

# Approach to Responsible Lending

## Consultation Feedback Report

December 2023

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# Overview of the consultation process

## About the consultation

AFCA has developed a range of Approach documents to help stakeholders understand how AFCA assesses and determines complaints under its Fairness Jurisdiction.

On 31 July 2023, AFCA issued a draft Approach to Responsible Lending complaints for consultation. The public consultation process ran from 31 July 2023 until 11 September 2023. AFCA has considered the feedback received during this process from all stakeholders and has now finalised the Approach.

During the consultation, AFCA asked stakeholders to comment on a range of matters, including whether the Approach:

- was easy to understand
- covered all relevant matters
- could be improved in its clarity, fairness or scope, or
- may cause any unintended consequences in its application.

As part of the consultation, AFCA published resources online, welcomed written submissions, hosted roundtable meetings and hosted a public webinar. AFCA is mindful that not all stakeholders were able to provide full written submissions, so AFCA also considered single-issue feedback and comments received in emails and during meetings.

## Overview of submissions received

AFCA received 25 submissions from different stakeholder groups during the consultation period, including:

- 7 submissions from consumer groups
- 6 submissions from AFCA member financial firms
- 7 submissions from industry peak bodies
- 4 submissions from other stakeholders.

All non-confidential submissions have been published on the AFCA website [here](#).

We are grateful for the time and expertise of all stakeholders who have provided input into this consultation process, and the resulting improvements to the document.



**310** registrations to our public webinar



**41** attendees at round tables



**25** full submissions made to AFCA



**1003** views of the new approaches consultation website

### The consultation is now closed

This consultation report explains how AFCA has considered and responded to the feedback received during the consultation process. The final Approach has now been published on the AFCA website.

We will continue to engage with our stakeholders about the application of the Approach in our handling of complaints, including a formal check-in after 12 months of operation. This will include reaching out to key stakeholders to hear their feedback about how the Approach is operating in practice.

## AFCA's consideration of stakeholder feedback

AFCA thanks all stakeholders for the considered, thoughtful and helpful submissions we received through the consultation process.

Overall, the feedback was positive. Many stakeholders were generally supportive of the Approach and agreed it aligned with the law and regulatory guidance. Many recognised AFCA's work in clearly describing and documenting its approach to the complex issues that often arise in responsible lending complaints. AFCA also received positive feedback about the accessibility and thoroughness of its consultation process.

Some stakeholders raised possible unintended consequences of the draft Approach, which have now been taken into account. In many instances, stakeholders representing different constituencies within the financial services sector also had differing (and in some cases opposing) views about changes AFCA should make to the document or how AFCA should reconcile those differences.

Following feedback, we have provided greater clarity in the published Approach about:

- factors affecting the level of inquiries and verification steps that are reasonable in any given complaint, including:

- > circumstances where it may be reasonable for a financial firm to take fewer steps, and
  - > circumstances where it may be reasonable for a financial firm to take more steps
- how we may consider whether a financial firm reasonably presumed a complainant would forego existing expenses in order to afford to make repayments
  - how we review whether a financial firm reasonably assessed a credit product was likely to meet a complainant’s requirements and objectives
  - the role of technology and innovation in credit assessment methods that comply with the law
  - reasonable foreseeability of retirement, and
  - repayment of adjusted debts and applicable interest rates.

AFCA’s objective has been to align the Approach with relevant laws and regulatory guidance. The Approach does not create new obligations. Instead, it is intended to provide general guidance about how AFCA may draw on existing law and regulatory guidance to inform our complaints handling and decision-making processes. In response to stakeholder feedback, we have made changes to a number of sections to make this intention clear. We have set out the key feedback and our response below.

### Verification requirements and use of benchmarks

Financial firms and industry peak bodies, in particular, requested that:

- the Approach further illustrates the ‘scalability’ of reasonable inquiries and verification steps
- AFCA ensure the Approach is consistent with the Full Federal Court’s decision in the *ASIC v Westpac* decision about responsible lending assessments, and
- the Approach include reference to circumstances where a borrower can reduce their living expenses to amounts in the Household Expenditure Measure (**HEM**) benchmark index without suffering substantial hardship.

Consumer groups sought:

- clarity about the sufficiency of using benchmarks alone to meet the required standard of reasonable verification
- recognition that benchmarks such as the HEM are inappropriate for some consumers including First Nations people who live in remote areas, and
- more guidance about a minimum baseline of verification required.

### AFCA response

We have strengthened this area of the Approach to include:

- new separate sections about circumstances where we may consider the reasonableness of verification steps
- a case example about where fewer verification steps may be reasonable adjustments to the 'Reviewing use of benchmarks as verification tools' section, and
- a new section titled 'Undertakings to reduce existing expenses'.

We have not included minimum verification requirements in the Approach as the responsible lending obligations in the National Credit Act are principles based and do not establish minimum verification requirements.

### Changes the financial firm could reasonably have foreseen

One of AFCA's key objectives was to align the draft Approach with ASIC Regulatory Guide 209 (**RG 209**). This was also a key theme for stakeholders in their feedback. Several stakeholders asked for clarification about:

- how AFCA determines 'retirement age' when assessing responsible lending complaints
- what inquiries and verification steps AFCA may consider reasonable to inform an assessment of whether a consumer will be able to repay a loan in retirement, and
- the application of APRA interest rate buffers for non-APRA regulated entities.

### AFCA's response

We have improved this section in a number of ways, including:

- making it clearer that reasonable steps will likely be different depending on whether a consumer is closer to retirement or further from retirement
- providing information about how we may determine retirement age, and
- adding information about reasonable use of interest rate buffers.

### Assessing requirements and objectives

Consumer groups requested AFCA outline how we assess if a credit contract was likely to meet a complainant's requirements and objectives.

Industry stakeholders asked AFCA to further explain when we would consider a lender should take further steps to assess whether a loan met a consumer's requirements and objectives and what steps lenders are required to take to ascertain consumer benefit.

### AFCA's response

In response to this feedback, we have included in the Approach:

- examples of common issues relating to requirements and objectives, and

- a new section about how we assess if a contract meets a complainant's requirements and objectives.

### How we determine fair outcomes and calculate a complainant's loss

One of AFCA's key objectives is to align section 4 of the Approach with ASIC Regulatory Guide 277 (**RG 277**) and relevant case law about remedies. We also aim to provide clarity about how we calculate loss and determine fair outcomes.

Stakeholders were engaged with these issues and requested AFCA provide more detail about how we calculate loss and benefits in circumstances where we determine a loan is unsuitable.

Industry stakeholders requested AFCA amend the Approach to:

- ensure alignment with RG 277 and principles of good industry practice
- provide that financial firms can charge the contract interest rate on an adjusted debt (rather than a reduced rate) where a complainant retains a secured asset as part of the AFCA outcome
- include negative gearing as a benefit and exclude property maintenance costs in loss calculations for investment property loans
- account for the 'benefit of use' of a vehicle when considering car loans
- revisit how we assess capital loss from car loans, and
- consider more benefits a complainant may receive from a loan.

Consumer groups requested AFCA:

- provide further examples of factors we would take into account when deciding how an adjusted debt will be repaid
- clarify how we would assess compensation where a complainant is a victim of duress, coercion or elder abuse, and
- reconsider whether 'rent avoided' is a benefit from unsuitable home loans.

### AFCA's response

In response to this feedback, we have clarified:

- how we may apportion capital loss from an unsuitable investment property loan between the parties
- how we may assess complainant benefit where a third party misappropriates loan funds
- how we determine a fair interest rate for adjusted debts (where it is fair for interest to be applied)
- circumstances where a financial firm may reasonably and unknowingly rely on falsified verification information, and

- that we may require financial firms to request credit reporting bodies remove adverse credit listings when remediating unsuitable loans.

### Serviceability Assessment Tool

Further to industry feedback, we have now clarified that the submission tool for financial firms is intended as a guide only and is optional.

### Our approach to Industry Codes and good industry practice

Stakeholders requested further detail about how we apply industry codes and consider good industry practice under our ‘fairness in all the circumstances’ test.

In response, we have added more information about how we consider industry codes, including when the financial firm is not a subscriber, and how we assess good industry practice.

### Technology neutrality and innovation in credit assessment processes

Following feedback, we have reiterated that the Approach is technology neutral and AFCA understands and will take into account innovation in credit assessment methods. We have updated some examples to reflect this intention.

### Feedback outside of scope

We have passed on general feedback provided by stakeholders on matters outside the document’s scope. This feedback has been referred to other AFCA teams for their consideration and action.

## References

### Definitions

Term	Definition
<b>Complainant</b>	An individual or small business that has lodged a complaint with AFCA
<b>Financial firm</b>	An organisation or individual that is a Member of AFCA
<b>National Credit Act</b>	<i>National Consumer Credit Protection Act 2009 (Cth)</i>

## Appendix 1 – Summary of feedback and changes made

Feedback	Change in published Approach
<p>Clarify that the Approach does not impose obligations on financial firms to carry out their assessments using a specific method or technology.</p>	<p>Inserted additional text about technological neutrality and amended examples to refer to more diverse assessment methods.</p>
<p>Reflect in the Approach that financial firms may assess that a consumer can reduce discretionary expenditure to afford a new loan.</p>	<p>Added a new section about circumstances in which a financial firm can reasonably assess that a complainant will reduce their existing expenses without suffering substantial hardship, in a way that is likely to meet their requirements and objectives.</p>
<p>Recognise that inquiry and verification obligations are scalable, depending on the nature of the credit product or the consumer's circumstances.</p>	<p>Inserted a new section about circumstances where fewer verification steps may be reasonable and added an example about a circumstance where fewer verification steps may be reasonable.</p>
<p>Expand on AFCA's approach where benchmarks such as the Household Expenditure Measure (HEM) are used during the verification process.</p>	<p>Added further detail about how AFCA will assess whether a financial firm used appropriate data within a benchmark dataset as part of its verification process.</p>
<p>Provide further clarity about reasonably foreseeable changes to a complainant's circumstances.</p>	<p>Inserted additional text to highlight the likely reasonable differences in the nature of inquiries, verification and assessment for consumers who are closer to retirement and those who are further from retirement. Clarified wording around use of buffers for new and existing variable rate loans.</p>
<p>Confirm that the factors listed in various sections of the Approach are not exhaustive or mandatory and are illustrative only.</p>	<p>Inserted new text boxes at the beginning of several sections of the Approach to clarify these matters.</p>
<p>Explain how AFCA assesses if a credit contract met a complainant's requirements and objectives.</p>	<p>Added a new section about how AFCA reviews a financial firm's assessment of whether a credit contract was likely to meet a complainant's requirements and objectives.</p>



Feedback	Change in published Approach
Update consumer leases and Small Amount Credit Contract discussion to take account of legislative reforms.	We have updated references to consumer leases and small amount credit contracts to reflect the new obligations and terms that apply from 12 June 2023.
Give guidance on AFCA's approach to dealing with negative credit listings that have been recorded for an unsuitable loan.	AFCA's usual practice is to require rectification of default listings and repayment history information where we find a loan is unsuitable. We have added wording to the published Approach to reflect this.
Collect information from financial firms in the first instance to reduce burden on consumers in a vulnerable situation.	<p>We have added an information box to Guide Three acknowledging that while we will ask both parties for information:</p> <ul style="list-style-type: none"> <li>• some information may be easier for a financial firm to identify and provide</li> <li>• consumers experiencing vulnerability may not be able to provide large volumes of information easily, and</li> <li>• we will work with both parties to target information requests as best we can.</li> </ul>
Add further information about AFCA's Approach to financial abuse.	We have included additional information in the sections of the Approach covering requirements and objectives assessments, and how we assess benefit where funds are misappropriated by a third party.
Include reference to how AFCA deals with 'sham' business purpose declarations.	We have included a reference to business purpose declarations being ineffective under the National Credit Act where the financial firm knows or should reasonably have known they were false.
Outline how shared expenses are treated.	We have added some factors we may consider when determining whether a financial firm's apportionment of shared expenses was reasonable.
Review the example relating to fraud by consumer.	We have amended this example to make clear that it is generally not a breach of the responsible lending obligations for a financial firm to reasonably and unknowingly rely on false verification information where it reasonably believed the information was true at the time of its assessment.