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MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA

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Natalie Cameron
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Australian Financial Complaints Authority
GPO Box 3
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By email: *consultation@afca.org.au*

Dear Ms Cameron

AFCA CONSULTATION ON RESPONSIBLE LENDING APPROACH

The Mortgage and Finance Association of Australia (**MFAA**) appreciates the invitation to make a submission on AFCA's draft responsible lending approach (**AFCA RL Approach**).

As context to this submission, the MFAA is Australia's leading professional association for the mortgage and finance broking industry with over 14,500 members. Our members include mortgage and finance brokers, aggregators, lenders, mortgage managers, mortgage insurers and other suppliers to the mortgage and finance broking industry. Brokers play a critical role in intermediated lending, providing access to credit and promoting choice in both consumer and business finance. Brokers facilitate more than two thirds of all new residential home loans[1] and approximately four out of ten small business loans[2] in Australia.

The MFAA's role, as an industry association, is to provide leadership and to represent its members' views. We do this through engagement with governments, financial regulators and other key stakeholders on issues that are important to our members and their customers. This includes advocating for balanced legislation, policy and regulation and encouraging policies that foster competition and improve access to credit products and credit assistance for all Australians.

INTRODUCTORY COMMENTS

As we have recognised in previous submissions, the MFAA has an excellent relationship with AFCA. Both organisations continue to work constructively and collaboratively, sharing data and information to build awareness of systemic and emerging issues in relation complaints and dispute management for the betterment of the system for our respective members and for their customers.

External dispute resolution is a critical part of an accessible, efficient and fair financial system. All MFAA members are members of AFCA, either as holders of an Australian Credit License, as credit representatives or simply because of the MFAA requirement of membership that its members are members of an EDR scheme.

[1] MFAA Industry Intelligence Service Report 15th Edition pg 4
[2] Productivity Commission research paper Small business access to finance: The evolving lending market pg 44

The MFAA welcomes AFCA's Responsible Lending Approach. The Approach is a significantly important document providing guidance for industry and for consumers when dealing with AFCA. Responsible lending complaints are a significant portion of the complaints to AFCA with respect to financial services, and specifically with respect to credit. Because responsible lending complaints can be complex and relate generally to whether a consumer should or should not have been provided with a loan, the guidance will assist industry in understanding how AFCA will address responsible lending complaints.

We believe it is critical that AFCA strike an appropriate balance between guiding industry participants as to AFCA's approach without asserting financial firms should be adhering to an overly complex approach to responsible lending that is outside the principles outlined in the *National Consumer Credit Protection Act 2009 Cth* (**NCCP**) and in ASIC Regulatory Guide (**RG 209**). In particular, AFCA's approach to responsible lending should reflect the appropriate balance of protecting consumers, whilst maximising continuing access to credit for consumers that have the desire and ability to service their loans.

Given AFCA's key role in considering and determining complaints, its approach to responsible lending can have significant impacts to the consumer credit sector and, therefore, the whole economy. Therefore, while we appreciate that AFCA's Responsible Lending Approach is not law, the Approach will be a source for lenders (and brokers) in determining settings for credit policy, in the assessment of consumer credit applications, and to inform the assessment of responsible lending complaints through IDR channels. It is therefore important that the Approach is considered and balanced and does not have the unintended consequence of constraining the flow of credit through the economy.

Our objective therefore in providing this submission is to assist AFCA to achieve the policy objective of the responsible lending requirements contained within the NCCP - that is to provide consumer protection in a way that balances access to credit.[3] To that end we set out the following recommendations for AFCA's consideration:

1. Consider including specific guidance on how AFCA will consider broker related responsible lending complaints.
2. Include the concept of scalability in the guidance, consistent with RG209.
3. Include in the guidance consideration of broader circumstances i.e. economic conditions when the credit was provided.
4. Include more complex responsible lending complaint examples.
5. Ensure that the Approach does not go above and beyond RG 209.

RECOMMENDATION 1: UPDATE GUIDANCE TO CONSIDER RESPONSIBLE LENDING COMPLAINTS RELATED TO MORTGAGE AND FINANCE BROKERS

The mortgage and finance broking industry is characterised by high consumer sentiment and low complaint volumes. Over the last three years, complaints made to AFCA in relation to mortgage brokers made up less than 0.5% of all banking and finance complaints. Research also highlights that more than two thirds of home loans in Australia are originated using the services of a mortgage broker. Brokers are an important part of a customer's home loan journey. Therefore, while complaints in relation to brokers are low, where broker originated loans are the subject of a complaint, these complaints can be complex and there may be multiple parties joined into the complaint (i.e. the broker and the lender).

To this end we believe, whilst this Approach document is largely for the benefit of financial firms that are credit providers and states it would be a helpful guide for mortgage brokers, providing specific examples related to mortgage broking should be included. In particular it would be helpful for lenders, brokers and complainants to understand AFCA's approach where the complainant has made a complaint against both the broker and the lender (i.e joinder complaints) and AFCA's approach to joinder complaints.

[3] The Revised Explanatory Memorandum to the National Consumer Protection Bill noted: *The key objective is to establish a regulatory framework for responsible lending conduct (in accordance with the decisions of the Australian Government and COAG) in a manner that strikes a reasonable balance between the goals of minimising the incidence of consumers entering unsuitable credit contracts, and the goal of maximising access to credit for consumers who have the desire and ability to service it.*

With joinder complaints, the guidance needs to be clear as to how AFCA will determine where responsibility lies if it finds that the loan is unsuitable for the consumer. Specifically, the Approach document should outline what AFCA considers the difference between a broker's preliminary assessment, and the lender's final assessment. In doing so, the Approach needs to take into account the information that is available to the broker (which is often less than what is available to the lender) in undertaking verification steps for the preliminary assessment, and that lenders have access to different means by which to complete a reasonable enquiry to achieve the final assessment.

RECOMMENDATION 2: CONCEPT OF SCALABILITY NEEDS TO BE INCLUDED IN THE APPROACH DOCUMENT

The NCCP Act states that the inquiries and verification that licensees need to take when assessing an application for credit must be 'reasonable'.

What is 'reasonable' is dealt with in RG 209 through the concept of 'scalability'. Scalability in relation to what kinds of inquiries and verification steps lenders should take is enshrined in RG 209 and supported by the wording of the NCCP Act. Specifically, RG 209 provides:

> *The National Credit Act requires that you make inquiries about the consumer you are dealing with, and verify information about their financial situation, to a reasonable standard. We consider that what you need to do to meet these obligations in relation to a particular consumer* ***will vary depending on a range of different circumstances relevant to their particular application.***[4]

ASIC sets out in RG 209 when ASIC considers that a licensee should be undertaking more extensive enquiries in relation to an application for credit, which in RG 209 includes in circumstances where the credit product is more complex.

It is impractical for both lenders and borrowers to treat all credit in the same away. Further, most consumers will not expect or desire invasive inquiry into their financial situation for a small value loan.

For example, the Approach seems to indicate that a review of a consumer's bank statements must occur in all circumstances whether the credit application is for a small personal loan or a mortgage. The Approach seems to indicate that AFCA would expect for a licensee to obtain and review bank statements for all forms of consumer credit (including, by way of example, a $1,000 credit card). In practice, and in accordance with the guidance within RG 209, licensees generally (subject to any information indicating that the consumer is vulnerable):

- undertake more extensive verification steps where the loan is larger, and more complex;
- and less extensive verifications steps (for example simply getting a credit report and wage slips) for simple, small value loans e.g. personal loans.

Given the concept of scalability is contained in RG 209, it should also be considered in AFCA's Approach.

RECOMMENDATION 3: APPROACH DOCUMENT NEEDS TO ALSO CONSIDER ECONOMIC ENVIRONMENT IN WHICH THE LOAN WAS PROVIDED

It is critical that AFCA considers the context and the environment in which the credit is provided. For example, during the pandemic, lenders looked to support borrowers in stress, for example borrowers on furlough, by offering moratoriums and repayment holidays (which potentially meant deferred and higher repayments later in the loan life).

Equally in the current environment, which has seen a sharp increase in interest rates and higher cost of living, many borrowers are finding themselves as "mortgage prisoners". RG 209.243 specifically outlines situations where lenders may undertake less verification steps to support 'mortgage prisoners'. Specifically, RG 209 provides:

> *In the event of a refinance under a lower rate loan, the consumer's repayments will likely reduce even if the period during which they are making payments is the same (assuming they are not borrowing additional funds). In these circumstances, it is reasonable for lenders to*

[4] RG 209.79

specifically consider the consumer's payment history under their existing loan. Other matters may be given less weight, unless they identify particular risks with the consumer's financial situation.

Under RG 209, lenders can conduct less inquiries and verification steps for those borrowers that are considered to be mortgage prisoners under certain conditions. These conditions include that the loan the borrower is refinancing into is "like for like" in terms of repayments and loan term, that the borrower can demonstrate they have met their repayments under their pre-existing loan and that they have no adverse changes in their circumstances. This is to allow these borrowers who are mortgage prisoners to refinance to a more suitable loan and thus reduced their repayments (putting them in a better financial position).

We recommend that the Approach document include consideration of the conditions under which the borrower was provided the loan. This recommendation also aligns with AFCA's fairness mandate.

RECOMMENDATION 4: INCLUDE MORE COMPLEX RESPONSIBLE LENDING EXAMPLES

While the MFAA appreciates the use of examples throughout the Approach document, we are concerned that the examples do not include the level of complexity required to be useful to industry. Our observation is that many of the examples show behaviour by the lender that is clearly problematic. The types of examples that would greatly assist industry are examples where the behaviour of the lender was less clear, and the situation more nuanced.

For example, the Approach document rightfully states that lenders should be looking for 'red flags', and specifically red flags relating to financial abuse, domestic violence or another type of vulnerability. Examples of the types of less obvious and more nuanced red flags that AFCA expects financial firms to see would be of great use to industry.

RECOMMENDATION 5: ENSURE THE APPROACH DOCUMENT DOES NOT GO ABOVE AND BEYOND RG 209

There are a number of areas where we consider the AFCA Approach deviates from RG 209, and in effect applies a higher standard than RG 209.

One example is that the Approach document does not deal with a consumer's obligation to reduce discretionary spending in order to make their loan repayments. In times of rising interest rates and cost of living, understanding AFCA's expectations when it comes to consumers reducing discretionary expenditure is of vital importance.

RG 209, along with the Federal Court decision in *Australian Securities and Investments Commission v Westpac Banking Corporation [2020]* (**ASIC v Westpac**) support the notion that a consumer should be expected to cut back on discretionary expenditure in order to afford their loan. This concept is not included in the Approach document.

As per our comments at Recommendation 2, the law only requires lenders to do what is 'reasonable'. This concept has been included in RG 209 as 'scalability'. As AFCA's Approach does not deal with the concept of scalability nor the approach taken in RG 209 with respect to discretionary expenditure (see RG 209.57), it risks going above and beyond both the law and RG 209.

Closing remarks

We also suggest AFCA establish a regular forum for industry representatives to discuss how the Approach has been applied in practice and to identify whether any changes are required to the Approach or other action is necessary. We note that AFCA's Operational Guidelines to its Rules specifically notes that it has formal and informal review mechanisms to allow for industry bodies to raise concerns with AFCA's approach and forum would be an appropriate mechanism by which to give effect to this guideline.

We again extend our thanks. Responses to consultation specific questions can be found in **Attachment A**. If you wish to discuss this submission or require further information, please contact me at [redacted] or Naveen Ahluwalia at [redacted].

Yours sincerely

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Chief Executive Officer
Mortgage and Finance Association of Australia

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ATTACHMENT A

Questions	MFAA Response
1. Do you consider our approach to assessing the reasonableness of inquiries and verification steps aligns with the guidance in RG 209?	The Approach seems to document the process that AFCA has been taking with reviewing responsible lending complaints to date. AFCA will likely receive feedback in relation to this consultation that may require AFCA to consider implementing into its policies and processes with respect to responsible lending complaints. Further to the recommendations that we make in our covering letter, we reiterate that we believe the Approach document needs to be updated to: • include the concept of scalability in the Approach. • consider how AFCA would assess a borrower that was in mortgage prison situation prior to refinancing. • include AFCA's approach on broker complaints (and in particular joinder complaints), and • include consideration of the principles outlined in *ASIC v Westpac*) in terms of a consumer's obligation to reduce discretionary spending in order to afford the loan.
2. Do you have any other comments about our proposed approach to assessing the reasonableness of inquiries and verification steps?	See above Recommendations 2 and 3. **Benchmarks** On page 18 of the Approach, AFCA states that a benchmark may not be a reliable indication of likely living expenses where for example, a consumer estimates their expenses are higher than or **significantly lower than** the relevant benchmark amount (emphasis added). We note that it would be prudent for a lender to use a benchmark

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	amount in all instances where a consumer has estimated their living expenses as lower than the benchmark – this is the approach that many lenders take unless they are requested by the borrower to undertake extensive income verification in order to use the lower amount (which the borrower may request in order to obtain the loan). The only reason a lender would potentially undertake further verification steps for a consumer than has estimates their expenses as significantly lower than the benchmark (other than on request of the borrower) is where it may be an indicator that the customer is being deliberately deceptive. We recommend AFCA clarify its guidance. **Small surplus rule** On page 25 of the Approach, AFCA says that small surpluses may indicate that further verification may be required. RG 209.205 provides guidance in relation to small surpluses, specifically providing that it helps indicate how sensitive a consumer is to the effect of reasonably foreseeable changes to circumstances or changes to day-to-day occurrences such as absences from work (which might affect income). We suggest that AFCA align its approach with regard to small surpluses with RG 209. We further note that small surpluses are reasonable without further verification if a lender has effectively 'dialled up' expenses through, for example, using benchmarks and applying reasonable and generous buffers. We also note the points made by Perram J in ASIC v Westpac "*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*" alluding to the fact that a customer's living expenses (and potentially therefore surpluses) are not the most important indicator of whether they can afford a loan – and that expenses can often be reduced if necessary. By extension – a small surplus should not always be a barometer for whether further verification steps are necessary. **Good industry practice** We note that AFCA will also consider and provide guidance on what it considers to be good industry practice. We note that the use of digital data capture (screen-scraping), CDR and other data capture and aggregation tools are used by industry to make reasonable enquiries and to undertake verifications steps. We recommend that AFCA

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	consider the use of those tools as an independent way for licensees to perform verification activities.
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?	We consider that the approach in relation to reasonably foreseeable changes align with RG 209 however it is important that AFCA does not apply a one size fits all approach. For example, AFCA will need to distinguish between the assumptions that a licensee may make of future changes (i.e. interest rate changes and therefore the use of buffers) from changes that the borrower discloses and how these are dealt with (for example, retirement during the loan term).
4. Do you think it is 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?	This is reasonable, but AFCA needs to ensure that the Approach is not overly prescriptive as there are multiple ways a financial firm may deal with this. There is a difference between retirement age and pension age which we suggest should be recognised in the Approach, and there also be a differentiation from a self-employed borrower that has options such as sale of the business or otherwise has no plans to close the business. We also note where a borrower is of a certain age and where there is a presumption that the borrower could exit the workforce during the loan term, brokers will discuss and document clear exit strategies for the borrower with respect to the loan. This information will be extremely important to AFCA in assessing the complaint.
5. Do you have any comments about our proposed approach to considering the reasonableness of applying interest rate buffers to loans?	AFCA says in its Approach that it considers it appropriate for a financial firm to apply buffers to a complainant's proposed loan. AFCA should not be viewing buffers in isolation of other calibration tools used by lenders in their responsible lending assessments (for example debt to income ratios and the use of benchmarks). **<u>APRA Prudential Framework</u>** Unlike the NCCP responsible lending obligations, APRA's macro-prudential policy settings are not intended for consumer protection purposes. Instead, it applies only to

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	ADIs and the key objective of these settings is to mitigate risks to financial stability at a system-wide level and not to test the affordability of individual loans. APRA notes that "*the objective of the serviceability buffer is to ensure that banks make prudent lending decisions, lending to borrowers that are able to repay their loans in a range of scenarios. The buffer provides an important contingency not only for rises in interest rates over the life of the loan, but also for any unforeseen changes in a borrower's income or expenses*." **APRA macro-prudential policy does not apply to non-ADIs** While some smaller lenders (non-ADIs) have implemented buffers to manage their credit risk and because they are required to do so as part of their access cheaper funding lines (with ADIs) there is no requirement to do so either within RG 209 nor elsewhere. We caution AFCA applying APRA obligations to smaller lenders which could potentially impacts competition in the market, and the ability of smaller lenders to compete. **Non-bank lenders may apply lower buffers because they have used benchmarks instead** We further note that in RG 209, ASIC recognises that lenders may calibrate assessments through the use of a combination of benchmarks and buffers, therefore the use (or absence of) of buffers should not be viewed in isolation. Lenders may also use debt to income ratios (DTIs) as part of their assessment process and also as a calibration tool, and we recommend the AFCA include a consideration of the use of DTIs into its Approach. Ultimately it is important for AFCA to ensure that in its assessment of a responsible lending complaint, that it is not considering the use (or not) of buffers in isolation of other tools that a lender may use to consider whether the loan is suitable for a borrower.

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	<u>There may be good reasons for why lenders apply a lower buffer</u> We also note in the current environment some lenders have moved buffers in compliance with RG 209 (see RG 209.243), to assist with mortgage prisoners under strict conditions. AFCA's approach should be flexible in the way that it considers the use of buffers.
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?	No we do not on the understanding that consumers are responsible also to provide accurate (and not misleading) information to financial firms to enable financial firms to assess the consumer for a loan.
7. Do you have any comments about how we propose to use further information to determine whether the loan was unsuitable for the borrower?	It is only reasonable for AFCA to use further information to assess whether a loan was unsuitable for a borrower if the information was available to the financial firm **<u>at the time</u>** of loan assessment, and it was reasonable, taking into account scalability, for the financial firm to have obtained that information.
8. Do you have any comments about the way we propose to assess the complainant's loss and benefit?	We would like further guidance on how AFCA would assess non-financial loss and consider that an example here would be very useful. For example, our members tell us that there are cases where AFCA has found in the financial firm's favour, however non-financial loss is awarded to the complainant. Further insight into AFCA's approach and thinking would be beneficial to our members. We welcome AFCA's recognition that the complainant's conduct may be relevant to both whether the financial firm breached its obligations and when determining an appropriate remedy. We believe that this should be a determining factor in whether to award compensation or not, particularly where despite specific requests, the borrower has intentionally withheld information that would be material to the credit assessment process or where the complainant has engaged in fraud. We do not think that the compensation awarded in the example on page 41 is at all appropriate and question whether AFCA has appropriately discharged its fairness mandate in assessing that complaint and awarding compensation. The complainant in that instance intentionally perpetrated a fraud by altering payslips to obtain a loan and

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	has then been awarded compensation despite that fraud. Such behaviour should not in any way be incentivised including by way of a compensatory award.
9. Do you have any comments about how we propose to assess loss and benefit for different types of loans?	We note that AFCA has not included the tax benefits that is derived from investment property loans in its assessment. For example, a loan on an investment property provides the borrower with significant tax benefits to lower taxable income using negative gearing strategies. But for the investment loan, the borrower may have a higher taxable income. We would recommend AFCA considers the tax benefits flowing from investment loans in assessing the loss and benefit of investment loans. We also note that AFCA has not considered benefits from the receipt of cashback offers which are often offered to borrowers as an incentive to change lenders.
10. Do you have any comments about how we propose to consider capital loss from investment property loans?	No comment.
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?	We have not comment other than that we agree that AFCA should be taking a flexible approach.
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?	No comment, however noting that financial firms will have their own tools to make those assessments and there should be no requirement for this to become a standard for industry.
13. Do you have any feedback about the 'Quick reference guides' included in the Approach?	We believe the Quick reference guides are helpful. In terms of Guide 3 – when requesting additional information from complainants, consumer friendly language should be used. It may be helpful for AFCA to consult with consumer advocates in relation to communications sent to complainants for the purposes of requesting further information.

Questions	MFAA Response
14. Do you have any other feedback about how the draft Approach meets with our objectives?	On page 22, AFCA provides guidance to lenders on instances where it considers lenders should take particular care in assessing broker originated loans. In relation to dot point 3 – the consumer indicates they do not understand the representations of the broker or provides conflicting information - we note in almost all instances, a broker will be the only touchpoint for a customer in their credit decision and application process. A customer expects a broker to do all things necessary to both recommend and also apply for a loan on their behalf. Therefore, it would be rare that a lender would hear from a customer in relation to what they do or do not understand with the loan document. To suggest or imply that a lender should engage directly with a customer in terms of their understanding of the documents is inappropriate as a requirement. We recommend that component of the Approach be deleted. On page 23 AFCA states that the lender should take particular care if they are aware of circumstances where the broker has a conflict of interest (noting specifically where the broker is related to the borrower). We note the MFAA Code of Practice requires for our members to tell a lender when they are lodging an application on behalf of a family member. However, we are uncertain from the guidance why the nature of the relationship between the broker and the borrower should be a matter that would concern how a responsible lending complaint is assessed. It would be helpful for AFCA to provide further detail in its guidance. Lastly, we also note the statement made in the Approach *" in some circumstances, we may find the broker failed to meet its responsible lending obligations because it knew the complainant's true financial situation, whilst the lender met its responsible lending obligations because it reasonably relied on the information the broker provided."* We would appreciate AFCA expanding on in what circumstances a broker may have failed to meet responsible lending obligations in this scenario. As noted above, the Approach needs to consider that brokers may have less information to conduct a preliminary assessment and that the lender may more information available and will have responsible lending obligations to obtain and use that further information to make a final assessment.