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Empowering Indigenous Consumers

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Lead Ombudsman – Banking & Finance
Australian Financial Complaints Authority
GPO Box 3
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By email: consultation@afca.org.au

To whom it may concern,

RE: AFCA DRAFT RESPONSIBLE LENDING APPROACH

Thank you for the opportunity to provide a submission on AFCA's Draft Responsible Lending Approach (the Approach).

ABOUT THE INDIGENOUS CONSUMER ASSISTANCE NETWORK (ICAN)

ICAN provides consumer education, advocacy, and financial counselling services to Aboriginal and Torres Strait Islander peoples across North and Far North Queensland, with a vision of "Empowering Indigenous Consumers". We also provide our services to non-Indigenous peoples across the region.

The people our services work with are strong, resilient, and knowledgeable about their lives and communities. However, structural barriers and an uncompetitive marketplace in remote and regional communities create conditions in which exploitation occurs. The cost of living is unacceptably high, with basic food and necessities costing significantly more than in cities and large regional centres. Employment is limited, and regional centres are susceptible to significant events such as pandemics, industry downturns and extreme weather. Housing is limited and costly, and the consequent rate of homelessness and overcrowding is unacceptably high. Cars are essential items in the family home as they are the only form of transport and pose a significant upfront and ongoing expense.

Against this backdrop, we regularly see exploitative lending businesses and failures by financial firms to undertake credit assessments that appropriately account for these realities. We frequently rely on responsible lending laws when negotiating resolutions for our clients and often have to lodge complaints with AFCA when financial firms fail to resolve our clients' complaints appropriately. For this reason, AFCA's approach to responsible lending is of critical importance to our work and to our clients' ability to access and enforce these important consumer protections.

SUMMARY OF SUBMISSION

1. We want to sincerely thank AFCA for developing the Approach and for giving the guidelines the time and thought necessary to develop an approach that, overall, reflects the law, good industry practice and fairness. The Approach is reflective of the issues we see in our casework and the resolutions sought by the people we work with. We believe that it will result in faster resolutions of disputes both at the IDR stage and the EDR stage and more consistent outcomes for consumers. We are particularly pleased to see that AFCA's approach to remedies is fair,

reasonable and considerate of the different situations that people can face and the needs that arise for them when creditors have breached the law.

2. We have specific feedback about sections of the Approach together with recommendations for improvement. Our specific concerns are informed by our daily casework with financial firms on behalf of people in vulnerable circumstances and, if addressed, will significantly improve the Approach for industry representatives, AFCA case managers, and importantly, consumers.

3. We do have some concerns about the overall flexibility and discretion embedded within the Approach. We appreciate the need for an approach that considers the different circumstances of each case. However, in the absence of clear and mandated statements of expectation, we are concerned that some industry practices that currently fall short of what is expected will continue. We are also concerned that without meaningful training and understanding of the realities that people in vulnerable circumstances experience, what might seem like fair or standard conduct to industry and AFCA representatives, won't result in fair outcomes for people surviving in spite of the very challenging circumstances that they live through.

4. We do not comment on all aspects of the Approach, focussing instead on those parts that are of greatest concern to our financial counsellors. Our submission generally follows the order of the the Approach. We have had the benefit of reading the draft joint submission by Consumer Action Law Centre (CALC). Where we are silent on parts of the Approach it is because we generally agree with and adopt the feedback to it within CALC's submission.

5. By raising the concerns expressed above and below, we do not wish to detract from our overall view that this is a useful guide that provides realistic examples and resolves many of the uncertainties that we have held about AFCA's approach to these issues.

6. Finally, we have based our submission on communications from AFCA that the Approach is intended for industry; consumer advocates who understand the protections referred to; and AFCA representatives. We also understand that a separate document or series of documents will be developed specifically for consumers. We recommend AFCA do this as a matter of priority as the current document is lengthy and in some parts quite complex in its articulation of AFCA's position.

7. **Section 1.3** of the Approach currently includes consumers as the intended audience, we assume that this reference will be removed based on the comments made by AFCA in its roundtables.

DETAILS OF SUBMISSION & RECOMMENDATIONS

Section 1.4 – About Responsible Lending Complaints

8. We note that there is no reference to Consumer Leases in the products that are subject to responsible lending obligations (RLOs) and it is therefore not immediately clear that these products are covered by the Approach. However, AFCA has helpfully provided a specific guide to how it will approach remedies for consumer lease products. We recommend a reference to consumer leases being covered by the Approach should be inserted into section 1.4.

Section 2.2 – Complaints Not Covered

9. We regularly see breaches of the responsible lending laws by brokers, particularly in relation to used car finance. Given the prevalence of their role in the financial services sector, we query

why brokers' obligations are not included within the Approach when they have very similar RLO obligations. In many cases, the focus of consumer complaints is on the lender and not on the broker who was also complicit in the breach. This is understandable given an outcome regarding the borrower's ongoing debt obligation is dependent on a resolution that involves the lender. However, it means that in many cases, brokers are not being held to account for their conduct. Guidance on how to raise complaints against brokers and the possible remedies that could be obtained through doing so would support more complaints regarding broker misconduct. Given brokers are often sole traders or small businesses that may have limited resources to maintain knowledge about their obligations, they too would benefit from an RLO guide. This would, in turn, lead to faster complaint resolutions with brokers.

If brokers are not to be included in the current Approach, we recommend AFCA develop a specific guide for brokers.

10. **Section 3.2** – In reference to the factors indicating 'higher risk of consumer harm' in section 3.2, we urge AFCA to include the following two factors:
    - account statements indicating significant reliance on money from family and friends; and
    - frequent cash withdrawals – ie reliance on cash-based transacting.

11. These factors are regularly seen in our casework. However, when we raise responsible lending complaints the response of lenders is to dismiss the cash withdrawals as being for discretionary spending. In fact, clear reliance on cash should prompt further questions about what the cash is used for. In our experience, cash is frequently used for essential living expenses such as groceries, transport (bus and taxi fares), school expenses and the costs of kids' extra-curricular activities (eg. sport) to name a few. It is also common to see high cash withdrawals in financial abuse cases where a victim survivor has limited or no control over their bank account or is being pressured to hand over cash to avoid tracking of the abuse. We also note that the reliance on bank account scraping has resulted in some creditors failing to appropriately identify the reason for cash deposits and withdrawals and their impact on the person's overall financial position.

12. Given the above, we also recommend that the example on page 16 should be reconsidered because the regular withdrawal of cash to repay the debt should have prompted more questions from the financial firm not an acceptance that there were no other debts.

13. The list of factors in 3.2 are often referred to as 'Red Flags' in other guidance and we suggest that this list be similarly described.

14. We are also concerned about the following statement within this section:

    Fewer inquiries or verification steps may be appropriate where the increased financial obligation is immaterial to the consumer's available income or where the financial firm can assess the consumer's financial situation with a reasonable level of confidence based on available information.

15. In our experience, lenders currently undertake a bare minimum approach to income and verification. A statement endorsing fewer inquiries or verification will be relied upon by lenders to do even less. Indeed, the statement itself is contradictory because lenders cannot know if a

consumer has sufficient *available* income to afford an increase in their financial obligations without undertaking appropriate inquiries *and verification* about their expenses (rather than fewer inquiries and verification).

Requirements & Objectives

16. We note that there is no explanation provided in relation to the obligation that a loan meets peoples' requirements and objectives. This requirement of the responsible lending obligations is regularly overlooked and therefore an explicit statement of expectations regarding the inquiries and verification needed to ensure lenders meet this obligation would be helpful. We regularly see this obligation breached in relation to credit charges, costs and products added to the loan which are not brought to the consumer's attention, such as broker fees and junk insurance.

17. We also see it in the amounts that are lent to people where the person seeks less than what is in fact loaned to them. We are particularly concerned about this in the context of the recent changes to the Small Amount Credit Contract provisions as we expect people will go to traditional SACC providers seeking to borrow less than $2000 but will be offered more than this to push them into a Medium Amount Credit Contract with less onerous regulations.

18. Information about requirements and objectives is referred to in the list of information asked of lenders under the categories – complaints about 'no benefit from the loan' and 'add on insurance'. It is also implied in the first dot point under complaints about 'lender's mortgage insurance'. We suggest a separate category that catches any complaint in which the loan, its terms, or its purpose, differs to what the consumer requested or required.

19. We recommend AFCA include guidance on the assessment of requirements and objectives and include a specific example that highlights additional costs and/or an increase to the loan amount beyond what was initially asked for.

Request for additional information

20. In relation to the information that AFCA requests from lenders and with reference to the list on page 58, each of the categories should include contemporaneous notes or recordings of conversations with the complainant that are held by the creditor.

Section 3.3 – Reviewing Unsuitability Assessments

21. In relation to the following statement:

    > *We are unlikely to find a financial firm breached its responsible lending obligations if it relies on information that it reasonably believed was accurate.*

22. We are concerned that it may be interpreted as stating that information from inquiries alone is sufficient for a firm to form a reasonable belief. To avoid any doubt, reference to documents used to verify the information should be included in this statement. Alternatively, an early definition within the Approach that information includes verification documents should be included. As is well known, information from inquiries alone can be incorrect, incomplete or not presented correctly. Information may be misrepresented by a broker or someone else preparing

the application, such as an abusive partner or family member. It is only with verification (and often further inquiries) that this becomes evident. Unfortunately, we see too many instances in which no or inadequate verification has occurred.

23. We therefore recommend the statement be updated to state:

    We are unlikely to find a financial firm breached its responsible lending obligations if it relies on information and verification documents that it reasonably believed were accurate.

Use of Benchmarks as verification tools

24. We are very concerned about the reference to the use of benchmarks as 'verification tools' and believe the Approach conveys a level of legitimacy to their use which is beyond what the law[1] and RG 209 allows. In our experience, benchmarks are frequently used by lenders as the only tool used to inform and verify a suitability assessment. We are concerned that this practice will be reinforced if benchmarks are referred to as 'verification tools' in the Approach. Benchmarks frequently under-estimate a potential borrower's expenses and result in poor assessments and are not 'a reliable indication of likely living expenses.' As RG 209 states:

    RG 209.133 - Benchmarks (and in particular expense benchmarks) are commonly used by lenders as a part of their assessment of the credit risk to them of lending to a consumer. Licensees have also sought to rely on expense benchmarks as a way of streamlining the verification steps undertaken for the responsible lending obligations.

    *RG 209.134 - **You should be aware that income and expense benchmarks do not provide any information about the individual consumer, and do not confirm or verify that the information that has been obtained about the consumer is true.*** [our emphasis]

25. The Approach goes on to reference HEM and HPI. There are significant shortcomings to these benchmarks. As the Approach states, HPI is a poverty index. In our view, there is no legitimate circumstance in which this benchmark should be used as a means of assessing the affordability of credit. Furthermore, the reference to a reasonable buffer without any indication of what this might be provides a level of discretion to financial firms that all too often results in a poor suitability assessment. We note that HEM is no better. In fact, as RG 209 highlights, depending on location adjusted data, expenses may be lower than what HPI provides – see below:
    - Single person, HEM Living expenses not including rent = $254 per week. HPI[2] not including housing = $291.03.
    - Single parent plus 2 children, HEM living expenses not including rent, $392 . HPI not including housing $585.23.
    - Two parent plus 3 children, HEM living expenses not including rent $669. HPI not including housing $903.83.

26. In each of the above examples, HEM was based on the regional Queensland dataset and a basic lifestyle. While this is in recognition that lower income families necessarily have less to spend, it should be a red flag to lenders that people in lower income regions are already financially

[1] See reference to ASIC v Channic in RG 209
[2] N.B - The HPI was for the March quarter, 2023 which are lower figures than this time last year.

stressed. In our view, this highlights the risks associated with using HEM as it does not adequately reflect the true cost of living. RG 209 clearly highlights this: *Under this methodology, it could be expected that the majority of households would spend more than the benchmark figure.*[3] It goes on to provide specific guidance when using HEM which we urge AFCA to reference in the RLO Approach (see RG 209.142 – 154).

27. Relevant to this, we welcome AFCA's acknowledgment that it is 'unlikely to presume a complainant would have agreed that significantly reducing discretionary spending met their requirements and objectives, if the financial firm did not ask during the assessment.'[4] The importance of this check cannot be overstated and we urge AFCA to state this position firmly by replacing 'unlikely' with 'we won't'. We also urge AFCA to consider stating the importance of incorporating discretionary spending in the assessment and having a conversation with potential borrowers to check their willingness and ability to reduce discretionary spending with the expectation that these conversations are appropriately documented. We regularly hear firms claim that they don't account for discretionary spending in their assessments on the assumption that the borrower will necessarily reduce spending on these without checking with the borrower. For many people who cannot easily reduce spending on cigarettes, alcohol and gambling due to addiction, this approach quickly results in inappropriate assessments and significant harm due to the unaffordable debt that is incurred.

28. The examples on pages 19 and 24 reflect an approach in line with many of the above points. We therefore assume that our recommendations accord with AFCA's current practice. We simply urge AFCA to reconsider how it has explained its approach to benchmarks to ensure its approach is clear and benchmarks are not normalised within the assessment process.

Dealing with Shared Expenses

29. We are concerned that the statement that AFCA 'will consider whether the financial firm reasonably apportioned those expenses' is too vague. We recommend that AFCA provide guidance on what reasonably apportioned means and how this is assessed. In our experience, firms will claim that the other party pays for certain expenses but without any verification of this. Shared expenses should be a red flag for further verification. While we appreciate that shared expenses are the reality for many people, there needs to be recognition that taking this into account in the assessment assumes that the third party will continue to contribute to expenses. For this reason, significant care and thought needs to be put into what a reasonable apportionment looks like.

Changes the financial firm could reasonably have foreseen

30. This section usefully provides specific examples of changes that are reasonably foreseeable. Another example that we regularly see being overlooked by firms during assessments relates to the additional, ongoing costs that arise from the particular purchase that the loan is financing. Car loans are a good example of this. We see many cases in which the customer does not own a

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[3] See at RG 209.141

[4] See page 25 of the draft AFCA Approach to Responsible Lending

car at the time of application and the lender fails to account for the additional costs associated with the car including petrol, registration, repairs, maintenance and insurance.

A financial firm's policies may be relevant

31. We understand that reliance on financial firm's policies has always been part of the AFCA approach. However, it is important to acknowledge that there is no transparency around both the firm's and AFCA's reliance on such policies as they are not provided or disclosed to complainants, ostensibly on the basis they are commercial in confidence. By way of example, in AFCA Case 836111, both the complainant's advocate and AFCA repeatedly requested that the firm produce their policy which the firm claimed supported their approval of the loan. However, these were only provided after the case was referred to an Ombudsman for final determination. On the basis of natural justice, firms should be required to provide these policies to complainants as part of the dispute resolution process and if AFCA is relying on them, AFCA should disclose them to complainants. Alternatively, reliance on the policies should be limited and a finding that the policy was followed, should not itself be a justification (by the firm or by AFCA) that the loan was suitable.

Parties' conduct

32. We regularly see complainants blamed for providing inaccurate or incomplete information during the assessment process. We have also been asked by AFCA case managers 'why did the person take out the loan if they could not afford it?' People regularly provide inaccurate information when estimating their expenses which is why the verification step is so important and was included in the responsible lending obligations. However, firms use these inaccuracies to defend claims of unsuitable lending, alleging that any inaccuracies were deliberate. This has the effect of either drawing out the resolution process or, in many cases where the consumer is unrepresented, results in people believing they were at fault and so can't pursue their complaint.

33. We appreciate that the approach document is not focused on the information-gathering stage of the assessment and instead focuses on borrowers who have knowingly provided false verification documentation. However, we ask that this section include a statement that it is natural for people to underestimate their expenses and to be wrong about their ability to repay the loan and that is why the onus is on the lender to verify the information. People do not set out to get into unaffordable debt. They seek loan options that they believe (rightly or wrongly) will be affordable and in doing so, they rely on lenders, as experts in the lending process, to guide and assess their ability to repay.

Section 4.1 – AFCA's Approach to Determining Fair Outcomes

34. We welcome AFCA's approach to determining fair outcomes. The remedies listed are what we would expect of a dispute resolution body established to uphold consumer protection laws. We note that the list of three compensation categories should be stated as operating in combination rather than as alternative options with the insertion of: 'and/or' on pages 31 and 41.

35. We particularly welcome and strongly support the option of retaining a secured asset where it is fair in all the circumstances. We also support the explicit recognition that credit reports be corrected as part of the remedy. We are concerned about the level of discretion provided in relation to whether AFCA will apply the principles for remediation in RG 277 as indicated through use of the word 'may' and urge AFCA to amend this to 'will'.

36. We ask that the list of principles for remediation that firms proactively consider include non-financial loss. While it is stated as a category of loss that AFCA may award, we have difficulty in getting firms to include this at the IDR stage where it is apparent that the consumer experienced unnecessary stress as a result of the irresponsible loan.

Section 4.2 - Calculating Responsible Lending Remedies

37. We welcome the section on calculating remedies. We note the terms 'gross loss', 'net loss', 'capital loss' and 'holding costs' may not be immediately understood in this context but the format of the Approach and the explanations of their operation within the calculation go some way to supporting understanding.

38. We see many cases in which payments to third parties under the loan, such as extended warranties, add on insurances, direct debit fees to third parties and broker fees, are bundled into the 'amount of credit' and often considered by lenders to be 'benefits' to the borrower, despite the borrower not knowing of them or never benefitting from them.[5] It appears from the Approach that these payments may be captured under 'gross loss' as 'amounts paid to third parties related to a credit contract'. However, it is not entirely clear and as they are often framed as 'benefits' by financial firms, we believe that further explanation may be required. If such additional costs are not what is intended under 'gross loss', we recommend that they be listed as examples of when AFCA may determine that the complainant's 'benefit' is less than the amount of credit. This may also be usefully addressed through the example on page 32.

39. We strongly support the approach to 'capital loss' as demonstrated through the example on page 32. It is a really good example of the remedy to be applied when the complainant receives no benefit. However, it would be made clearer if all the amounts relevant to the calculation were provided. Ie – an amount be given for how much the person remained liable for under the loan contract, the deposit, and the government charges. A numerical representation of the calculation will enhance understanding. We note that the explanation for capital loss that precedes the example is not entirely clear and requires further explanation to support understanding. We are also concerned that without a sub-heading that demarcates the approach to 'capital loss' from the approach to calculating 'net loss' on the preceding pages, the example on page 32 may create confusion as it does not result in an adjusted debt.

40. Overall, the examples provided throughout section 4.2 are practical examples grounded in the reality of the cases we see. However, given the complexity of this section of the Approach, more examples would support greater understanding. We also believe that greater detail

[5] See our notes in relation to requirements and objectives.

regarding each of the amounts relevant to the calculations within the examples would clarify the remedy applied.

Specific guidance for certain products

41. We particularly appreciate and support the specific guidance on how AFCA will approach car loans and consumer leases. Both products are ones that particularly impact people on lower incomes. Car loans are one of the most expensive and complex products that people on low to middle incomes will obtain and the impact of these products when financial firms breach the responsible lending laws is significant. Vehicles are generally the only form of accessible transport in regional and remote areas and play a critical role in people being able to access services, maintain employment and get kids to school. They can often be the only significant asset that people will ever own. An approach that recognises the importance of retaining the vehicle is strongly supported. Equally, recognition that people don't always obtain a benefit under these loans when the vehicle is faulty is critically important and we strongly support the recognition of this in the factors considered by AFCA. We again recommend that AFCA use less flexible language and state firmly that you 'will' rather than 'may' consider a range of factors when calculating a complainant's net loss.

42. Equally, we strongly support the approach to determining benefit in the consumer lease section of the Approach. For consistency, we believe that the language and definitions in the *National Consumer Credit Protection Act* regarding consumer leases may be usefully replicated here with an explanation as to their meaning. Eg. 'base price of goods' cf 'market value'.

43. Finally, we wish to specifically support the points made by Consumer Action in its joint submission regarding the information that AFCA requires from complainants. We would add that to the extent consumers are required to provide information, the request should be made using language that is easily understood and avoids the jargon inherent within consumer protection laws and frameworks. We also strongly recommend that AFCA avoid asking for documents, that borrowers are unlikely to have in their possession but which the credit provider ought to have, such as the credit application.

CONCLUSION

Once again, we thank AFCA for this important Approach document which seeks to grapple with what is a complex area of consumer protection and distil it into a practical approach. While we caution that the Approach remains complex in parts and provides too much discretion and flexibility to financial firms, overall it is a very helpful document that we believe will result in greater consistency and efficiency in dispute resolution.

Thank you for the opportunity to provide feedback. Please don't hesitate to contact Jillian Williams of our office on [redacted] if you require further information.

Yours sincerely,

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Indigneous Consumer Assistance Network