Approach to Lending to Small Business

Consultation Feedback Report

January 2023

Contents

Overview of the consultation process

About the consultation

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

On 18 August 2023, AFCA issued a consultation draft Approach to Appropriate Lending to Small Business complaints for consultation. The public consultation process ran from 18 August 2023 until 29 September 2023. AFCA has considered the feedback received during this process from all stakeholders and has now finalised the Approach.

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

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

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

310 registrations to our public webinar

84 attendees at round tables

17 full submissions made to AFCA

1,026 views of the new approaches consultation website

Overview of submissions received

AFCA received 17 submissions from different stakeholder groups during the consultation period, including:

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

All non-confidential submissions have been published on the AFCA website here.

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

The consultation is now closed

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

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

AFCA's consideration of stakeholder feedback

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

Overall, stakeholders were pleased that AFCA was providing its Approach to small business lending complaints. Many stakeholders were broadly supportive of the Approach and acknowledged the difficulty in providing guidance in this area given the range of small business credit providers, products and channels. AFCA also received positive feedback about the accessibility and thoroughness of its consultation process.

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

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

- how the type of financial firm, type of credit product and the distribution channel impacts what would be appropriate to consider when making an assessment to provide a small business credit product
- the factors we take into account when assessing if a financial firm has met its obligations and recognition that those obligations can vary depending upon the type of financial firm and type of credit product
- how we consider industry codes, including when a financial firm is not a signatory, and how we assess good industry practice

- how the process of assessing a loan to small businesses differs from lending to consumers.

We have also added more examples to illustrate the approach we take with different credit products and assessment methods.

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

Using the term "appropriate lending"

One of our key objectives was to recognise the difference between the obligations that apply when lending to consumers compared to lending to small businesses. One way we did this was by using the term "appropriate lending" to describe the obligations that we will consider when assessing a small business lending decision.

Many stakeholders were supportive of AFCA using the term "appropriate lending" and said it would assist small businesses to understand the different obligations. Some stakeholders suggested different phrases could be used, such as "fair and appropriate lending", "careful lending" or "considered lending".

Some stakeholders gave feedback that using the term "appropriate lending":

- may create a misconception that there is a single objective standard when lending to small businesses
- might be interpreted to mean the Approach was creating new obligations.

AFCA's response

Following this feedback, we have updated the title of the document to make it clear it is our approach to all small business lending complaints. We have maintained our use of the term "appropriate lending" in the document and have provided greater clarity about what the term means in the Approach by:

- making it clear there is not one set of obligations that apply to all financial firms and credit product types
- clarifying the term does not create new obligations
- adding more information about how we assess the different obligations that may apply depending on the type of financial firm and the type of credit product.

Identifying the obligations that apply to a financial firm

Many stakeholders provided positive feedback the Approach provided valuable guidance about how AFCA considers all obligations, being legislative, regulatory or industry code-based, to ensure fair outcomes.

Other stakeholders requested AFCA clarify the different obligations we may consider when assessing a complaint about small business credit product. Industry stakeholders requested AFCA:

- ensure the Approach does not create new obligations for financial firms, as this could cause an unintended consequence of limiting small business access to credit, or increasing the cost of providing small business credit products
- make it clearer that obligations owed by a financial firm lending to a small business are different to those owed for consumer lending under the National Credit Act
- ensure the Approach allows financial firms to have full flexibility in how they assess small business credit product applications.

AFCA response

In response to this feedback, we have added content to clarify:

- AFCA assesses complaints against the particular obligations owed by a particular financial firm and the Approach is not intended to create new obligations
- our expectations of a financial firm's assessment process, including reference to relevant court decisions, which depend on the type of credit product and channel
- the Approach is technology neutral and does not prescribe or require firms to use any particular method or technology in their assessment process.

Industry codes

A key theme of stakeholder feedback was around how we consider industry codes. Stakeholders requested further guidance about how we apply and consider industry codes when assessing complaints and asked for clarification about:

- how we consider industry codes where a financial firm is not a signatory to an industry code
- our expectations of a financial firm's assessment process where no industry code applies.

Consumer groups also requested that we include links to relevant industry codes to assist readers to find relevant information.

AFCA response

In response to this feedback we have:

- clarified our approach to financial firms that are not signatories to relevant industry codes

- added a link in the Approach to our [published factsheet] about 'AFCA's Approach to Code obligations for credit providers'
- included more references to particular industry codes in our examples to illustrate our approach
- added links to relevant industry codes to assist parties to access these documents.

Assessing good industry practice

Stakeholders requested further information about 'good industry practice' and how AFCA determines what it is, including how we may consider industry codes when assessing good industry practice.

AFCA response

We have clarified how we may consider industry codes when assessing good industry practice.

AFCA's Rules require our decision makers to take into account 'good industry practice' when determining what is fair in all the circumstances of a complaint. It is an integral part of our decision-making process. We have added information about how we assess good industry practice. We may ask complainants and financial firms to make submissions about good industry practice, if a complainant or AFCA considers good industry practice was relevant.

Factors AFCA may consider relevant to credit assessments

One of our key objectives was to provide useful and specific guidance to stakeholders about factors AFCA may consider relevant when assessing particular complaints. The consultation draft Approach included a list of factors that AFCA may take into account when considering if a credit assessment was appropriate. The list was developed in response to earlier requests for AFCA to provide more detail about how we assess the appropriateness of credit assessments.

Some stakeholders were supportive of the list. They said it was comprehensive, especially if small businesses are not familiar with the commercial lending process. Consumer groups also requested that we specifically include financial or economic abuse as a relevant factor.

Many Industry stakeholders expressed concern that including this information in a list format could have the unintended consequence of:

- being viewed as a checklist of factors that must be taken into account for all credit assessments
- being interpreted as guidance that a financial firm must review each listed factor in every credit assessment.

The overall concern was that it if the lists were used in this way, it could increase credit assessment times, processing costs and limit the availability of credit to small businesses.

AFCA response

AFCA intended to provide specific and useful guidance illustrating common types of factors we take into account for different types of credit products. We have changed the way we present this information to make our intention clear. We have amended the Approach by:

- replacing the list of factors with principles that may be relevant in a credit assessment
- adding several examples to illustrate different types of information or circumstances we may consider relevant to a credit assessment, depending on the type of credit product and the obligations of the financial firm
- clarifying that any reference to factors we consider in an example does not mean those factors will apply to every complaint.

Where a financial firm should make further inquiries

We received similar feedback about the list in the consultation draft Approach of common circumstances that may arise in the credit assessment process that could require further inquiry.

AFCA response

In response to this feedback, we replaced the list with examples to illustrate common circumstances where a financial firm may need to make further inquiries to determine if a loan is appropriate.

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

One of our key objectives is to provide clarity about how we assess loss and determine fair outcomes. Stakeholders provided a range of feedback about how we determine fair outcomes and calculate loss including that AFCA should:

- adopt a narrower approach to assessing loss
- take into account costs incurred by a financial firm when assessing loss
- provide further information about how it calculates a 'fair amount for benefit of use' for a commercial lease.

AFCA response

We have made changes to section 4 of the published Approach in response to this feedback including:

- adding information about circumstances where we may consider waiving the principal amount borrowed such as where there is financial abuse

- amending the examples to clarify the particular obligations that applied
- clarifying how we calculate loss in the example relating to a commercial lease.

We have otherwise maintained our approach to calculating loss and determining fair outcomes, which is consistent with common law principles and allows us to do what is fair in all the circumstances of each complaint, in accordance with our Rules.

Examples and case studies

Many stakeholders provided feedback the examples used in the Approach were useful and would assist small businesses to understand how the Approach may apply to their situation.

Stakeholders also gave feedback:

- some examples should be simplified to provide more useful guidance
- the Approach should include more examples to reflect the variety of small business credit assessment processes and products.

AFCA response

In response to this feedback we:

- amended examples to refer to more diverse assessment methods (such as manual or online assessments) and types of financial firm
- clarified the obligations that apply to the financial firm in each example (including whether the firm is signatory to an industry code)
- added a number of new examples that deal with a variety of small business credit products and circumstances.

Interest rate buffers

Some stakeholders noted the application of interest rate buffers as part of the assessment process is an Australian Prudential Regulation Authority (APRA) requirement, applicable only to Australian deposit-taking institutions (ADIs).

We agree, and the Approach has now been amended to clarify how we consider interest rate buffers.

Feedback outside of scope

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

References

Definitions

Term	Definition
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)

Appendix – Summary of feedback and changes made

Feedback	Change in published Approach
Update discussion of business purpose declarations to take into account Regulation 28RB of the *National Consumer Credit Protection Regulations in 2020*	We have added a footnote identifying that this regulation may modify the application of the National Credit Act where credit is provided to an individual for the purposes of a small business and it is not merely minor or incidental
Using the term “appropriate lending” may create a misconception there is a single objective standard that applies to all financial firms when provide credit products to small businesses	We have updated the title of the document and added further detail about our use of the term “appropriate lending”, including clarification the term does not create new obligations
Clarify the circumstances AFCA will consider complaints that have been through a farm debt mediation (FDM) process	We have amended ‘Complaints in farm debt mediation’ to clarify when we can consider complaints that have been through FDM
Specifically reference industry codes include provisions that relate to guarantors	Inserted new text in section 2.3 referring to these provisions
Add further information about AFCA’s approach where a small business may have contributed to their loss, such as by knowingly providing false or misleading information during a loan application process	We have added information about our approach at section 3.7
Add further information about how AFCA considers industry codes	Added further information about how we consider industry codes and linked the relevant fact sheet
Amend the list of factors in the consultation draft Approach that AFCA may consider relevant to credit assessments	Replaced the list with principles that may be relevant to consider in a credit assessment and added several examples to illustrate our approach
Amend the list of factors in the consultation draft Approach of common circumstances that may arise in the credit assessment process that could require further inquiry	Replaced the list with common examples to illustrate our approach

Feedback	Change in published Approach
Refer to the need to make further enquiries if there are signs of financial or economic abuse	Added financial or economic abuse as a relevant factor AFCA will consider when assessing loss
Amend examples to include more variety of assessment processes and products	Amended examples to reflect a range of credit products and assessment processes
Provide further detail about how AFCA considers personal credit histories when reviewing small business credit assessments	Some examples now include reference to personal credit histories