 of the Approach, and a copy is attached to this consultation paper, see Appendix 1.

The ABA opposes the introduction of the unsuitability assessment tool proposed by AFCA. This is on the basis that:

- the tool is an entirely manual process, and using it for each complaint is likely to be administratively burdensome and costly,
- it is prescriptive and does not acknowledge that there are forms of serviceability assessments that may reasonably not rely upon an income less outgoings calculation, and
- the nature of the tool may encourage a focus on individual elements of the assessment and pull focus from whether the overall outcome of the assessment was unsuitable or not unsuitable. A likely outcome is that AFCA's approach will become overly prescriptive when compared to the intent of the NCCP.

For example, AFCA has said it will "revise a financial firm's unsuitability assessment to correct any errors".[5] This sort of assessment would need to incorporate consideration of:

- the financial firm's assessment process at the time for the provision of the loan, as well as
- whether a financial firm has applied buffers and margins that exceed the industry standard in other aspects of its servicing assessment.

It may be that the deficit from an error identified by AFCA is offset by other items in the servicing assessment where a financial firm has applied margins and buffers that exceed industry norms and the expectations of regulators.

In addition, it does not contemplate serviceability assessments that are made on a basis other than the 'income less outgoings' calculation. Other reasonable approaches can include:

- Serviceability assessments based on assets rather than income, for example for bridging loans or reverse mortgages.
- Serviceability assessments based on the applicants' repayment histories for existing loans being refinanced where repayments following the refinance will be the same or less than for the existing loans. (Please refer to ASIC's guidance in RG 209 on "like for like" refinancing and "mortgage prisoners").
- Serviceability assessments based on an analysis of the customers' historical "free cashflow" (calculated as the aggregate of their increase in savings/offset balances, additional loan repayments and superannuation contributions and acquisition of assets over a period during which the customer has taken on no or limited additional debt).

The ABA suggests that when financial firms are requested to provide information in connection with a complaint, they should be given the opportunity to specify the approach to the assessment of serviceability they used for the particular application.

Finally, the ABA opposes AFCA's proposal to include calculations for financial loss for all complaints that involve responsible lending. It is premature to ask for this assessment to be done at the beginning of the complaint process, as many complaints are resolved through negotiation or determined in the financial firm's favour. Instead, the assessment of financial loss should be made at the determination stage (i.e., once it has been decided that a credit provider did not lend responsibly).

13. Do you have any feedback about the 'Quick reference guides' included in the Approach?

N/A.

14. Do you have any other feedback about how the draft Approach meets our objectives?

Application to loans approved before 2011

The approach uses the language of RG 209 and is broadly based on the responsible lending regime introduced in 2011. However, it is not clear whether this framework would be applied to pre-2011 loans. We request that AFCA provide clarity that pre-NCCP contracts should be dealt with in accordance with the NCCP transitional legislation. Under the transitional legislation, responsible lending would only apply to an increase or top-up of a pre-NCCP loan.

Credit reporting

We would welcome more specific information from AFCA about how it will expect credit providers to amend previous credit reporting, including RHI and FHI, for loans that it finds were not responsibly approved.

Clerical Error

The Reference section defines a complaint as an “individual or small business that has lodged a complaint with AFCA”. As the approach document is for credit contracts regulated by the NCCP, it should not include small business entities.