The AFCA Approach to Responsible Lending

Australian Financial Complaints Authority

January 2024

AFCA Approach documents help consumers and financial firms to better understand how AFCA reaches decisions about key issues.

These documents explain the way we approach common issues and complaint types. However, it is important to understand that each complaint that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no AFCA Approach document can cover everything you might want to know about a key issue.

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Australian Financial Complaints Authority

Part 1

Executive summary

How AFCA assesses responsible lending complaints

How we decide if a financial firm has met its responsible lending obligations

Part 2

How we determine fair outcomes and calculate complainant loss

Quick reference guides

Contents

Part 1

Part 2

1 Executive summary

1.1 About AFCA's approach documents

The purpose of AFCA's approach documents is to explain how we look at common issues and complaint types. Approach documents provide greater clarity around what to expect from AFCA processes, explain how we investigate complaints and how we make decisions.

1.2 The purpose of AFCA's Responsible Lending Approach

The purpose of AFCA's Responsible Lending Approach document is to outline how AFCA considers responsible lending complaints about different credit products. It has been developed to help ensure AFCA's approach in this area is transparent, consistent, clearly documented and fair in all the circumstances.

This approach document explains how we consider responsible lending complaints, including:

- how we assess a financial firm's compliance with responsible lending obligations
- how we apply legal principles, industry codes and regulatory guidance when considering complaints about responsible lending
- how we determine a fair outcome where a firm breaches its responsible lending obligations
- how we calculate loss and assess benefits to determine compensation
- how we consider all the circumstances to determine an outcome that is fair to all parties.

> This Approach is intended to be informative and summarise issues we may consider in responsible lending complaints.
>
> It is not definitive or exhaustive, and it does not create any new obligations.
>
> Our Approach provides examples about how we may consider the law, regulatory guidance issued by ASIC and APRA where relevant, and good industry practice, to determine what is fair in the circumstances of complaints.
>
> We consider each complaint on its unique facts and circumstances. Where we discuss factors we may consider, the factors that apply will depend on the circumstances of each complaint.

1.3 Who should read this Approach?

Financial firms	Consumer representatives	Consumers

This approach is for financial firms, consumer representatives, consumers, and anyone else who wants to understand how AFCA applies legal principles, industry codes and guidance, and good industry practice when considering complaints about responsible lending.

1.4 About responsible lending complaints

Responsible lending complaints are complaints about credit contracts regulated by the *National Consumer Credit Protection Act* 2009 (Cth) (National Credit Act). This approach document does not apply to complaints about lending to small businesses or other credit contracts not regulated by the National Credit Act. The National Credit Act commenced on 1 July 2010, and some obligations under the Act commenced on 1 January 2011. Consumer loans granted under the Uniform Consumer Credit Code prior to 1 July 2010 are now regulated by the National Credit Code.

The responsible lending obligations apply to credit that is used wholly or predominantly for personal, domestic or household purposes, or for the purchase or improvement of residential investment property. This includes loans described as being for business purposes which the financial firm knew or should reasonably have known were wholly or predominantly for the above purposes.

Common types of consumer credit include (but are not limited to) the following:

- Personal loan
- Home loan
- Consumer lease
- Investment property loan
- Credit card
- Small amount credit contract
- Car loan
- Other consumer credit

Buy Now, Pay Later (BNPL) products are not currently subject to responsible lending obligations and are not specifically discussed in this Approach. However, the Commonwealth Government has announced it intends to amend the National Credit Act to include BNPL products. AFCA will amend this Approach to reflect these changes once they are legislated.

Throughout this approach, AFCA uses ‘credit contract’ and ‘loan’ as terms encompassing credit contracts and credit limit increases, unless it is necessary to refer to particular types of credit products or credit limit increases separately.

1.5 AFCA’s purpose

AFCA is the independent external dispute resolution (EDR) scheme for the financial services sector. AFCA’s purpose is to provide fair, independent and effective solutions for financial disputes. We do this by providing fair dispute resolution services. We also work with financial firms to improve their processes and standards of service to minimise future complaints. In addition to resolving financial complaints, AFCA identifies, resolves and reports on systemic issues and serious contraventions of the law.

2 How AFCA assesses responsible lending complaints

2.1 Complaints AFCA can consider

Complaints against AFCA members

It is important to understand that each AFCA complaint has a unique set of facts and this information is a guide only. We will always consider the nature, size and scale of a complaint and the impact of issues on all parties.

AFCA can consider complaints against financial firms that are members of AFCA, provided the complaints meet the other requirements in our Rules (for example Rule A.4).

If a complaint is not resolved by agreement, negotiation or conciliation, we make a decision. Our decision reflects what is fair in all the circumstances having regard to legal principles, applicable industry codes or guidance, good industry practice and previous decisions of AFCA or predecessor schemes (which are not binding).

Complaints about financial difficulty

We can also consider complaints about the variation of a credit contract where the borrower is in financial hardship. Please refer to the Financial Difficulty series of approach documents on the AFCA website for further information.

2.2 Complaints not covered

Brokers and other credit assistance providers

Brokers and other credit assistance providers also have responsible lending obligations under the National Credit Act. However, this approach focuses on the obligations of credit providers.

Some of the concepts discussed in this approach may be helpful for brokers and credit assistance providers who want to understand how AFCA may consider and apply responsible lending obligations.

Credit risk

We cannot usually consider a complaint about a lender's decision not to provide a loan. However, we may be able to consider a complaint about a lender's decision if it relates to a breach of a contractual or legal obligation. For example, we may be able to consider the complaint if the borrower says the lender:

- unlawfully discriminated against them when deciding not to provide a loan
- made an error when declining a request to substitute a security property for an existing loan.

2.3 AFCA's fairness jurisdiction

Our decisions are intended to reflect what is fair in the circumstances of each complaint. This includes providing a fair outcome where we find the financial firm made an error or breached an obligation to the complainant.

In assessing what is fair, we apply a standard of fairness which focuses on concepts such as fair dealing, fair treatment and fair service. We may consider the conduct of both parties when determining a fair outcome, and we will consider all the circumstances to determine an outcome that is fair to the parties.

Law

Regulatory guidance

Good industry practice and industry codes

Past decisions

Fair in all the circumstances

2.4 How AFCA assesses responsible lending complaints

The responsible lending laws require credit providers to assess whether credit contracts are unsuitable before providing them to consumers. Our process to consider complaints about responsible lending is:

Gather

Gather information about the credit application and approval process

Assess

Assess whether the firm met its responsible lending obligations

Determine

Determine a fair outcome considering all the circumstances

Investigation steps

When we investigate a responsible lending complaint, we consider whether the financial firm complied with its responsible lending obligations under the National Credit Act.

To do this, we usually take the following steps:

1. Ask the parties to provide correspondence, forms and notes showing why they entered into the contract.
2. Review the inquiries the financial firm made and the verification steps it took before it offered the credit product to the complainant.
3. Ask the parties to provide their views about the financial firm's unsuitability assessment.
4. Review the financial firm’s unsuitability assessment.
5. Consider whether the financial firm’s unsuitability assessment was reasonable based on the available information.

How we determine whether a financial firm met its obligations

We consider whether the financial firm met the responsible lending obligations, including whether it:

- made reasonable inquiries about the consumer’s financial situation and requirements and objectives;
- undertook reasonable verification of the consumer’s financial situation; and
- provided a credit product that was not unsuitable for the consumer.

When we provide examples illustrating how we may determine whether the financial firm undertook reasonable inquiries and verification steps, the examples are illustrative only.

For example, where a case study refers to a face-to-face meeting or a phone call with the consumer, this does not mean those steps are mandatory or are the only ways financial firms can meet its obligations. This Approach does not prescribe or require that a financial firm use any particular technology or methodology to meet its obligations.

The inquiries and verification steps required under the National Credit Act will depend on the circumstances of each complaint.

When we consider whether a financial firm should have assessed a credit product as unsuitable, we will consider whether the unsuitability criteria in the National Credit Act were likely to be met. We will make this assessment based on the information that was or should reasonably have been available to the financial firm at the time.

How we determine loss

If we determine the financial firm made an error or breached its responsible lending obligations, we consider whether the complainant has suffered loss because of that breach.

How we determine fair outcomes

When assessing conduct of a financial firm, we have regard to the law, codes, and standards of industry practice that were in place at the time of the conduct.

We may decide that a financial firm must compensate a complainant for direct financial loss, indirect financial loss or non-financial loss. We may also decide that a financial firm is required to take, or refrain from taking, particular actions. If a complainant accepts our decision, the financial firm is bound by that decision.

3 How we decide if a financial firm has met its responsible lending obligations

Important note about application of this Approach to individual cases

This section sets out example approaches we may apply in some scenarios to assess a financial firm's compliance with their responsible lending obligations.

This approach covers a broad range of credit products, consumer circumstances and other factors. Where we discuss factors we may consider, the factors that apply will depend on the circumstances of each complaint.

3.1 How does AFCA assess whether the financial firm met its obligations?

Assessing if a credit contract was unsuitable

In responsible lending complaints, our focus is to assess whether the credit contract was unsuitable for the complainant.

The law requires credit providers to assess a credit contract as unsuitable if it is likely:

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

If a credit contract is unsuitable for a consumer, the credit provider must not provide it.

Considering if an unsuitability assessment was reasonable

To determine whether a financial firm met its responsible lending obligations when making its unsuitability assessment, AFCA considers whether the financial firm:

- made reasonable inquiries and took reasonable verification steps; and
- reasonably assessed the credit contract was not unsuitable for the complainant.

We review the information the financial firm used in its unsuitability assessment. When making an unsuitability assessment, the financial firm should only consider information:

- about the consumer's financial situation, requirements or objectives; and
- that, at the time of the assessment, the financial firm had reason to believe was true (or would have reason to believe was true if the financial firm had made reasonable inquiries and taken reasonable verification steps).

This section reflects the guidance in the Australian Securities and Investments Commission (ASIC) Regulatory Guide (RG) 209 and court decisions that have considered the application of the responsible lending obligations.

Referring to laws, codes, good industry practice and past decisions

When assessing complaints, AFCA must determine what is fair in all the circumstances under our Rules. When considering what is fair in the circumstances of a responsible lending complaint, we may consider:

- the National Credit Act
- relevant regulatory requirements and guidance from regulators including ASIC and the Australian Prudential Regulation Authority (APRA)
- the provisions of applicable industry codes, such as the diligent and prudent banker obligation under the Banking Code of Practice and the Customer-Owned Banking Code of Practice
- the financial firm's own policies
- good industry practice at the time the financial firm made its assessment
- past determinations of AFCA and predecessor schemes, which are not binding but are taken into account for consistency in decision making.

AFCA recognises that the law, regulatory guidance, codes of practice and industry standards will change from time to time. When we determine responsible lending complaints, we consider the law and standards in force at the time of the relevant conduct.

Some contracts are presumed to be unsuitable

The National Credit Act requires lenders to presume that a consumer can only repay a credit contract with substantial hardship if:

- the consumer could only repay the credit contract by selling their principal place of residence; or
- the credit contract is a small amount credit contract (SACC) and was entered into before 12 June 2023 and:
  - at the time of the lender's assessment, the consumer is in default under another SACC; or
  - the consumer had two or more other SACCs at any time in the 90-day period before the assessment.

To overcome this presumption, the financial firm will need to show that the contract was not likely to cause substantial hardship to the consumer.

Since 12 June 2023, other obligations have applied to SACC and consumer lease assessments, including protected earnings caps, a cap on consumer lease costs relative to the price of the goods and other contract requirements.

Other legal principles and obligations may be relevant

Where the complaint raises concerns about a possible breach of responsible lending laws, it may also be necessary for AFCA to consider other relevant legal principles. For example, we may consider the implied warranty of due care and skill, unconscionable conduct, misleading or deceptive conduct, whether the contract includes unfair contract terms or was an unjust transaction.

AFCA has separate published approaches on some of these topics, including the AFCA Approach to misleading conduct.

Reviewing a financial firm's unsuitability assessment

1. Firm provides unsuitability assessment to AFCA
2. AFCA considers unsuitability assessment
3. AFCA revises unsuitability assessment if required
4. AFCA reviews whether contract was unsuitable

3.2 AFCA considers whether inquiries and verification steps were reasonable

Reasonable inquiries and verification by financial firms

In order to assess the unsuitability of most credit products, financial firms are likely to require information about the following matters:

The steps a financial firm needs to take to satisfy its obligation to make reasonable inquiries and undertake reasonable verification will vary depending on the consumer's circumstances and the nature of the credit product, including:

- the type of credit product
- the amount of credit
- the risks to the consumer if the contract is unsuitable and they default on their repayment obligations
- the complexity of the credit product
- the consumer's capacity to comprehend and understand the credit product and their obligations
- the source and nature of the consumer's income, including whether it is seasonal or variable
- the consumer's expenses and outgoings, including existing debts and liabilities
- what benefit (if any) the consumer will receive from the credit product and how it will meet their requirements and objectives
- the consumer's credit history
- the consumer's net debt position
- any other information the financial firm knows or discovers about the consumer during the credit assessment process that indicates further inquiries or verification steps may be warranted.

Circumstances where more verification steps may be reasonable

A financial firm may need to make more detailed inquiries or undertake further verification steps where there are factors indicating there will be a higher risk of consumer harm if the credit contract is unsuitable.

This could include:

- circumstances indicating the consumer is experiencing vulnerability
- a recent increase in the consumer's debts
- where the consumer has, or has recently ended, multiple credit related debts
- where the consumer's savings account is frequently overdrawn or direct debit transactions are reversed
- there is a significant volume of unexplained cash withdrawals evident in the available information
- where the consumer is likely to have to sell their home if they default.

The risk of harm will be different for different consumers. For example, where the new repayment obligations are a significant proportion of the consumer's income, the risk of consumer harm will likely be higher.

A lender should be mindful of possible elder or financial abuse and take reasonable steps to ensure the borrower is giving free and informed consent. A higher risk of harm could exist where there is significant direct financial benefit to another person such as a family member, for which the borrower is assuming liability but receiving no direct financial benefit.

Circumstances where fewer verification steps may be reasonable

Fewer inquiries or verification steps may be appropriate where the risk of consumer harm is lower. For example, the risk of consumer harm may be lower where the repayment amount is immaterial to the consumer's available income.

The financial firm may verify the consumer has a comfortable surplus after the required repayments for the new credit product are considered.

Alternatively, the financial firm may already have information to show its existing customer has significant assets and investments. The customer may advise the firm they intend to liquidate these assets periodically or at a particular time to meet the required repayments or repay the loan.

Example

Reasonable verification steps

A complainant applied for a home loan from a bank with which they held a transaction bank account.

As part of its assessment, the bank obtained information from the complainant to verify their current rental expenses. The bank could also see from the complainant's statements they had a consistent savings pattern for the past six months.

The new home loan repayments would be less than the complainant's current monthly rent combined with the savings amount they have been setting aside.

The bank verified the complainant's income from payslips and checked the complainant's credit history, which was clear. There were no obvious inconsistencies or omissions on the information.

AFCA found the bank had taken reasonable steps to verify the complainant's financial situation, including their general living expenses. These factors indicated the complainant would not need to reduce their existing expenditure and had capacity to meet the repayment obligations without substantial hardship.

Requesting information from financial firms

We request information from the financial firm to help us understand the process it followed before it entered into the credit contract with the complainant.

Financial firms should provide AFCA with a clear explanation of the process they followed in making their unsuitability assessment, supported by references to other documents or verification information. For example, if the financial firm uses a credit assessment system, the financial firm should explain to AFCA why the system assessed that the loan was not unsuitable based on the information it held about the complainant. If the financial firm's credit assessors considered the available information and formed the view the loan was not unsuitable, the financial firm should explain why they formed that view. This helps AFCA assess whether the financial firm met its obligations.

AFCA has developed an optional tool to enable financial firms to set out their unsuitability assessment clearly and simply. This document helps AFCA understand the link between the assumptions in the financial firm's unsuitability assessment and the supporting documents. Financial firms who wish to use the tool to assist them to make submissions to AFCA can find it on our website here. AFCA does not require financial firms to use the tool.

We also have a quick reference guide in this Approach that contains a list of information we commonly ask financial firms to provide for responsible lending complaints.

Requesting information from complainants

At the beginning of the complaints process, AFCA will ask the complainant to outline:

- Their concerns about the financial firm's assessment process.
- The information the financial firm did not obtain or consider in its assessment that the complainant believes the financial firm should have obtained or considered.
- Their financial position at the time they obtained the loan, including supporting documents.

We have a quick reference guide in this Approach that contains a list of information we commonly ask complainants to provide for responsible lending complaints.

Requesting additional information

Where AFCA finds that a financial firm did not make reasonable inquiries or take reasonable verification steps, AFCA will consider what the outcome would have been if the financial firm had taken those steps. This usually requires AFCA to seek information that the financial firm, acting reasonably, should have considered before it conducted its assessment.

Verification of income

Example

AFCA identified the financial firm held inconsistent information about the complainant’s income when it conducted its unsuitability assessment. However, the financial firm said it did not take further steps to verify the correct income figure.

The complainant declared on the online application form their income was $4,000 per fortnight and the complainant uploaded payslips showing this level of income. However, elsewhere in the online application form, the complainant said their income would reduce to $2,000 per fortnight the following month. The financial firm’s credit assessment system adopted the figure of $4,000 per fortnight in its unsuitability assessment.

AFCA formed a view the financial firm should have taken further steps to reasonably verify the complainant’s income because it held inconsistent information.

AFCA requested the complainant provide bank statements from the period to verify their income, which showed their income had declined to $2,000 per fortnight before the firm conducted its assessment.

Using additional information to revise an unsuitability assessment

AFCA may use information it obtains through further inquiries and verification steps to revise a financial firm’s unsuitability assessment. AFCA will only revise a financial firm’s unsuitability assessment if the financial firm:

- used information in its unsuitability assessment that was incorrect or untrue;
- could have obtained the correct information through reasonable inquiries and verification steps at the time it conducted its original unsuitability assessment; and
- would have been permitted to use the information in its unsuitability assessment at the time because:
  - it is information about the complainant’s financial situation or requirements and objectives; and
  - the financial firm would have had reason to believe it was true if it had made reasonable inquiries or taken reasonable verification steps.

We will consider whether there were gaps or inconsistencies in the information available to a financial firm (often referred to as ‘red flags’) which should reasonably have caused it to make further inquiries or seek verification before making its unsuitability assessment.

Example

Taking further reasonable steps

When AFCA took reasonable steps to verify the complainant’s income and obtained bank statements from the period, AFCA formed the view that the complainant’s income was $2,000 per fortnight.

The financial firm had adopted a figure of $4,000 per fortnight in its unsuitability assessment.

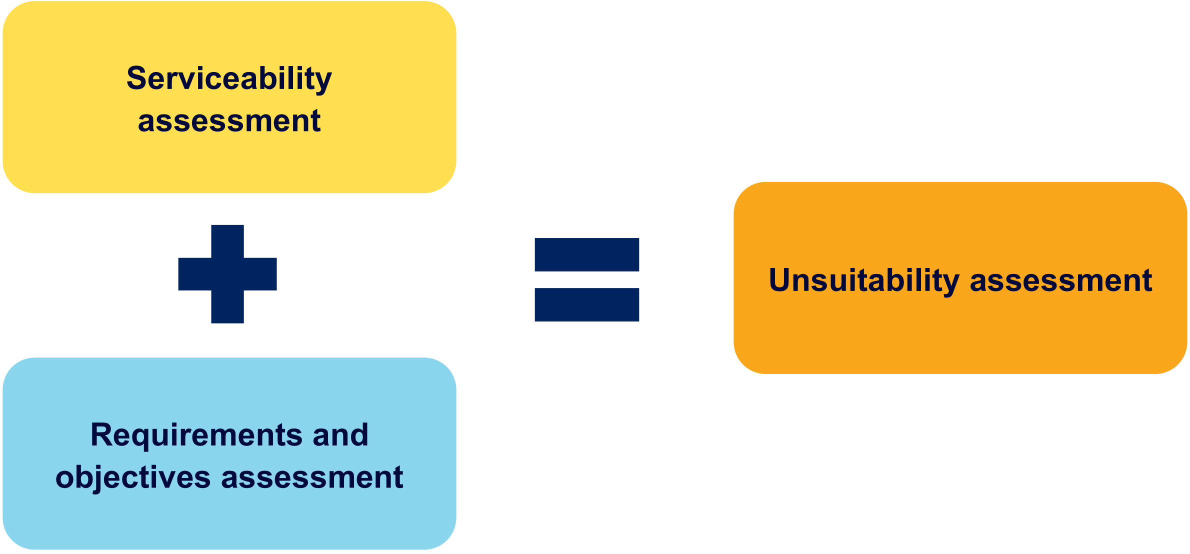
AFCA revised the financial firm’s assessment to adopt the correct income figure of $2,000 per fortnight.

The information AFCA used to inform this revision was permitted under the National Credit Act because it was relevant information the financial firm could have obtained at the time it made its assessment. The financial firm would have had reason to believe this information was true if it had made reasonable inquiries and taken reasonable verification steps.

3.3 Reviewing unsuitability assessments

AFCA will review a financial firm's unsuitability assessment

AFCA uses the available information to review how the financial firm conducted its unsuitability assessment.



When we review a financial firm's unsuitability assessment, we consider the available information, including:

- information the financial firm held at the time it made its unsuitability assessment
- the financial firm's credit assessment notes reflecting its consideration of the credit application
- the financial firm's policies and procedures
- information AFCA has obtained through its own inquiries and verification steps (if AFCA has determined it would have been reasonable for the financial firm to obtain that information at the time).

We are unlikely to find a financial firm breached its responsible lending obligations if it relies on information that it reasonably believed was accurate. This is the case even if this results in a consumer entering into a credit contract that accurate information (which the financial firm did not have) would have shown was unaffordable for them, unless the financial firm should reasonably have obtained that other information to meet its inquiry and verification obligations.

Example

A financial firm could not reasonably have discovered existing debt

A financial firm's credit assessment system did not include the required repayments for the complainant's existing informal debt to his friend in its unsuitability assessment.

The complainant did not disclose this informal debt to the financial firm in the loan application form.

The financial firm's system checked the complainant's credit file and scanned his transaction bank statements to verify his financial situation.

The debt was not listed on the complainant's credit file, and the complainant made repayments to his friend in cash, so there was no evidence of the debt on his bank statements.

AFCA found the financial firm took reasonable steps to verify the complainant's financial situation. AFCA also found the financial firm had a reasonable basis on which to conduct its unsuitability assessment based on the information available to it. There was no indication the informal debt existed in the information the financial firm obtained through its reasonable verification process, so the financial firm did not make an error when it excluded the informal debt from its unsuitability assessment.

Assessing capacity to repay without substantial hardship

The financial firm's assessment of a complainant's ability to meet their financial obligations under a new credit contract is commonly referred to as a 'serviceability assessment'. A serviceability assessment generally involves comparing the consumer's income with their outgoings to calculate whether they have sufficient 'uncommitted income' available to meet repayments.

The amount of income and outgoings a financial firm includes in its serviceability assessment may be different than the amount of income or outgoings the consumer has prior to the loan. This may be, for example, because the financial firm knows a particular commitment will end (such as rent for a first home buyer) or because it factors in a reduction in existing outgoings.

When we review a financial firm's serviceability assessment, we consider what income and outgoings the available information suggests were reasonably likely to continue into the future.

To do this, AFCA may:

- Consider the basis for each item in the serviceability assessment, including what inquiries the financial firm made and what verification information it obtained
- Confirm each of the figures the financial firm adopted was calculated correctly
- Confirm that any necessary adjustments to the figures 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)
- Check whether each figure matches information available to the financial firm or is otherwise based on reasonable assumptions
- Where the figures the financial firm adopted do not reflect the consumer's actual financial situation at the time, consider whether there were any 'red flags' that should have led a reasonable lender to make further inquiries
- Where relevant, consider whether the financial firm has assessed the complainant could reasonably reduce their outgoings without substantial hardship

Reviewing use of benchmarks as verification tools

Financial firms may use benchmarks as part of their verification process, for example to test whether a consumer's declared living expenses are broadly reasonable.

A benchmark should not be used as an estimate of a consumer's likely future expenses when information known to the financial firm indicates that the consumer's actual future expenses may be higher than the benchmark.

It would generally be reasonable for the financial firm to take further steps to verify the consumer's expenses to ensure they have a reasonable basis to estimate what future expenses are necessary for the consumer to avoid substantial hardship and to meet their requirements and objectives.

A benchmark may not be a reliable indication of future living expenses where, for example:

- a consumer estimates their expenses are higher than, or significantly lower than, the relevant benchmark amount in the application form for the credit product
- the financial firm obtains information indicating the consumer's expenses are likely to exceed those of others in a similar demographic (e.g. due to complex medical needs, disability supports, or significant disclosed outgoings or expenses)
- the financial firm obtains information indicating the consumer has significant fixed ongoing costs that are not included in calculation of the relevant benchmark index amount
- the verification documents provided to the financial firm (such as the consumer's bank statements) indicate the consumer's existing total outgoings significantly exceed the total of the benchmark combined with their other assessed outgoings in the serviceability assessment.

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 uses the Household Expenditure Measure (HEM) dataset, it would generally be reasonable to use the income and location-adjusted data and select the data appropriate to the complainant's family size. There may be some circumstances where an amount other than the income and location adjusted amount is more appropriate for the consumer's circumstances. Financial firms should regularly monitor their benchmarks to ensure they use the most up-to-date version.

If the financial firm use the Henderson Poverty Index (HPI) benchmark to test a borrower's general living expenses, AFCA generally considers it good industry practice to apply a reasonable buffer to the benchmark amount, because the HPI is a poverty index.

Example

Inconsistent information about living expenses

A single mother with two children applied for a $3,000 personal loan from a financial firm. The financial firm obtained documentary information, including the complainant's recent bank statements, to verify her financial situation. The complainant estimated her total expenses as $1,000.

The financial firm compared the complainant's declared general living expenses with the relevant Household Expenditure Measure (HEM) benchmark amount. The financial firm discovered the HEM benchmark amount for a single person with two children, with the complainant's income and in her capital city, was $1,850 per month. The firm then adopted the amount of $1,850 per month in its assessment.

The complainant's bank statements showed in the last month that her total net expenditure was $9,500. The financial firm did not consider the nature of those existing expenses or ask the complainant to explain this discrepancy.

In AFCA's view, the financial firm did not have a reasonable basis to adopt living expenses of $1,850 per month in its serviceability assessment when her bank statements indicated her previous month's expenses were over four times higher than that amount. The financial firm should have taken further steps to verify the complainant's existing expenses and consider whether she could reduce her expenses from $9,500 to $1,850 without suffering substantial hardship.

Undertakings to reduce existing expenses

Financial firms may adopt amounts for expenses and income in their serviceability assessments that are different from the consumer's previous expenses or income.

This can include reductions in outgoings compared with the consumer's existing outgoings. Some examples include where:

- the available information indicates a consumer has an existing commitment that will end when the new credit product is provided
- the financial firm assesses the consumer can reduce their expenses to meet their obligations under the new credit contract without suffering substantial hardship.

If a financial firm adopts a lower amount for a consumer's outgoings in its serviceability assessment than the consumer's existing outgoings, the financial firm should ensure the reductions are realistic and achievable. Financial firms should also ensure the reductions are likely to meet the consumer's requirements and objectives.

When AFCA reviews a financial firm's serviceability assessment and the assessment includes reductions compared with the complainant's pre-existing expenses, AFCA will consider whether:

- the reductions were realistic and achievable without causing the complainant substantial hardship;
- the reductions were likely to meet the complainant's requirements and objectives;
- if the financial firm could not reasonably assess without the complainant's input that the reductions were realistic, achievable and met the complainant's requirements and objectives, the financial firm presented the reductions to the complainant; and
- the reductions were disclosed to the complainant so the complainant could understand the basis for the financial firm's assessment.

Where AFCA finds the required reductions were likely to cause the complainant substantial hardship or cause the credit contract to fail to meet the complainant's requirements and objectives, we are likely to find the credit contract was unsuitable for the complainant.

Dealing with shared expenses

Where a complainant's expenses (including liabilities and general living expenses) are shared with another person, we will consider whether the financial firm reasonably apportioned those expenses between the complainant and the third party. When we consider whether a financial firm reasonably apportioned expenses between a complainant and a third party, we may consider factors like their relative income levels and existing liabilities.

Changes the financial firm could reasonably have foreseen

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 to income or outgoings which are reasonably foreseeable over the term of the credit contract at the time it conducts its unsuitability assessment.

Examples of reasonably foreseeable changes

Example

The complainant reaching retirement age and retiring from the workforce

Example

A variable interest rate on a loan changing during the term of the loan

If a financial firm is aware a complainant is likely to reach retirement age during the term of a loan, it should consider how the complainant will meet their repayment obligations or otherwise repay the loan in retirement.

The consumer’s likely retirement age may vary depending on their occupation. AFCA will consider what is reasonable in the particular consumer’s circumstances and may have regard to the statutory Age Pension eligibility age.

Where the consumer is further from retirement

If the term of the loan is longer, for example a 30-year home loan, and the consumer is only likely to retire towards the end of the loan term, it will usually be reasonable for the ‘exit strategy’ to be less specific. For example, if the consumer is likely to have surplus uncommitted income available before they retire, they may plan to make additional repayments and repay the loan before they retire or make provision from their savings to supplement their retirement income to repay the loan.

Where the consumer is closer to retirement

If the consumer is likely to retire earlier in the loan term, it may be reasonable for the financial firm’s consideration of the consumer’s exit strategy to be more specific. For example, if the loan is a home loan, the consumer is likely to retire earlier in the loan term, and the consumer plans to continue living in the home in retirement, it may be reasonable for the financial firm to consider what the complainant’s likely income will be in retirement and whether they will be able to continue to meet the required repayments. Alternatively, the consumer may intend to sell their home and downsize when they retire.

A financial firm may make allowances for fluctuations in a consumer’s variable interest rate debt obligations through the use of buffers. 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 debts in its serviceability assessment (where those loans have a variable rate period). There are exceptions, for example where the financial firm has documented reasons why some variable interest rate obligations are likely to be impacted differently by future interest rate changes. It is not generally necessary for firms to apply buffers to loans which have a fixed interest rate for their entire term (for example some vehicle loans or personal loans).

When considering whether an appropriate interest rate buffer has been applied for a residential home loan, AFCA may consider requirements specified by APRA from time to time (where applicable). We may also consider other regulatory guidance, and good industry practice. AFCA will consider all the circumstances to determine whether the financial firm considered reasonably foreseeable increases in variable interest rates in its assessment.

Example

Interest rate buffers

If the variable interest rate is 4% per annum, the financial firm may apply a higher interest rate in its serviceability assessment and test affordability.

This allows the financial firm to test whether the borrower is likely to be able to repay the loan even if variable interest rates increase.

A financial firm's policies may be relevant

AFCA may consider whether a financial firm complied with its own policies when it conducted an unsuitability assessment. AFCA will consider the policies that applied at the time the financial firm made its unsuitability assessment.

If AFCA identifies that a financial firm breached its policy, we will consider whether the breach is relevant to the firm's compliance with its responsible lending obligations. This can include considering the purpose of the particular policy provision. Where the policy provision is relevant to the responsible lending obligations, we may also consider whether the financial firm relied on an exception in the policy or otherwise reasonably believed there were reasons the policy should not apply to the particular assessment.

Example 1	Example 2
Where a financial firm does not confirm **funds to complete** a property settlement	Where a financial firm does not obtain a **valuation** as required under its policy
This is likely to be relevant to the firm's responsible lending obligations.	This may not be relevant to its responsible lending obligations.
The complainant may have sourced the funds to complete an asset purchase through another loan which has not been considered in the serviceability assessment.	Financial firms obtain valuations for their own purposes to assess the security they require for a loan.
The credit contract may be unsuitable for the complainant once the required repayments for that other credit contract are considered.	Whether a loan is unsuitable for a consumer depends primarily on the consumer's ability to meet future repayments through ongoing cashflow, rather than their asset position.

Where a financial firm relies on an exception under its policy, we will ask the financial firm to outline why it considered it was appropriate to rely on the exception in the particular circumstances of the complaint.

Industry codes and good industry practice

When considering responsible lending complaints, AFCA primarily focuses on whether the financial firm complied with the law as interpreted by the courts and supplemented by regulatory guidance.

AFCA is also required to have regard to other factors including 'applicable industry codes' and 'good industry practice'.

Where an industry code imposes additional or more specific obligations to a subscriber, AFCA will consider whether the financial firm complied with those obligations.

AFCA may consider whether some principles in a code reflect good industry practice within a particular industry sector or sub-sector, beyond subscribers to the code.

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.

When we consider whether a financial firm met the standard of 'good industry practice' in its lending conduct, we will consider the standard of good industry practice at the time the conduct occurred.

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'.

The parties' conduct may be relevant to the assessment

When reviewing responsible lending complaints, AFCA focuses on the conduct of the financial firm. This is consistent with the National Credit Act, which imposes positive conduct obligations on financial firms in relation to responsible lending.

The conduct of the borrower may be relevant when considering whether a financial firm has complied with its responsible lending obligations. An example is where a complainant knowingly provided falsified documents to verify inaccurate information in a credit application. In that situation, the financial firm will usually not have breached its responsible lending obligations if it could not reasonably have been aware the documents were false and it otherwise undertook reasonable inquiries and verification.

Equally, if we find an employee of the financial firm knowingly relied on false or misleading information in the unsuitability assessment, we may determine that the financial firm has breached its responsible lending obligations.

The conduct of the borrower may also be relevant when considering the compensation to be awarded. This is discussed further below under the heading 'Reducing compensation due to complainant conduct'.

Where a broker is involved in the loan application

Brokers have their own responsible lending obligations under the National Credit Act. Complaints against brokers are beyond the scope of this approach document.

The involvement of a broker does not change the credit provider's independent responsible lending obligations. The credit provider cannot merely rely on a broker's preliminary assessment of unsuitability or assume that information provided by the broker is necessarily correct. This is particularly the case where there are red flags indicating the information may be unreliable.

Some examples of circumstances where a credit provider should take particular care in relying on information a broker provides include where:

- the broker has not taken reasonable steps to verify a particular source of income, type of expenditure or has not provided the credit provider with reasonable verification material
- the credit provider is aware of circumstances indicating the broker may be acting in a position of conflict of interest (for example the broker is related to the borrower or has an interest in the intended use of the funds from the loan)
- the consumer:
  - indicates they do not agree with or understand representations the broker has made on their behalf
  - says they are not aware of certain information in the loan application form, or provides conflicting information
- the credit provider otherwise knew or should have known the broker may be acting in breach of its obligations.

3.4 AFCA determines whether the loan was unsuitable

Information a financial firm should have obtained

Where AFCA considers a financial firm's unsuitability assessment, we 'stand in the shoes' of the financial firm at the time it made its assessment.

This means we take into account the information that was available to the financial firm at the time, or information that would have been available if it had undertaken reasonable inquiries and verification steps. This allows us to determine what the firm, acting reasonably and in accordance with its obligations, would have included in its unsuitability assessment.

AFCA will use this information to determine whether the firm would have found the credit contract was unsuitable if it had used the information when it conducted its assessment.

Obtaining further information

AFCA may obtain further information if we identify:

- a calculation error
- omission of an existing debt repayment obligation
- inadequate or inappropriate use of benchmarks or buffers
- inadequate verification of a particular aspect of the consumer's financial situation
- that a financial firm held inconsistent information about a complainant's financial situation and that the inconsistency remains unresolved
- there is insufficient information available about the complainant's requirements and objectives.

How further information affects the assessment

In some cases, the way the new information affects the assessment will be straightforward. In other cases, AFCA will need to form a view as to the alternative approach the financial firm, acting reasonably and in accordance with its obligations, should have taken.

For example, where AFCA forms the view that the financial firm did not reasonably estimate the consumer's living expenses, AFCA may consider:

- the available information about the consumer's likely future living expenses;
- whether the financial firm, acting reasonably, should have obtained further information; and
- what this further information (if any) suggests is a reasonable estimate of the consumer's likely living expenses necessary to avoid substantial hardship and meet their requirements and objectives.

Example

Available information showed a loan was unaffordable

A 42-year-old single mother with three children applied for a $1,500 small amount credit contract. The financial firm obtained copies of her transaction account statements for the past 90 days and other verification material about her financial situation, such as payslips and Centrelink statements.

On the application form, the complainant declared $800 per month in general living expenses. The financial firm compared this to the HEM benchmark amount for a single adult with three children in the complainant's city with her income. The benchmark amount was higher, so the financial firm adopted that amount in its assessment.

When AFCA reviewed the transaction account statements the complainant provided to the financial firm, they showed her income was generally spent within 7 days of her receiving it, and her account was regularly in a negative or debit balance. She also had an escalating number of buy now, pay later arrangements evident on her bank statements.

AFCA considered the information on the bank statements was a red flag that the complainant's expenses may be higher than her available income, and that she may be unable to meet her existing expenses without substantial hardship. There was no suggestion on the available information that the complainant would be able to, or had undertaken to, reduce her existing expenditure, or that she could do so without substantial hardship.

AFCA considered the available information on the complainant's bank statements indicated it was likely she would be unable to meet her repayment obligations under the small amount credit contract without substantial hardship. AFCA found the financial firm breached its responsible lending obligations when it provided the small amount credit contract because it was unsuitable for the complainant.

What a complainant would have provided on request

Where we find the financial firm did not make reasonable inquiries or take reasonable verification steps, we need to determine what information it would reasonably have obtained.

When we consider what information the complainant is likely to have provided to the firm at the time:

- we are unlikely to presume the complainant would not have provided information on request unless there is information suggesting they would not have done so
- 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 or have a reasonable basis for

presuming the consumer would agree to do so based on the information available to it.

AFCA considers whether the credit contract was unsuitable

Once AFCA has revised a financial firm's unsuitability assessment to correct any errors, we consider whether the credit contract was unsuitable for the complainant.

The key steps AFCA will take are:

- if we have amended a financial firm's serviceability assessment, we will consider whether the revised serviceability assessment suggests it was likely the complainant could afford to meet their repayment obligations without substantial hardship; and
- if we have amended a financial firm's assessment of a complainant's requirements and objectives, we will consider whether it was likely the credit product would meet the complainant's requirements and objectives.

If the revised assessment shows the credit contract was in fact unsuitable for the complainant, we will consider the financial firm breached its responsible lending obligations when it provided the unsuitable credit product.

Further verification may be reasonable where surplus is small

Where the revised serviceability assessment demonstrates a complainant was likely to have surplus uncommitted income after the new loan repayment is considered, this usually shows the complainant could afford to meet their repayment obligation without substantial hardship. However, we may consider it was reasonable for the financial firm to take further verification steps to confirm the loan would not cause substantial hardship where:

- the revised serviceability assessment indicates there was likely to be little or no uncommitted income available; or
- there is a high use of estimation or approximation in the assessment.

We may consider further verification steps were reasonably necessary in these circumstances, to address the higher risk of complainant harm if estimates in the assessment are incorrect. We may then request further information to verify the complainant's financial situation from the time of the financial firm's original assessment and factor that information into the revised serviceability assessment.

Assessing whether a contract meets requirements and objectives

When we review the financial firm's unsuitability assessment, we will consider whether the financial firm reasonably assessed the credit product was likely to meet the consumer's requirements and objectives.

Depending on the circumstances and the type of credit product, AFCA will consider how the financial firm considered the consumer's requirements and objectives in its assessment. Some credit products will usually be more closely tied to a particular objective, like the purchase of a home or car. Other credit products may be more generally related to the consumer's financial or personal objectives.

ASIC RG 209 sets out some items financial firms are likely to require information about (see RG 209.51) when considering consumers' requirements and objectives.

The amount of information financial firms should obtain about a consumer's requirements and objectives to reasonably assess whether the credit product is likely to meet them will depend on the consumer's circumstances.

There are some circumstances that may indicate further consideration of requirements and objectives would be reasonable. Some examples include:

- where it is not clear to the financial firm that the credit product will deliver a direct financial benefit to the consumer (because for example the information indicates it will be used to purchase an asset for, or refinance a debt owed by, a family member or third party)
- where the information shows the consumer will need to make significant reductions to their existing levels of expenditure to meet the required repayments.

AFCA will consider whether the financial firm reasonably concluded the credit product met the complainant's requirements and objectives. We will make this assessment based on the information available to the financial firm at the time, or information that would have been available if it had made reasonable inquiries into the complainant's requirements and objectives.

Subsequent events are usually irrelevant

When considering a responsible lending complaint, we focus on the information available at the time the financial firm conducted its unsuitability assessment. Subsequent events (e.g. illness or unemployment) that later cause the consumer to be unable to meet their repayments will not be relevant to the assessment unless the financial firm was on notice of these events, or would have been on notice if it had:

- made reasonable inquiries; or
- taken reasonable steps to verify the complainant's financial situation.

4 How we determine fair outcomes and calculate complainant loss

Important note: AFCA makes decisions based on what is fair in all the circumstances. As a result, it is not possible to set out a definitive approach that will apply to all scenarios. This section of the document sets out common approaches applied in some typical scenarios related to the calculation of loss. It is indicative only and will not apply in all complaints.

4.1 Overview of AFCA's approach to determining fair outcomes

The AFCA Rules and delivering fair outcomes

Under the AFCA Rules, we may decide that a financial firm must compensate a complainant for the loss its errors cause them, including:

- direct financial loss
- indirect financial loss
- non-financial loss.

There are compensation caps in our Rules that limit the amount of compensation we can require a financial firm to pay to a complainant.

We may also decide a financial firm is required to take, or not take, particular actions to remedy the practical impact of its error.

The remedies that AFCA may provide in responsible lending complaints include requiring:

- payment of a sum of money
- forgiveness (in whole or in part) or variation of a debt
- release of security for a debt
- repayment, waiver or variation of a fee or other amount paid to or owing to the financial firm, including a variation of the applicable interest rate on a loan
- reinstatement, variation, rectification, or setting aside of a contract
- a financial firm refraining from enforcing a default judgment; and/or
- an apology by the financial firm.

The focus of AFCA's outcomes is to compensate the complainant for the loss the financial firm's error caused them. AFCA does not award compensation to 'punish' an error or breach and we do not impose fines or sanctions.

Our approach is informed by law and regulatory guidance

AFCA aims to provide a remedy that is fair in all the circumstances of the complaint.

ASIC Regulatory Guide (RG) 277 provides guidance to lenders about factors they should consider when proactively remediating responsible lending breaches. The principles outlined in this approach document have been developed considering RG 277. We may apply principles for remediation of unsuitable credit contracts from RG 277, which include:

- if a loan is secured, allowing the consumer to retain the underlying asset where it is fair in all the circumstances (see below for more detail)
- considering the net loss a consumer has suffered as a result of the loan (see section 4.2 for more detail)
- correcting a consumer's credit information.

AFCA also considers the approach courts have taken in responsible lending cases and cases involving similar consumer protection remedy provisions, such as those in the National Credit Code, ASIC Act and Australian Consumer Law.

Seeking information to provide a comprehensive resolution

When we consider appropriate remedies, we seek to provide a clear pathway for the parties to deal with secured assets and remaining debts. We aim to minimise the requirement for the parties to undertake further negotiations or other processes after the AFCA complaint is closed. We also attempt to avoid the need for the parties to return to AFCA later.

We will often ask for relevant information at an early stage of our investigation process to assist in exploring possible resolutions. This may include:

- historical information about repayment history on the account
- detail and supporting documents showing costs a complainant incurred and benefits they derived from the credit contract
- information about a complainant's current financial situation.

Dealing with secured assets fairly in the circumstances

If AFCA finds a credit contract is unsuitable, there will often still be an ongoing arrangement between the parties after we close our complaint. For example, there may be a loan that continues on varied or amended terms.

When AFCA considers whether to vary an unsuitable credit contract to enable the complainant to repay their adjusted debt over time, we will consider what steps are fair in all the circumstances for the complainant to take, to mitigate their future loss and avoid ongoing hardship. This may include selling assets to repay the adjusted debt.

We recognise that in many cases, a complainant may suffer significant upheaval and distress if they are required to sell a family home or car to repay an outstanding adjusted debt. For example, the complainant may rely on their car to drive to work, particularly if they live in a regional area. Similarly, some complainants may have particular difficulty securing alternative accommodation if they are required to sell their family home.

We will consider a range of factors to determine whether it is fair in all the circumstances to require a complainant to sell a secured asset or to instead vary the terms on which the adjusted debt is repaid.

In some cases, it may be fair to:

- allow the complainant to retain the asset and repay the adjusted debt over time, where it is fair to the parties in all the circumstances. We will consider whether the financial firm should be entitled to apply interest to the adjusted debt from the date of the determination and if so, what the appropriate interest rate should be
- vary the terms of the credit contract to reduce required repayments to a level that is affordable for the complainant, based on their current financial position
- vary the principal amount or interest rate of the adjusted debt
- in exceptional circumstances, implement a 'life tenancy' style arrangement for loans secured by a mortgage over a complainant's home, with minimal or no repayments until they pass away. This outcome would be fair in only limited cases but may be appropriate in the case of an elderly or vulnerable complainant who is unlikely to be able to access suitable accommodation if they were required to sell their home to repay the debt immediately.

Where the determination finds no adjusted debt remains outstanding to the financial firm, the complainant will usually be entitled to retain secured assets.

Where we find a lender breached its responsible lending obligations and a complainant is required to sell a secured asset as part of the outcome of a complaint, the lender will generally be required to compensate the complainant for their net loss, as described in section 4.2. This usually means any outstanding adjusted debt will be waived once the asset is sold and the sale proceeds are applied to the loan.

4.2 Calculating responsible lending remedies

AFCA calculates the complainant's net loss

AFCA will generally require a financial firm to compensate a complainant for their 'net loss'.

We generally consider the complainant suffers gross loss to the extent they become liable for a debt under an unsuitable credit contract (including interest, fees and charges). We then offset the complainant's gross loss by the amount of financial benefit the complainant received under the credit contract to determine their net loss.

The complainant's benefit is defined further below.

Gross loss − **Benefit** = **Net loss**

The next step is usually to subtract the net loss from any outstanding debt balance under the relevant credit contract at the time the AFCA decision is made:

Outstanding debt balance − **Net loss** = **Adjusted debt balance**

The result of this calculation is the complainant's adjusted debt.

How we calculate net loss

As outlined above the complainant's net loss is their gross loss, less the benefit they received from the credit contract.

Gross loss

Amounts paid to the financial firm under a credit contract, for example:

- repayments
- fees.

Outstanding liability under a credit contract (including interest and fees)

Amounts paid to third parties related to a credit contract

Benefits

Amount of credit

Other benefits a complainant received from the use of credit, for example:

- rental income
- crystallised capital gains.

When complainants do not receive a benefit from the loan

In some cases, AFCA may determine:

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

Some examples include where:

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

Complainants may not receive the benefit of the full amount of the loan funds where the loan (including a joint loan) was for the benefit of a domestic partner or family member. In circumstances where there is family violence, we will determine a fair outcome by taking into account the substantive benefit the complainant received from the loan. For more detail, see our Approach to financial elder abuse and our Approach to joint accounts and family violence.

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

If a complainant suffers capital loss from the sale of a secured personal asset (such as a family car or home), AFCA may consider their benefit is the value of what is left in their hands at the time of our determination (that is, the current value of the asset or the sale price if it was sold before our determination).

This approach only applies to secured personal assets such as family homes and cars purchased with loan funds. In contrast, AFCA generally considers a complainant received a benefit from the full amount of credit used to purchase a residential investment property, even if they suffer a capital loss on resale of that property.

Example

The complainant may not receive a benefit

The complainant obtained a secured loan to purchase a vehicle for $50,000, which AFCA found was unaffordable and unsuitable for them.

The complainant had only made $3,000 in repayments and had no employment income or capacity to make ongoing repayments. The complainant agreed they would surrender the vehicle to the lender so the lender could sell it. The vehicle was now worth $30,000. There was no information to show the complainant had caused the vehicle's value to deteriorate unusually quickly or that they had damaged the vehicle.

AFCA considered the complainant's gross loss was the $3,000 in repayments they had made to the lender, plus the amounts they remained liable for under the loan contract. AFCA considered the complainant's benefit was the present value of the vehicle, which the lender would recover when it sold the surrendered vehicle.

If the complainant surrendered the vehicle to the lender, the lender was required to waive the outstanding amounts under the loan contract and refund the complainant the $3,000 repayments they had made to date plus the deposit they paid the dealer and government charges, which represented their net loss from the unsuitable loan.

A complainant's benefit may include interest for refinanced debts

AFCA does not generally apply interest when calculating the complainant's benefit from an unsuitable loan. However, where a new unsuitable loan refinances an existing loan with a better interest rate, AFCA may consider the interest the complainant avoided repaying on the refinanced debt as being part of their benefit.

However, if the existing loan was also unsuitable (or unjust under the National Credit Code), AFCA usually considers the complainant's benefit from both the existing loan and new loan to be non-interest bearing when assessing their net loss.

Example

Complainant benefits included a better interest rate

The complainant obtained a $15,000 personal loan to refinance their existing $10,000 credit card debt and provide them $5,000 additional funds. AFCA found the $15,000 personal loan was unsuitable.

AFCA calculated the complainant's net loss from the $15,000 personal loan on the basis they received a $15,000 benefit from the personal loan, with $10,000 of that benefit (the refinanced amount) being interest-bearing because it refinanced an existing interest-bearing obligation.

AFCA applied the personal loan interest rate to the interest-bearing portion of the complainant's benefit, which was lower than the credit card interest rate. AFCA applied the complainant's repayments to reduce the interest-bearing balance first when calculating the adjusted debt.

Benefits other than the loan funds

The complainant's benefit is usually the amount of credit the financial firm provided (that is, the principal amount borrowed).

AFCA will consider if the complainant received other benefits from the loan. If, in the circumstances, we consider the complainant received other benefits, we may take this into account when calculating their net loss.

Other benefits may include positive changes in a complainant's circumstances that may have resulted from their use of the loan. For example:

- receiving rental income from an investment property
- capital gains from sale of assets purchased using loan funds (where that sale has occurred and the gain has crystallised)
- other benefits the complainant obtained from use of the loan funds.

In most cases, AFCA will consider a complainant has accounted for their benefit from an unsuitable credit product when they repay the principal amount borrowed.

There may be some circumstances where we would consider other benefits, such as rent avoided when purchasing a new home. When we do so, the guidance in ASIC RG 277 will apply (for example, when making assumptions about what the complainant would have done if the lender had not provided the unsuitable loan). We may then also take into account holding costs associated with the property.

There may be exceptional circumstances where the benefits obtained from the loan are more than the principal amount borrowed, and we will consider these when calculating the complainant's net loss.

Assessing benefit from investment property loans

Where a complainant receives rental income from an investment property purchased with an investment property loan, AFCA generally considers the rental income (less holding costs such as agent's fees, rates, and insurance) to be a benefit to the complainant.

We may also consider property maintenance costs are part of the complainant's gross loss. However, we will generally exclude upgrade or renovation costs, as these generally improve the value of the property.

Where an investment property loan is unsuitable, AFCA will consider how to fairly apportion any capital loss between the complainant and the financial firm. We will consider all the circumstances of each complaint, including for example:

- the fair allocation of investment risk between the parties, considering the complainant's intention to use the loan funds for an investment
- the extent of the capital loss and the size of the resulting shortfall debt
- the financial firm's interest in recovering the shortfall debt as soon as possible
- the complainant's pre-existing position before the loan was provided
- what other assets are available that the complainant could sell to repay the shortfall debt
- what impact the sale of other assets would have on the complainant
- whether the loan is also secured against the complainant's family home and whether the lender intends to exercise its power of sale over the complainant's family home to recover the shortfall debt
- whether the financial firm or its agent was involved in the selection of the particular investment property or induced the complainant to purchase the particular property.

Example

Calculating benefit for investment property

The complainant approached a bank to obtain an investment property loan. The bank employee they dealt with was undertaking a property development in their spare time.

The bank employee encouraged the complainant to purchase a property in their development. They said it was a sure bet and their projections showed the properties were likely to double in value in five years. The complainant obtained a loan and purchased a property in the development.

The complainant could not afford to make the required repayments and complained to AFCA. AFCA found the loan was unsuitable for the complainant because it was unaffordable. When deciding a fair remedy, AFCA considered that a recent valuation showed the property had declined in value by 50% in the three years the complainant had held the property.

AFCA decided it was fair for the bank to compensate the complainant for the capital loss they suffered from the investment property purchase because the banker's conduct, including misleading representations about future matters, induced the complainant to purchase the particular property.

Where a financial firm may need to pay interest on compensation

If the complainant has repaid the debt under the unsuitable credit contract prior to the AFCA determination, AFCA may apply interest to any compensation amounts the financial firm is required to pay the complainant.

For example, we may determine a complainant received $50,000 benefit from a loan, but they have made $75,000 repayments to the financial firm. We may require the financial firm to pay the complainant interest on the $25,000 overpayment. We will apply interest from the date the complainant paid the excess amounts to the financial firm.

Determining how the adjusted debt should be repaid

Where the complainant has an adjusted debt to the financial firm, AFCA will consider what is fair in all the circumstances in determining how the debt should be repaid. This includes:

- the complainant's current uncommitted income and value of their secured assets
- the complainant's position before the financial firm provided the loan, including whether they sold or relinquished assets
- the complainant's other relevant circumstances, for example:
  - their age
  - any other vulnerability such as disability
  - their capacity to replace any assets they sell to repay the adjusted debt; and

    - the impact and burden of selling certain assets to repay the adjusted debt (such as a home or family car)
- the impact on the lender of varying the repayment terms to require lower repayments (or in exceptional circumstances nominal or no repayments until a particular event or date in the future)
- if the complainant retains the secured asset, whether it is fair to allow the lender to apply interest for the remaining term of the credit contract because the complainant is not selling the asset to mitigate their future loss.

See Guide one for further details.

Assessing how secured assets can be dealt with fairly

AFCA recognises that requiring sale of the asset or waiver of an outstanding debt may have significant adverse practical implications for the parties.

For example, if the complainant has sold their home to purchase a new home with an unsuitable loan, it may not be possible for them to return to their previous home and circumstances, if they are required to sell their new home.

In other cases, it may be fair that the complainant sells an asset in order to repay the loan and allow the lender to recover the adjusted debt within a reasonable timeframe. If we require a complainant to sell an asset, we will also consider adverse impacts from external factors. For example, we may consider the impact of a natural disaster on the complainant's capacity to secure alternative accommodation. AFCA will balance each of these factors to determine an outcome that is fair to both parties.

Where a complainant retains a secured asset, we generally consider their acquisition costs (such as stamp duty) and holding costs (such as rates and insurance) are not part of their gross loss. This means the financial firm will generally not be required to compensate the complainant for these amounts.

Example

Keeping the family home

The complainants obtained a $700,000 loan to buy a new, larger home for their growing family. The complainants struggled to meet their repayment obligations for five years, before complaining to AFCA that the loan was unaffordable for them. AFCA found the $700,000 home loan was unaffordable and unsuitable for the complainants.

The complainants' gross financial loss was $860,000 (made up of $200,000 in repayments made, the $650,000 they remained liable for under the loan contract and $10,000 in fees and charges). AFCA then subtracted their benefit (the principal loan amount of $700,000), to calculate the complainants' net financial loss of $160,000. AFCA subtracted this net financial loss of $160,000 from the outstanding loan amount of $650,000 to calculate the adjusted debt of $490,000.

AFCA then considered how the complainants should repay the adjusted debt. The complainants had owned their own home before the financial firm provided the new loan, but they could not move back to that property because they had sold it.

The complainants had three children in primary school and were working full time, with incomes that would enable them to make reasonable repayments towards the adjusted debt. Rather than ask the complainants to sell their home to repay the adjusted debt immediately and mitigate ongoing loss, AFCA considered it was fair to allow the complainants to remain in their home given their circumstances.

The AFCA determination gave the complainants two options:

- Keep their home and repay the adjusted debt over the remaining loan term. In the particular circumstances of this complaint, AFCA determined it was fair for the financial firm to apply interest to the adjusted debt at a rate equal to the Reserve Bank of Australia cash rate, varied from time to time in accordance with movements in the cash rate.
- Sell the property and repay the adjusted debt within six months. With this option, the financial firm was required to compensate the complainants for their acquisition costs (such as stamp duty and legal fees) and pay their reasonable costs of selling the property (such as agent's fees).

Applying interest to secured adjusted debts

If a complainant surrenders or sells a secured asset which was purchased with an unsuitable loan as part of the implementation of an AFCA determination, AFCA may require the financial firm to refrain from applying interest to the adjusted debt until the asset is surrendered or sold.

However, AFCA will generally consider it appropriate for a financial firm to apply interest to an adjusted debt after the date of an AFCA determination if:

- the loan is a secured loan for purchase of an asset, or a construction loan;

- the complainant is not required to sell the asset; and
- there is an adjusted debt outstanding.

Applying interest to adjusted debts in these circumstances may be appropriate because the complainant is choosing not to take an available step to mitigate their ongoing loss (e.g. selling the asset to pay back their adjusted debt), which disadvantages the financial firm.

AFCA will determine the rate of interest to apply to the adjusted debt based on the circumstances of each case.

AFCA will consider a range of factors to determine the fair rate of interest to apply to the adjusted debt, including the guiding principles in ASIC RG 277 and the circumstances of the complaint. In some complaints, this may include reference to external interest rate benchmarks like the Reserve Bank of Australia cash rate. AFCA may determine it is fair to add a margin or discount to that external rate benchmark based on the circumstances.

Financial firms may request deeds reflecting AFCA decisions

Where AFCA determines it is fair in the circumstances for a complainant to repay an adjusted debt over time and retain an asset like a house or car, financial firms may request complainants sign a release reflecting the terms of the AFCA determination.

This process is governed by AFCA Rule A.15.3, which requires any deed of release to be limited to the matters in the determination and to be consistent with the determination.

Repayment of adjusted debts for unsecured loans

Where the financial firm provides an unsuitable unsecured loan (such as a personal loan or credit card), AFCA will generally require the financial firm to refrain from charging interest on any adjusted debt.

Once AFCA has calculated the adjusted debt for an unsuitable unsecured loan, AFCA usually considers it fair for the lender to:

- not apply interest to the adjusted debt moving forward
- negotiate a reasonable repayment arrangement with the complainant.

Refer to Guide One for more detail, including exceptions to this approach.

Example

Repaying adjusted debt for an unsecured loan

The complainant complained to AFCA about a $50,000 personal loan and as they could not afford their repayments. AFCA found the loan was unsuitable and the financial firm should not have provided it.

AFCA considered the complainant's gross loss to be the repayments they made up to the date of the AFCA determination ($12,000), plus fees and charges ($1,000) and all amounts they remained liable for under the loan contract. The complainant's benefit was the $50,000 amount of credit they applied for their benefit.

AFCA required the lender to reduce the outstanding debt to $37,000, cease charging interest and fees, and arrange an affordable repayment plan with the complainant for the adjusted $37,000 debt.

A complainant may suffer loss even if they meet repayment obligations

When AFCA finds a credit contract was unsuitable, we will not reduce a complainant's entitlement to compensation because of improvement in their financial circumstances (e.g. a salary increase after a loan is provided), or because they do not actually default on their repayments.

Financial firms are prohibited from providing unsuitable loans to consumers, and the law requires a point in time assessment of unsuitability.

Consumers are considered to suffer gross loss when they enter into an unsuitable contract. In some cases, consumers may find a way to make repayments but will endure substantial hardship when doing so. This could include forgoing essentials or borrowing money from family and friends.

Conversely, AFCA will not find a loan is unsuitable simply because a complainant subsequently suffered financial hardship or was unable to make the required repayments (e.g. where a complainant loses their job after a firm provides a loan).

Loss may end when a debt is refinanced with a responsible loan

Where a complainant refinances an unsuitable debt using a subsequent credit product (that is not unsuitable), the complainant will generally only be entitled to compensation for loss suffered during the period between those unsuitability assessments.

The complainant generally ceases suffering loss from the unsuitable credit contract after the new credit contract is provided.

We recognise there may be some circumstances where the practical impact of the unsuitable loan persists despite the new loan not being unsuitable.

Where a complainant refinances an unsuitable loan using a further loan that is also unsuitable, AFCA will generally find the complainant continues to suffer loss.

Contracts that are affordable but do not meet requirements and objectives

Where AFCA finds a credit contract is unsuitable because it did not meet a complainant's requirements and objectives (but it was affordable), we may assess the complainant's loss differently.

This may be appropriate where:

- there was another product available that met the complainant's requirements and objectives and was otherwise not unsuitable, or the product could have met their requirements and objectives with a simple variation;
- the difference between the first and second product can be effectively remedied by a payment of compensation, variation to the contract or adjustment to the outstanding debt; and
- the harm the product has caused the complainant can be fully remedied using this approach.

This approach is not appropriate where a credit contract is unsuitable because the complainant was unlikely to be able to meet their repayment obligations, or was only likely to be able to meet them with substantial hardship.

Example

Loan didn't meet requirements and objectives

A complainant obtained a $40,000 credit card from a financial firm. The application form shows the complainant requested a basic credit card with no fees. However, the firm approved and provided a high-fee credit card which offered increased rewards points.

AFCA found the high-cost credit card was unsuitable because it did not meet the complainant's requirements and objectives. The firm's basic credit card at the time had no fees, and the complainant otherwise met the eligibility requirements at the time they applied for the card. The complainant said the outcome they sought was to obtain a no-fee credit card and be compensated for the firm's error.

AFCA determined it was appropriate to adopt a 'different transaction' approach, and it required the firm to refund the fees the complainant had paid to date, with interest on the compensation amount from the date the complainant had paid each fee. AFCA required the firm to convert the complainant's card to a basic credit card from the date of the determination.

Reducing compensation due to complainant conduct

The conduct of a complainant during the credit application process may be relevant to whether the financial firm breached its obligations and when determining an appropriate remedy.

If we find that the complainant has knowingly provided false information, with the intention of deceiving the financial firm, we may reduce the compensation payable to the complainant. We may also determine that no compensation is payable in exceptional circumstances.

We will not generally reduce the compensation awarded to a complainant who has unintentionally provided inaccurate or incomplete information to the financial firm. Our approach recognises that the National Credit Act imposes a positive obligation on credit providers to conduct reasonable verification of a consumer's financial situation.

Example

Complainant provides fraudulent verification documents

A financial firm requested the complainant provide bank statements and payslips to verify their financial situation as part of a loan application process.

The complainant provided doctored bank statements to show salary credits of $5,000 per fortnight. The complainant's real income was $2,000 per fortnight. They also provided payslips showing $5,000 per fortnight net income.

The financial firm also requested payslips from the complainant as part of the application process, and the complainant provided false payslips showing $5,000 per fortnight net income.

The complainant later fell behind on their repayments and complained to AFCA that the loan was unsuitable. AFCA reviewed the financial firm's unsuitability assessment and found that the verification steps it took were reasonable in the circumstances. The verification information the complainant provided was not inconsistent with any other information the financial firm held about the complainant. There were no red flags evident on the face of the documents that they were false.

AFCA found that if the financial firm used the income figure of $5,000 per fortnight (which it had reasonably verified was accurate) in its serviceability assessment, the loan appeared affordable for the complainant. AFCA found the financial firm had:

- made reasonable inquiries and taken reasonable steps to verify the complainant's financial situation; and
- reasonably assessed the loan was not unsuitable based on the information it held about the complainant and reasonably believed to be true.

The financial firm was not required to compensate the complainant because the loan was not unsuitable.

Where a consumer is unaware their agent, such as their broker, has engaged in fraud or deception, but the bank has also breached its responsible lending obligations, AFCA will not generally reduce the compensation awarded to that consumer. Where a broker is joined to the AFCA complaint, AFCA will consider the impact of the broker’s actions in determining an appropriate outcome.

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.

Awarding compensation for indirect and non-financial loss

AFCA may require a financial firm to pay compensation for indirect or non-financial loss, subject to the monetary limits in our Rules.

For example, we may award compensation for indirect loss where the consumer obtains additional short-term credit at higher interest rates to fund their repayments on an unsuitable loan. We expect consumers who claim they have suffered indirect financial loss to provide reasonable supporting information to substantiate their claim.

When determining the appropriate amount of non-financial loss, AFCA will consider the factors outlined in 'The AFCA Approach to non-financial loss claims'.

Credit reporting and repayment history information

Where AFCA finds a loan was unsuitable, we may require the financial firm to request that credit reporting bodies remove adverse credit listings relating to the loan and amend repayment history information for the loan to 'not reported'.

5 Other issues

5.1 Joinder

Under AFCA's Rules, we may decide at any time that it is appropriate to join another financial firm as a party to an existing complaint. A joined financial firm has the same rights and obligations during the complaint process as if they were the original financial firm. Information about the joinder process is contained in AFCA's Operational Guidelines.

In responsible lending complaints, AFCA may consider joining a financial firm where the original complaint is lodged against a broker, but where the credit provider may also have contributed to the loss claimed. Likewise, a broker may be joined to a complaint against a credit provider.

If AFCA decides compensation is payable to the complainant, we will allocate liability between the financial firms in a way that is fair in all the circumstances.

6 References

Definitions

Term	Definition
Complainant	An individual or small business that has lodged a complaint with AFCA
Financial firm	An organisation or individual that is a member of AFCA
National Credit Act	*National Consumer Credit Protection Act 2009* (Cth)

Useful documents

Document type	Title
Rules	AFCA's Rules
Operational Guidelines	AFCA's Operational Guidelines
Act	*Australian Securities and Investments Commission Act 2001* (Cth)
Guide	RG 209 Credit licensing: Responsible lending conduct | ASIC
Guide	RG 277 Consumer remediation | ASIC
Code of Practice	Australian Banking Association's Banking Code of Practice
Code of Practice	Customer Owned Banking Code of Practice

7 Quick reference guides

Guide one Calculating loss from different credit products	Read this Guide for more detail about how AFCA assesses loss for different loan types. This Guide covers home loans, investment property loans, car loans, unsecured personal loans and credit cards, consumer leases and reverse mortgages.
Guide two Information we may request from financial firms	A summary of information we commonly request from financial firms to help prepare for the AFCA process.
Guide three Information we may request from complainants	A summary of information we commonly request from complainants to help you prepare for the AFCA process.

Guide one

Calculating loss from different credit products

- This guide provides information about our approach to remedies and loss calculation for different credit products
- This guide should be read in conjunction with section 4.2 of this Approach.

Home loans

We acknowledge that an unsuitable loan used to purchase a home can have a significant practical impact on a consumer and their family.

We may consider a range of factors when calculating a complainant's net loss from an unsuitable home loan, including:

Gross loss	Benefit
• total repayments made • amount they remain liable for • fees and charges paid to the financial firm or any third party • acquisition and holding costs such as deposit, stamp duty, maintenance, rates, and insurance (usually only where the complainant sells or surrenders the property), and • any capital loss suffered from sale of the property.	• benefit received from use of the credit (usually the principal amount provided, but may include other benefits depending on the circumstances of the case) • usually, if the complainant retains the home after our determination, the amount of credit used to purchase the home and pay acquisition costs will be considered a benefit, and • if the complainant sells or surrenders the home, the amount of credit used to purchase the home, or the sale or current market value (i.e. what is left in their hands) may be their benefit, depending on what is fair in the circumstances.

We calculate the complainant's net loss by subtracting their benefit from their gross loss. If there is an adjusted debt, AFCA will determine how the adjusted debt should be repaid. We will consider:

- whether the complainant previously owned a home and sold it because of the unsuitable loan (e.g. they purchased a new home with the unsuitable loan)
- the complainant's age
- the complainant's personal circumstances, including their family size and type
- whether the complainant has vulnerabilities or requirements, such as a disability and modifications they have made to their home to assist with mobility
- the complainant's current financial situation and capacity to make future repayments
- the complainant's capacity to secure alternative accommodation if the property is sold, including if the complainant's net loss is paid to them from the sale proceeds before the financial firm recovers the outstanding adjusted debt
- the practical impact on the complainant of selling their home, finding a new home and moving to it (including factors such as those listed above)
- the impact on the financial firm if:
  - > the complainant does not sell the home immediately and instead repays the adjusted debt over time; or
  - > AFCA varies the terms on which the loan is repaid.

After considering these factors, we will determine whether it is fair in all the circumstances for the complainant to retain their property or sell it to repay the unsuitable loan immediately.

If the complainant is required to sell their home, any capital loss is generally captured when we calculate their net loss. In most circumstances, this means where a property is sold, after the sale funds are applied to the loan, any outstanding adjusted debt owing will be waived.

If we consider it is appropriate to allow the complainant to retain the property and repay the adjusted debt over the term of the contract (or, if they are elderly, when they pass away or move to another home), we will consider whether the financial firm can charge interest on the adjusted debt. The interest in this circumstance is to reflect the impact of the complainant’s decision (choosing not to mitigate their future loss by selling their property) on the financial firm.

Example

Home loan remedy

A complainant was close to retirement age and already owned their own home (property A). They applied for a loan to purchase vacant land and construct a dwelling on this land (property B). A financial firm provided these loans, totalling $700,000.

The complainant could not afford the repayments, and because of this financial hardship, had to sell property A. They complained to AFCA about the financial firm's decision to provide the loans.

AFCA found the loans were unsuitable and the financial firm should not have provided them.

AFCA considered the financial firm should compensate the complainant for both her net financial loss and non-financial loss. There was an adjusted debt remaining after the complainant's net loss was applied to reduce their outstanding debt. AFCA had to determine how the complainant would repay the adjusted debt.

Property A (the complainant's previous home) had been sold, so it was not possible to return the complainant to their previous position. AFCA considered it reasonable for the complainant to retain property B rather than selling to repay the adjusted debt.

AFCA required the complainant to repay the adjusted debt in affordable monthly repayments based on her financial circumstances. This adjusted debt had an interest rate equal to the Reserve Bank of Australia cash rate, applied for the remainder of the loan and varied in accordance with movements in the cash rate from time to time.

The financial firm was only entitled to take possession of the property to recover the outstanding debt if the complainant moved to another property or passed away. In this event, any surplus after the sale would need to be paid to the complainant or her estate. If there was a shortfall debt, the financial firm was required to waive this debt.

Investment property loans

AFCA recognises the practical consequences of an unsuitable investment property loan are different to the practical consequences of an unsuitable home loan.

We may consider a range of factors when calculating a complainant's net loss from an unsuitable investment property loan, including:

Gross loss	Benefit
• total repayments made • contract fees and charges paid to the financial firm or any third party • acquisition and holding costs such as deposit, stamp duty, rates, and insurance (usually only where the complainant sells or surrenders the property) • capital loss suffered from sale of the property (only in exceptional circumstances as outlined in section 4.2), and • amounts outstanding under the loan contract.	• benefit received from use of the credit (usually the principal amount provided, but may include other benefits depending on the circumstances of the case), and rental income from an investment property is usually considered an additional benefit.

We calculate the complainant's net loss by subtracting their benefit from their gross loss.

If there is still a debt owing after this adjustment is applied, AFCA will determine how the adjusted debt should be repaid.

We generally expect a complainant to refinance or sell an investment property purchased with an unsuitable investment property loan to mitigate their ongoing loss within a reasonable period (usually within six months). A complainant may also refinance the adjusted debt rather than sell the investment property to repay it.

In exceptional circumstances, we will consider whether it is appropriate to enable the complainant to retain the investment property and continue to suffer loss for the remaining term of the unsuitable credit contract. This may include where:

- the complainant now lives in the property
- 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
- the property is co-owned with a third party and it would be impractical or unfair to require it to be sold
- there are other circumstances that indicate sale of the property in the short term would cause the complainant a significant level of hardship.

We will balance the relative impact on each party in determining whether exceptional circumstances exist.

Example

Investment property loan outcome

Over six months, a complainant obtained four investment property loans from a financial firm. At the time the financial firm provided these loans, the complainant was close to retirement age. The complainant previously owned their home outright without any loans. The complainant provided the financial firm a mortgage over the four investment properties and their home as security for the new loans.

The complainant complained to AFCA that the four loans were unsuitable and the financial firm should not have provided them. At the time AFCA considered the complaint, all four investment properties had been sold and there was a shortfall debt owing on all loans because the properties had declined in value.

AFCA found the four loans were unsuitable and the financial firm should not have provided them.

The complainant was retired at the time of the AFCA complaint. They also had limited capacity to repay the shortfall debts from their available income, which consisted solely of Centrelink benefits. AFCA required the financial firm to reduce the outstanding shortfall debts to compensate the complainant for their net loss.

AFCA decided it was fair for the complainant not to be required to sell their home to repay the adjusted debts. The financial firm was entitled to recover the adjusted debt if the complainant elected to move from their home at any time in the future, or when they passed away.

Car loans

AFCA recognises it is often complex to determine fair compensation for the financial impact of an unsuitable car loan.

For example, where the complainant used funds from the unsuitable loan to purchase a new vehicle or they sold or traded in their existing vehicle, it will not generally be possible to return their previous vehicle to them. Even where a complainant did not previously own a car, the process of acquiring a new car can involve significant delay and costs.

We may consider a range of factors when calculating a complainant's net loss from an unsuitable car loan, including:

Gross loss	Benefit
• total repayments made • deposit paid for the vehicle (only where the complainant does not retain the vehicle) • amounts outstanding under the loan contract • fees and charges paid to the financial firm or any third party, and • capital loss suffered from sale of the vehicle.	• benefit received from use of the credit (usually the principal amount provided, but may include other benefits depending on the circumstances of the case) • if the complainant retains the car, their benefit is usually the purchase price of the car or its true value at the date of acquisition (which may be less than the purchase price if the car was purchased for an inflated value or was faulty), and • if the complainant sells or surrenders the car, their benefit may be the sale price or current market value of the car (i.e. the value of what is left in their hands).

We calculate the complainant's net loss by subtracting their benefit from their gross loss. If a complainant's net loss is greater than the outstanding debt, the complainant will have effectively repaid their debt and the financial firm may need to refund any amount paid in excess of their net loss. This usually means the complainant is entitled to retain the vehicle and the financial firm will be required to discharge its security interest.

Where the complainant's net loss is not greater than the outstanding debt, the complainant will have an adjusted debt.

If there is an adjusted debt, AFCA may explore options that enable a complainant to repay the debt over time and retain the vehicle. We will consider:

- whether the complainant previously owned a vehicle and whether they sold that vehicle after the unsuitable loan was provided
- whether the complainant has any specific vulnerabilities, such as a disability, which requires modifications to their vehicle

- the complainant's current financial situation and capacity to make repayments
- the complainant's capacity to secure an alternative vehicle
- the practical impact on the complainant of finding or being without a vehicle
- the impact on the financial firm if:
  - > the complainant does not sell the vehicle immediately
  - > AFCA varies the terms on which the loan is repaid.

If the complainant keeps the vehicle and repays the adjusted debt over time, we will consider whether it is appropriate for the financial firm to charge interest on the adjusted debt to reflect the practical impact of the complainant's decision not to sell the vehicle to repay the adjusted debt.

If the complainant sells or surrenders the vehicle, we will usually consider their gross loss includes any capital loss on resale of the vehicle. That is, we may consider the complainant's benefit to be equal to the proceeds of sale of the vehicle (e.g. the value of what is left in their hands at the time of our determination).

Example

Complainant keeps the car

A complainant obtained a car loan from a financial firm to purchase a car. They complained to AFCA that the loan was unsuitable and should not have been provided to them.

AFCA found the loans were unsuitable and the financial firm should not have provided them.

The purchase price of the vehicle was $50,000. At the time they complained to AFCA, the complainant had made $70,000 total repayments to the financial firm and wanted to keep the vehicle.

AFCA required the financial firm to waive the outstanding loan balance and release its security interest over the vehicle. AFCA also required the financial firm to pay the complainant $20,000 to compensate them for their net financial loss (being the total amount they had paid to the lender under the unsuitable contract that exceeded the purchase price of the vehicle), as well as an additional amount for non-financial loss.

Example

Complainant surrenders the car

A complainant obtained a car loan from a financial firm. The complainant said the financial firm didn't ask them about their existing liabilities and failed to include some existing expenses in its unsuitability assessment.

The complainant complained to AFCA that the loan was unsuitable and should not have been provided. At the time of the complaint, the complainant had made $6,000 in repayments towards the loan and wanted to surrender the vehicle. The complainant also said the car had many faults which started only a few weeks after he bought it.

AFCA found the loan was unsuitable and the financial firm should not have provided it.

AFCA required the financial firm to compensate the complainant for their net financial loss. AFCA allowed the financial firm to recover the vehicle and retain the proceeds of sale.

As the complainant surrendered the vehicle, their benefit was calculated to be the current value of the vehicle (i.e. the value of what is left in their hands), which they had provided to the lender by surrendering the vehicle.

The lender was required to waive the remaining debt, pay the complainant $6,000 compensation for his net loss, (the repayments they had made to date) and the purchase costs. The complainant surrendered the vehicle, and the lender was entitled to sell it for fair market value and retain the proceeds.

Personal loans and credit cards

We may consider a range of factors when calculating a complainant's net loss from an unsuitable unsecured loan or credit card, including:

Gross loss	Benefit
• repayments made to date • amounts outstanding under the loan contract, and • fees and charges they have paid the financial firm or any third party	• benefit received from use of the credit (usually the principal amount provided, but may include other benefits depending on the circumstances of the case).

We calculate the complainant's net loss by subtracting their benefit from their gross loss.

If the complainant has an adjusted debt, AFCA usually considers it fair for the financial firm to:

- not apply interest to the adjusted debt; and
- negotiate a reasonable repayment arrangement with the complainant based on their available uncommitted income.

Where a portion of an unsuitable unsecured personal loan or credit card debt was used to refinance a previous interest-bearing debt (or where a credit limit increase was unsuitable), AFCA will consider the refinanced loan amount or outstanding credit card balance at the date of the unsuitable credit limit increase to be an interest-bearing benefit.

In these circumstances, AFCA will apply interest:

- for a variable rate personal loan, 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
- for a fixed rate personal loan, at the lower of the variable reference rate in the new fixed rate loan contract and the interest rate on the refinanced loan (varied as above if the existing rate was variable)
- for a credit card, in accordance with the terms of the credit card at the lower of the interest rate on the credit card account and the refinanced debt (if applicable).

Examples

Personal loan

A financial firm provided a $2,500 personal loan to a complainant. The loan terms required the complainant to provide a charge over his vehicle as security. The complainant said the financial firm had breached its responsible lending obligations because they were already in financial hardship at the time the financial firm provided the loan.

At the time of the AFCA determination, the complainant had paid total repayments of $389 towards the loan. AFCA required the lender to reduce the outstanding loan balance to $2,111, which was the current loan balance less compensation for the complainant's net financial loss. AFCA also required the lender to refrain from charging interest on the adjusted debt.

Gross loss		**Benefit**		**Net loss**
$2,839	**minus**	$2,500	**equals**	$389
+ *interest charged*				+ *interest charged*

Credit card

A financial firm provided a complainant with a credit card and increased the credit limit four times over a three-year period. The complainant complained to AFCA that the credit card and each credit limit should not have been provided to them as they were unaffordable and unsuitable to them. The complainant said they applied for the credit card and each limit increase due to pressure and financial abuse by their partner at the time.

AFCA found that the financial firm had failed to take reasonable steps to verify the complainant's financial situation before providing the card and the increases, and that if it had done so, it would have assessed the product was unsuitable for the complainant.

AFCA required the financial firm to compensate the complainant for their loss. At the time of the determination the complainant had drawn down a total of $40,000 and had made $10,000 in total repayments.

AFCA found that the complainant had only received a benefit from 25% of the drawn down funds (because of the family violence circumstances).

AFCA calculated the complainant's net loss was $30,000 plus interest charged to date. When the complainant's net financial loss was subtracted from the outstanding balance (which was $30,000 plus interest charged to date), AFCA calculated the complainant had repaid their debt to the financial firm.

Consumer leases

We may consider a range of factors when calculating a complainant's net loss from an unsuitable consumer lease, including:

Gross loss	Benefit
• repayments made to date • amounts outstanding under the lease, and • contract fees and charges they have paid the financial firm or any third party	• the cash price, base price or market value of the goods at the beginning of the lease (where they retain the goods), or • the present market value of the goods (where they return the goods).

To determine the base price or cash price of the goods, we will consider the base price contained in the consumer lease contract (where applicable) and the requirements in the National Consumer Credit Protection Regulation 105AA and the definition in section 204 of the National Credit Code.

Where a complainant has already repaid the cash price or base price of the goods, they will generally have no adjusted debt. In these circumstances, we will generally give the complainant the option to retain the goods.

If the complainant keeps the goods, we generally require the financial firm (the lessor) to refund any amount the complainant has paid which exceeds the cash price or base price of the goods at the start of the lease (as defined in section 204 of the National Credit Code and Regulation 105AA). We will then usually require the lessor to release the complainant from any remaining liability under the lease.

We may also give a complainant the option to retain the goods if they have paid part of the base price or cash price of the goods and they have the capacity to pay the balance within a reasonable time.

If the complainant wishes to return or surrender the goods, or we consider that is the fair outcome in the circumstances of the complaint, we will generally consider their benefit is the present market value of the goods.

The lessor will be required to pay compensation to the complainant for any outstanding loss owed after the complainant has surrendered the leased goods. This is usually:

- repayments made to date; plus
- any remaining liability under the lease.

Reverse mortgages

Where a financial firm provides an unsuitable reverse mortgage, we will generally require them to waive any interest, fees, and charges. The financial firm will generally be entitled to recover the principal amount (the total drawdowns) when the conditions for recovery in the reverse mortgage are met.

This usually means the financial firm can recover the principal amount when the complainant passes away, sells the property, or no longer resides in the property for an extended period.

We may consider a range of factors when calculating a complainant's net loss from an unsuitable reverse mortgage, including:

Gross loss	Benefit
• repayments made to date • amounts outstanding under the loan contract, and • fees and charges they have paid a financial firm or any third party.	• any benefit received from use of the credit (usually the principal amount provided but may include other benefits depending on the circumstances of the case).

Guide two

Information we may request from financial firms

Information in this guide is indicative only.

This information may not be relevant to all complaints. Some items in this guide will not be relevant or available for some credit products and complaints. Some financial firms may reasonably make assessments that do not include some items on these lists.

Loan type	Information we may request from a financial firm
All credit types	• Credit application, along with any information a complainant provided with their application • An explanation on how the credit approved met a complainant's requirements and objectives, including: > what inquiries the financial firm made in relation to the complainant's requirements and objectives for the credit > the complainant's responses to the financial firm's inquiries into their requirements and objectives. • An explanation of how the financial firm complied with its inquiry and verification obligations under the National Credit Act and ASIC's RG 209 including: > any inquiries made in relation to the complainant's income, along with information to show the complainant's responses > what 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) > what inquiries a financial firm made in relation to the complainant's existing liabilities, along with information to show the complainant's responses > what steps were taken to verify the complainant's existing liabilities, along with all verification documents obtained (such as account statements and credit report) > what inquiries were made about the complainant's living expenses, along with information to show the complainant's responses > what steps were taken to verify the complainant's living expenses, along with all verification documents obtained (such as rental agreements, account statements, child support statements, school fees, etc) > whether a financial firm used a benchmark to verify the complainant's living expenses? If so, which one? • Whether the financial firm identified any red flags in the complainant's application and/or supporting information? If so,

	details of those red flags and what further steps the financial firm took to satisfy itself the credit was not unsuitable • Financial firm' credit policy, and an explanation of how the financial firm complied with its own credit policy • Final suitability assessment, including all serviceability calculations • Any pre-approval, conditional or unconditional approval letters (if applicable) • All account statements from the date of approval to present.

Additional information we may request if relevant

Particular issue or loan type	Additional information we may request from the financial firm
Loan	• Loan contract
Credit card	• Credit card terms and conditions • Approval letter
Credit limit increase	• Did the financial firm offer the complainant a credit limit increase? If so, why?
Refinance / debt consolidation	• Statements for all debts being refinanced • The applicable interest rate and fees on the previous debt/s • Whether a condition of approval was the payout and closure of the pre-existing loan? If so, what actions were taken to confirm this occurred?
Purchasing new home	• Contract of sale for the property purchase
Purchasing a new investment property	• Contract of sale for the property purchase
Purchasing a car	• Tax invoice or contract of sale for the car purchase
Purchasing of land only	• Contract of sale for the land purchase • Did the complainant have a construction contract or quote at the time? If so, please provide a copy of this • Was the financial firm aware the complainant intended to build on the land? If so, did the financial firm consider whether the complainant had funds to complete the construction or would be able to afford a loan for the construction?
Loan was for construction	• Construction or building contract
Complainant is close to retirement	• Whether the financial firm made inquiries about the complainant's exit strategy or retirement plan • All information to show the complainant's responses to the financial firm's inquiries about their exit strategy or retirement plan • How the financial firm satisfied itself that the credit was not unsuitable
Complainant is complaining about lenders mortgage insurance (LMI) or loan to value ratio (LVR)	• If the loan offered is different to what was requested by the complainant and if so, why? • Any valuation reports obtained by the financial firm

	• Whether the financial firm inform the complainant about the LVR or LMI prior to issuing loan documents
If the complainant spends money gambling	• Whether the financial firm was aware the complainant spends money on gambling • Statements for all accounts the complainant had with the financial firm for the six-month period prior to credit approval • Whether, in its verification process, the financial firm asked the complainant for copies of their account statements. If not, why not?
If the complainant says their living expenses were higher than usual	• Whether the financial firm was aware the complainant's expenses were higher than usual? • Statements for all accounts the complainant had with the financial firm for the six-month period prior to credit approval • In its verification process, did the financial firm ask the complainant for copies of their account statements? If not, why not?
If the complainant says they received no benefit from the loan	• Whether the financial firm engaged with the complainant directly in relation to the credit application (separate to the co-borrower)? If yes, details of all interactions between the financial firm with the complainant directly. If not, why not? • Prior to this credit application, whether there were any other applications for credit submitted to the financial firm by the co-borrower? • Was it always the intention to include the complainant as a co-borrower? • Why was the complainant included as a co-borrower under the credit? • What was the purpose for obtaining credit? • What benefit did the complainant receive from the credit? • How and where were credit funds advanced?
Add on insurance	• Whether the financial firm arranged any insurance policies for the complainant? If so, copies of the insurance policies and certificates of currency • Whether the insurance policies were included in the finance amount • If so, what inquires did the financial firm make with the complainant about their requirements and objectives for the insurance policies? What was the complainant's response? • Whether the financial firm explain the additional cost of including the insurance policy in the financed amount (i.e. that interest would accrue on the insurance premium)? If so, any supporting information to show when and how the financial firm explained this to the complainant.

Guide three

Information we may request from complainants

We may request information from both the complainant and the financial firm to give both parties the opportunity to provide their own copies. However, we acknowledge some information available to both parties may be easier for financial firms to compile and provide (such as statements for that financial firm's accounts) and complainants do not generally need to provide duplicative copies if they do not wish to do so.

We also acknowledge some consumers experiencing vulnerability may not be able to provide large volumes of information as easily. We will work with parties to target our information requests as best we can whilst still requesting the information we require to assess the complaint.

Loan type	Information we may request from the complainant
All credit types	• Credit application • Any information provided in support of the credit application (for example living expenses, other debts, expenses) • The complainants' requirements and objectives for obtaining the credit • Any information to show when and how the financial firm was told about the complainants' requirements and objectives • Whether the credit met their requirements and objectives and if not, why not • A statement of financial position (SOFP) outlining income, debts and expenses at the time they applied for the credit contract • Information to support the SOFP (for example such as pay slips, tax returns, PAYG summaries, Centrelink statements, account statements, credit report, rental agreements, etc) • Whether they were aware of the minimum repayments required under the credit contract • Any pre-approval, conditional or unconditional approval letters.

Additional information we may request if relevant

Particular issue or loan type	Other information we may request
Credit limit increase	• Information about why the complainant applied for a credit limit increase

Refinance / debt consolidation	• Final statements for all debts which were refinanced • The applicable interest rate and fees on the previous debt/s
Purchasing a new investment property	• Contract of sale for the property purchase • Settlement statement for the property purchase • All costs incurred from the property purchase, and supporting information to verify those costs • Rental ledgers for the investment property • Full copy of tax returns for all financial years from the purchase of the property to present, including the property schedules.
Purchasing a car	• Tax invoice or contract of sale for the car purchase
Purchasing of land only	• Contract of sale for the land purchase • If they were provided a construction contract or quote at the time, a copy of this • Whether they told the financial firm of their intention to build on the land
Loan was for a construction	• Construction or building contract.
If the complainant is close to retirement age	• How the complainant intended to continue to meet their financial obligations over the loan term • Whether the complainant had an exit strategy or retirement plan? If so, any details of this.
If there is gambling expenditure	• Whether the complainant had notified the financial firm that they spend money on gambling • Statements for all accounts the complainant had with the financial firm for the six-month period prior to credit approval.
If the complainant has told us their living expenses were higher than usual	• An explanation of why the complainant says their living expenses are higher than usual • Whether they told the financial firm that their expenses were higher than usual at the time they applied for credit? If not, why not? • An explanation of why they say the financial firm should have been aware their living expenses were higher than usual
If the complainant has told us they received no benefit from the loan	• Whether the financial firm engaged with the complainant directly in relation to the credit application (separate to a co-borrower)? If yes, details of the interactions they had with the financial firm • If they are a co-borrower, whether it was always their intention to be included as a co-borrower for the credit? • Why they were included as a co-borrower • The purpose for obtaining credit • How and where the credit funds were advanced to
If the complaint is about add on insurance	• What insurance policies were arranged for the complainant? • Did the complainant require insurance/s to be included in the finance amount? • Whether the financial firm explain the added cost involved in having insurance/s included in the finance amount (i.e. that interest would accrue on the insurance premium)?