AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

Lead Ombudsman, Banking & Finance
Australian Financial Complaints Authority

By email only:

11 September 2023

Dear Natalie

The AFCA Approach to Responsible Lending - draft

Thank you for the opportunity to provide feedback in response to AFCA's draft Approach to Responsible Lending (Approach).

We also thank you for the opportunity to attend the roundtable conducted on 24 August 2023. We note the feedback from AFCA in that meeting that:

- the Approach is intended to reflect the law as set out in the *National Consumer Credit Protection Act* (NCCP), case law (particularly the ASIC v WBC case) and ASIC's Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG209). As discussed in that meeting, some stakeholders consider that the guidance in RG209 may go beyond the legal requirements (including as established in the ASIC v WBC case). We acknowledge, however, that those concerns should be raised with ASIC and that AFCA should be applying the regulator's guidance (but not go beyond it).
- the Approach is intended to give effect to, and not limit, the 'scalable' approach allowed for under RG209. While we recognise that ASIC has limited the use of the term 'scalable' in RG209, it is still explicitly recognised in that document using that term, i.e. 'scalability' in RG209.81. We recommend that the same approach be taken in the Approach.
- AFCA largely considers the Approach as reflecting their current practice. Our commentary is made on that basis and our recommendations to clarify the Approach reflect feedback that ARCA has received about how previous determinations (particularly in the context of applying good industry practice/codes of conduct and in the consideration of interest rate buffers).

A. Overview

We support AFCA's intent to ensure its approach to responsible lending complaints is consistent, clearly documented and fair in all the circumstances.

Given AFCA's key role in considering and determining complaints, its approach to responsible lending can have significant impacts to the consumer credit sector and, therefore, the whole economy. Accordingly, it is important to have a common understanding of all parties' rights and obligations.

On that basis, we make the following general comments and key recommendations. In addition to the general observations made below, we have provided detailed feedback and specific recommendations in Appendix A.

While we have made several recommendations to refine the guidance in the draft Approach document, we recognise the significant amount of work that AFCA has done to develop very helpful commentary in respect of the complex and sometimes contentious issues arising from the NCCP responsible lending obligations.

Noting that the Approach document will likely be used as a form of process/checklist by AFCA's decision makers, many of our recommendations are based on ensuring individual statements within the Approach can be read – and understood – in isolation (rather than needing to read the entire document). This will help to ensure that a specific statement is less likely to be read out of context as suggesting a particular approach is 'required' of credit providers.

Importance of decision maker's judgment

Overall, we consider that the draft Approach reflects a sophisticated understanding and description of the responsible lending obligations under the NCCP. However, as the Approach recognises, it is generally not possible to dictate the precise steps that 'must' be taken in all cases and the Approach leaves much of that consideration to the AFCA decision makers.

On that basis, we consider the true test of whether the Approach is successful will be how it is applied in practice. For that reason, we think that the most critical recommendation we have made is Key Recommendation 4 (i.e. creating a regular forum to consider how the Approach has been applied by decision makers)

We have also identified several issues discussed in the Approach for which we believe additional guidance (in the form of principles to be applied by decision makers) will help the Approach be applied in a more consistent and appropriate manner.

B. Key recommendations

i. Role of Approach in setting out substantive guidance

The draft Approach sets out the process that is followed by AFCA in respect of complaints ('process guidance'), and the remedies that may be applied if AFCA determines a loan has been improperly made ('remedies guidance'). While we have included some specific comments on that guidance in Appendix A, we support the intent to provide clarity and transparency on those matters.

However, we are more cautious towards the role that the Approach has in setting out guidance in relation to the substantive obligations that apply under the NCCP ('substantive guidance').

We recognise that the Approach is potentially a consumer facing document and there is a need to provide a high-level summary of the requirements of the NCCP, the case law and RG209. However, going into this degree of detail regarding AFCA's expectations on how a credit provider is to meet the requirements to take reasonable inquiries and verification steps risks creating a duplicity of obligations.

At best, this would create confusion for consumers (i.e. if the Approach document was taken as setting out an AFCA 'requirement' which was not then applied in practice). Importantly, if AFCA's substantive guidance was seen as mandatory, it could act as a brake on competition and innovation as credit providers are reluctant to act inconsistently with AFCA's expectations.

AFCA is neither a policymaker or regulator, and we consider that it must avoid setting out views on what is required under the law where that could be seen as changing the substantive effect of the law. In the case of responsible lending, ASIC has already issued RG209, which provides a detailed discussion of the obligations relating to reasonable inquiries and verification steps. To the extent that any further guidance is required as to the substantive obligations under the NCCP, we consider that it should be left to that guide (and the comprehensive consultation process that ASIC is required to undertake when updating it).

Appendix A lists some specific examples of this concern.

Key recommendation 1:

(a) The Approach document should avoid setting out substantive expectations as to the inquiries and verification steps that a credit provider is expected to take to comply with their NCCP responsible lending obligations.

(b) If AFCA considers it necessary to include a summary of the legal obligations or the ASIC guidance in RG209 in the Approach, it should make it clear that AFCA will apply the law and/or RG209, rather than that summary. (While the draft Approach notes briefly on page 9 that the guidance 'reflects' RG209, we consider this should be made more explicit that it only 'summarises' RG209, and that this needs to be reinforced throughout the document.)

(c) If AFCA considers it useful to include examples of steps that a credit provider could take to meet their obligations or examples of conduct that it considers is generally inappropriate, it should make it clear in each place in the approach that the guidance is by way of illustration only, and that engaging or not engaging in that conduct is not necessarily a breach of the responsible lending obligations.

ii. Clarity on the role of AFCA decision makers

We consider that there needs to be greater clarity on the role of AFCA when considering a complaint about responsible lending. Based on the Approach document – and feedback from our Members regarding actual complaints – it appears that AFCA decision makers may consider that their role is to 'redo' the loan assessment process to identify whether they would have done things differently. We consider that this is inappropriate and does not give proper recognition of the role that each credit provider takes in establishing and managing their business (and risks creating the view that the AFCA Approach is the 'industry's credit policy').

Instead, we consider that the role of AFCA is to consider the complaint and determine whether there were any readily apparent material deficiencies in the conduct of the credit provider. Essentially, the AFCA should consider whether – from an objective basis – the conduct of the credit provider fits within the boundaries of what is reasonable; *not* whether there was something else that the credit provider *could* have done to come to a 'better' outcome.

In taking this approach, AFCA will be better positioned to act consistently with the scalable nature of the NCCP responsible lending obligations and does not inhibit competition and innovation. Importantly, we consider that this will help AFCA to process responsible lending complaints in a more timely manner and reduce AFCA response times.

Key recommendation 2:

(a) The Approach document should set out principles regarding the basis upon which the AFCA decision maker is reviewing the conduct of the credit provider. That is, the decision maker is reviewing the conduct of the credit provider to determine whether there are any readily apparent material deficiencies in the conduct of the credit provider and whether that conduct fits within the boundaries of what is reasonable; not whether there was something else the credit provider could have done to come to a 'better' outcome.

iii. Scalability and supporting innovation

As noted above, we consider that there is opportunity to better reflect the scalable nature of the NCCP responsible lending obligation.

Appendix A lists some specific examples of this concern.

Key recommendation 3:

(a) The Approach document should explicitly recognise the scalable nature of the NCCP responsible lending obligations (using that term).
(b) The Approach document should refer to the scalable nature regularly when discussing the inquiries and verification steps credit providers take (see Appendix A for specific examples).

iv. Regular review process

We agree that the Approach cannot and must not set out prescriptive requirements in relation to how a credit provider discharges its responsible lending requirements, including the inquiries and verification steps that a credit provider is expected to take. In fact, as noted in this submission, we consider that there are opportunities to further reinforce this in the Approach.

In the absence of a set of prescriptive steps and the need to assess 'reasonableness',, the successful application of the Approach relies significantly on the appropriateness of the judgments made by AFCA decision makers.

For that reason, we consider that it is vital to the success of the Approach document that there be a regular forum for relevant stakeholders to discuss how the Approach has been applied in practice. Of course, this is not to suggest that forum would involve relitigating individual complaints. Rather, it would look at whether the judgment calls of AFCA decision makers are resulting in appropriate and consistent determinations, and to identify whether there are any changes that are required to the Approach, or other steps should be taken to improve the quality and consistency of outcomes (e.g. additional training for decision makers). Implementing such a forum could help reduce the need to over-engineer the Approach document 'just in case' decision makers could misapply the guidance.

We would expect that such a forum would meet on a regular basis (possibly every 6 months) to discuss published determinations and other matters as identified by credit providers or consumer representatives. To avoid creating an unwieldy process, we would expect that attendees would be restricted to representative bodies.

We consider that it is important that this process involve representatives from both industry and consumer representatives as hearing the feedback of other stakeholders helps to avoid the perception that AFCA preferences the interests of one type of stakeholder over the other.

Key recommendation 4:

(a) That AFCA establish a regular forum for AFCA, industry associations and consumer representatives to discuss how the Approach has been applied in practice and to identify whether any changes are required to the Approach or other action is necessary (e.g. additional training for AFCA decision makers).

Given the importance of the Approach document to our Members, we would appreciate an opportunity to discuss this feedback with you in person. We will separately contact you to arrange a meeting.

In the meantime, if you have any questions about this submission, please feel free to contact me.

Yours sincerely,

Michael Blyth
General Manager – Policy & Advocacy

Appendix A - Detailed feedback and specific recommendations

Item	Approach Page	Recommended change
2. How AFCA assesses responsible lending complaints		
1.	8	**Section 2.4; "Investigation steps"** Step 5 on page 8 should explicitly state that AFCA applies the law, relevant court cases and RG209 in the assessment of whether the credit provider's unsuitability assessment was suitable. It should clarify that the summary of those requirements in the Approach document will <u>not</u> be applied.
3. How we decide if a financial firm has met its responsible lending obligations		
2.	9	**Section 3, "Important note"** The Important Note on page 9 should state that the inability to set out a definitive approach is due to the scalable nature of the obligations, rather than due to determining what is 'fair in all the circumstances'. Whether a credit provider has met their responsible lending obligations is a question of law, not fairness (although that fairness may play a role in determining the remedy if the credit provider has not met their legal responsible lending obligations).
3.	9	**Section 3, "Important Note'** The Important Note should clarify that the 'common approaches' are illustrative only, and that a credit provider will not have necessarily breached the responsible lending obligations by doing or not doing the relevant thing.
4.	10	**Section 3.1 "Referring to laws, codes, good industry practice and past decisions"** The approach to applying ancillary laws and other matters should be clarified to emphasise that they do <u>not</u> directly determine whether the credit provider has breached the responsible lending laws. Whether a credit provider has breached its responsible lending obligations depends on if, and only if, it has breached the NCCP Responsible Lending obligations. In determining whether this is the case – and subject to the comments below - we consider that AFCA should only apply the law as written in the NCCP, relevant case law and ASIC's RG209.

		Further, the commentary in 3.3 relating to the credit provider's policies and industry codes and good industry practice should be cross-referenced in 3.1. We have addressed the individual ancillary requirements below. **"regulatory requirements and guidance from … the Australian Prudential Regulation Authority (APRA)"** As noted above, we agree that AFCA should apply ASIC's RG209 in considering whether a credit provider has met its responsible lending obligations. However, we consider that care must be taken in applying the regulatory requirements and guidance of APRA in the context of the NCCP responsible lending obligations. Firstly, unlike the NCCP responsible lending obligations, the basis for the APRA requirements and guidance is <u>not</u> consumer protection of borrowers; rather it is to ensure the stability and resilience of authorised deposit-taking institutions (ADIs) and therefore protect the interests of depositors (and the broader economy). Secondly, those APRA requirements do not apply – and should not be applied – to non-ADIs. ADIs become subject to the obligations because of their deposit taking activities; where those activities give the entity access to cheaper funding sources than what is generally available to non-ADIs. That is, the additional obligations and costs that are associated with meeting the APRA requirements are offset by the ability to obtain cheaper funding by taking deposits. To apply the APRA obligations to non-ADIs impacts the non-ADIs' ability to compete. We do, however, recognise that there is some overlap in the outcomes the APRA and NCCP regimes are trying to protect against (i.e. to reduce the risk of debtors not being able to repay their debts). As with the other ancillary law and matters discussed below, the APRA requirements may point to matters that a credit provider *could* be considering when developing its policies to meet the NCCP responsible lending obligations. For example, when assessing a home loan, many credit providers apply an interest rate 'buffer' when assessing an applicant's capacity to continue to afford the repayments if interest rates rise (but also see item 19). In that context, a credit provider could consider the changing buffer requirements of APRA as it may be a relevant signal regarding future rate changes (based on the regulator's deep expertise and experience). However, the mere fact that APRA has set a particular buffer (or interest rate floor) does not mean that all credit providers should be using that buffer as part of their consumer protection practices. In fact, the current situation demonstrates that the APRA buffer is not always

		tied to 'affordability' issues given that the prudential regulator has maintained the buffer at 3% even though no reasonable person would expect interest rates to rise that much over the next few years (with many predictions now for rate reductions). See also our discussion in item 19. Unfortunately, our Members have reported instances where it is clear that the AFCA decision maker was unaware of the nature of the APRA requirements and inappropriately applied those rules to a responsible lending complaint (and, in some cases, applied the APRA requirements well beyond how they were intended to apply by APRA itself such as when assessing personal loans). For that reason, we recommend that AFCA include a more detailed discussion of when and why APRA's requirements and guidance are relevant to assessing whether a credit provider has met its NCCP responsible lending obligations (both in relation to interest rate buffers and more generally). Relevant decision makers should also receive specific training on the nature of APRA's requirement and guidance and how they are not consumer protection regulations. **"the financial firm's own policies" (and "A financial firm's policies may be relevant" in section 3.3)** *Relevance of credit provider's policies to their RL compliance* We welcome AFCA's acknowledgement that some policies have no relevance to a credit provider's responsible lending obligations. However, we consider that the commentary regarding when policies may be relevant needs to be expanded and clarified. It is our Members' experience that AFCA decision makers often apply a blanket approach under which a divergence from policy is taken as an automatic breach of the NCCP responsible lending obligations. That is simply not true – even if the relevant policy is relevant to the provider's responsible lending obligations. Policies will not be set to barely meet the credit provider's legal obligations (so that a single breach would push the provider into non-compliance). Rather, policies will be balanced so as to comfortably ensure the provider complies. If there is a breach of those policies, the AFCA decision maker must still consider the credit provider's overall conduct and whether that conduct results in a breach of the NCCP responsible lending obligations. In terms of Example 1 on page 21 of the Approach, the explanation should be expanded to include: • consideration of whether a relevant discretion applied (see below); • a more detailed consideration of the reasons for the policy (i.e. in the example this would involve a more detailed consideration of the credit provider's reason for confirming the source of funds). Simply forming the

		view that the process step ‘may have’ identified relevant information does not mean that the policy was intended to do so. At a minimum, the Approach should explicitly require the decision maker to ask the credit provider for an explanation of the background to the policy. This will be relevant to understanding why the policy may not have been followed; • a clearer statement that the complainant actually *had* another facility (rather than simply being a possibility); • recognition that the complainant in this situation has misled the credit provider by failing to disclose that other facility and/or lying about the source of funds (so that Section 4.2, “Reducing compensation due to complainant conduct” would apply); • tie in the consideration of unsuitability to the matters discussed in item 7 (*counter-factual situations*). *Availability of discretion under credit provider’s policies* Credit provider’s policies will generally allow for discretion, i.e. the ability for suitably experienced and authorised staff to divert from that policy to either do or not do certain things. The Approach document should explicitly recognise that those staff members are entitled to divert from policy in those respects. If the staff member has diverted from policy, it cannot be the role of AFCA to relitigate the exercise of that discretion. Doing so would essentially place AFCA in the role of running the credit provider’s business. Rather, the AFCA decision maker should limit their consideration to whether the exercise of discretion was not supportable in any reasonable way. **“the provisions of applicable industry codes” and “good industry practice” (and “Industry codes and good industry practice” in section 3.3)** As a preliminary matter, we recognise that a breach of an applicable industry code may result in a basis for compensation or other remedy for the complainant. However, that it a distinct matter to whether the credit provider has breached the NCCP responsible lending obligations. We consider that the statement on page 21 of the Approach that “AFCA primarily focuses” on whether the financial firm has complied with the law should be changed. In relation to the matters dealt with in this Approach document, AFCA’s *sole* focus should be whether there is a breach of the law; however, noting that consideration of industry codes and good industry practice may be indirectly relevant to that consideration (as described below).

		To say that a credit provider has breached its legal obligations because it has not complied with "good industry practice" (including where that practice is drawn from an industry code to which the provider is not a signatory) misconstrues the scalable nature of the NCCP responsible lending obligations and stands in the way of innovation and competition. Consideration of the inquiries and verification steps taken by other industry participants (whether or not in response to an industry code) may be *indirectly* relevant to assess a credit provider's compliance with their responsible lending obligations. That is, what inquiries and verification steps other credit provider take may be relevant to identifying what steps are 'possible' and, therefore, *potentially* 'reasonable' for the financial firm to take. However, the conduct of other participants should not dictate what a credit provider is expected to do, and AFCA should be open to understanding why the relevant financial firm does not take those steps. (For completeness, we note that the relevance – even if only indirect – of other codes must be considered in the context of (i) the relevant credit provider having no say as to the content of a code to which they are not a signatory, and (ii) codes that are not high-profile and known across the credit sector should having little, if any, relevance to non-signatories)
5.	12	**Section 3.2, "Reasonable inquiries and verification by financial firms"** The commentary on 'scaling down' of inquiries and verifications steps should be reviewed, including explicitly recognising that the discussion is a summary of RG209. This section over emphasises the need to 'scale up' inquiries and verification steps and treats the ability to 'scale down' as an unusual and extremely limited ability. For example, the reference to financial obligations being "*immaterial* to the consumer's available income" misdescribes the scalable nature of the NCCP responsible lending obligations, which would, for example, allow for 'moderate' scaling down based on a 'moderately' lower risk. Further, if the Approach is to set out circumstances in which a credit provider is expected to 'scale up', it should also set out the circumstances in which scaling down may be appropriate (or otherwise describe those circumstances in neutral terms). For example, the Approach notes that 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 harm will likely be higher". If the Approach is to include this level of detail, it should also explicitly note that the risk of

		harm will be lower if the repayment obligations form a small proportion of the consumer's income (i.e. a *low* debt-to-income ratio). For completeness, the commentary regarding debt-to-income ratio illustrates our concern regarding the over emphases on 'scaling up'. Despite forming part of the paragraph that discusses 'scaling down', the example only relates to the scaling up of obligations.
6.	12	**Section 3.2, "Reasonable inquiries and verification by financial firms"** We consider that the commentary regarding consumers experiencing 'vulnerability' should reflect the language of RG209 (at RG209.205), i.e. credit providers should have regard to 'red flags' of vulnerability. The language from RG209 emphasises that the credit provider should be aware of clear signs ('red flags') of vulnerability, rather than where there are mere "factors indicating … a higher risk of consumer harm". We consider that this then better allows for different distribution methods utilised by credit providers (e.g. online only; broker originated).
7.	12	**3.2, "Requesting information from financial firms'** **Serviceability assessment tool (in Approach to Responsible Lending – Consultation paper)** *General approach to reviewing counter-factual situations* We welcome AFCA's recognition that, in the case that an error is identified in the financial information used by the credit provider (e.g. application of wrong HEM figure), AFCA will consider the overall approach adopted by the credit provider (subject to our comments in item 8 regarding when this process should be undertaken in the complaint process). However, we consider that this principle should be set out more clearly and in more detail. There should be explicit recognition that credit providers may take various conservative approaches to the customer's income (i.e. 'shaving' income) and expenses (i.e. buffering those expenses). Should the credit provider make an error in respect of one element of the customer's financial situation (which would ostensibly push the customer into 'negative surplus'), it

		must be open to the credit provider to, where reasonable, ‘unwind’ the conservative approaches applied to other elements of the customer’s financial situation. That is, it is not appropriate to simply assume a worse-case scenario in respect of all elements of the customer’s financial situation. *Specific comments in relation to the tool* As noted above, we consider that it is important for AFCA to consider any adjustments a credit provider has made to the income or expenses disclosed by the customer. However, we note that the tool does not allow for this. At a minimum, we recommend that the tool allow for the credit provider to disclose the figures disclosed and any adjustments applied by the credit provider (with an explanation for those adjustments). Given the resource intensive nature of the information request, our Members are concerned by the need to complete the tool in all respect of responsible lending complaints. As noted in item 8, we recommend that further consideration be given to *when* in the complaints process this detailed information is requested.
8.	12; 57	**Section 3.2, “Requesting information from financial firms”** **Guide 2, “Information we may request from financial firms”** As a preliminary matter, we consider that further clarification is required as to *when* the relevant information is required by AFCA. We do not consider that it is appropriate to request all those documents as soon as a responsible lending complaint is made. There should first be an assessment as to whether the documents are reasonably necessary for considering the complaint (i.e. a ‘triage’ process). If necessary, requesting documentation may be an iterative process. Requesting all those documents in all cases not only risks blowing out AFCA response times but also creates a situation in which AFCA may be perceived as going on a ‘fishing’ exercise for issues that go beyond the principal complaint of the consumer. In terms of the specific documentation referred to: - The listing of documents (e.g. ‘pay slips, tax return’ etc, ‘rental agreements, account statement etc’) should be clearly identified as illustrative only and not a suggestion that a credit provider is required to collect these in all cases.

		- We fundamentally question the appropriateness of requesting credit policies in all cases (or the credit provider's 'full' policy in *any* cases). As noted in item 4, we consider that the Approach document needs to reconsider and clarify the relevance of a credit provider's policy when determining whether there has been a breach of the NCCP responsible lending requirements. The policies should only be of relevance if the AFCA decision maker identifies a potential breach of the NCCP responsible lending laws based on an assessment of the information regarding the customer's financial situation presented by the credit provider and requests the policies to understand the context and background of the credit provider's conduct. Policies should not be requested merely to identify whether those policies have been complied with (in the absence of any apparent breach of the NCCP responsible lending laws). (We note that limiting the frequency and nature of requirements to provide credit policies or, importantly, 'full' credit policies also reduces the problems caused by the release of those commercially sensitive materials.) - We question the relevance of account statements from the date of approval, i.e. on what basis is this material relevant to the consideration of whether the responsible lending obligations were satisfied? Asking for this information increases the risk of creating a hindsight bias. Those account statement should only be requested if AFCA decision maker considers that there is a prima facie case of not meeting the NCCP responsible lending obligations (i.e. to help understand the impact of that potential breach).
9.	12; 60	**Section 3.2, "Requesting information from financial firms"** **Guide 3, "Information we may request from complainants"** As with the guidance applying to documentation from the financial firm, we consider the quick reference guide relating to requesting documentation from the complainant should clarify *when* the documentation is requested in the complaint timeline. We recognise that some direction from the complainant as to the nature of their complaint is necessary, however the AFCA decision maker must initially review the complaint from the perspective of the credit provider, i.e. what information did they collect/verify and, based on that information, was there an apparent breach of NCCP responsible lending obligations and/or would a reasonable person consider that additional information should have been collected from the customer? As part of that process, the decision maker should ask the complainant to confirm whether the information presented by the credit provider accurately reflects the information that they provided (and, if the complainant raises concerns, to provide documentation to show the credit provider was aware of those other matters).

		However, asking the complainant to provide a fresh detailed breakdown of their financial position ('as at' the time of application) creates a risk of hindsight bias as the decision maker unconsciously looks for signs in the credit provider documentation of any previous issues that were undisclosed during the application process. This could, effectively, embed AFCA's documentary requirements as the 'required' inquiries and verifications steps (in contradiction of the scalable nature of the NCCP obligations). As an example of the above, if the complainant discloses that they had a gambling habit (which was *not* disclosed to the credit provider), knowing this will create the risk that the decision maker will look for signs of the gambling habit in the material received by the credit provider during the application and/or that the credit provider should have requested more information. That detailed information from the complainant should only be collected if the decision makers considers there is an apparent responsible lending concern arising from the credit provider's documentation.
10.	13	**Section 3.2, "Requesting additional information"** We support the 'what if' approach (should AFCA find the credit provider did not make reasonable inquiries or verification steps). However, as noted in item 7, additional clarity and detail in required in relation to this process.
11.	14	**Section 3.2, "Verification of income" example** We note that this example sets out a 'if you have it, you must use it' rule. While we agree that credit providers cannot turn a blind eye to information that they have, the application of the rule must recognise the practicalities of operating a credit business. Information (and documentation) will be requested by a credit provider for certain purposes. It is not reasonable for a credit provider to be deemed to be aware of all that information and to apply it for all purposes unconnected to the reason for collecting the information. Further, credit providers business are designed to operate at scale – with a consistent approach taken for all relevant credit applications (which improves the overall lending practices of the credit provider). Expecting the credit provider to forensically review each bit of information collected to identify signs of inconsistent information is not reasonable. Noting that the example on page 14 is a very straightforward illustration, we consider that the Approach needs to include additional clarity for when the credit provider will be deemed to have been *aware* of inconsistent information in its possession. At a minimum, this example should be clarified to note that the inconsistent information was clearly

		apparent and that there was no reason the credit provider couldn't have used that additional information. For example, would a different outcome have been determined if the email from the customer had been sent to address within the credit provider that was unconnected to the assessment of the loan? What if the representation regarding the probable drop in income was hidden in a long and otherwise irrelevant email?
12.	14	Section 3.2, "Verification of income" example We note that the draft Approach references the collection of 'bank statements' in this section (and other sections listed below). Those references could be taken as an inference that credit providers are expected to obtain statements in all cases (or, on a more limited basis, whenever assessing a home loan). This is clearly not a requirement of the law which allows a scalable approach. We consider there needs to be a clear statement that bank statements (or other transaction-level inquiries) are not a requirement or expectation for all responsible lending assessment (including for all home loan applications). Additional references to bank statements are in: • example on page 15 • example on page 16 • in the discussion of benchmarks on page 18. • example on page 19 • example on page 24 • example on page 41
13.	14 + 15	**Section 3.2, "Using additional information to revise an unsuitability assessment"** **Section 3.3, "AFCA will review a financial firm's unsuitability assessment"** As a preliminary matter, we are concerned by the reference to AFCA using information "it obtains through further inquiries and verification steps". This appears to equate the document collection process undertaken by AFCA to assess the complaint to the credit assessment/responsible lending assessment undertaken by the credit provider. As noted previously, we consider the Approach needs to clearly differentiate those processes. The complaint assessment should <u>not</u> be treated as AFCA "redoing" the credit assessment/responsible lending assessment. The complaint assessment is to review the process undertaken by the credit provider to identify any clear errors or deficiencies; not to redo the assessment to see if AFCA can 'do it better'.

		On that basis, we consider the process described on page 14 - 16 risks embedding a 'hindsighting' approach into AFCA's consideration of responsible lending complaints. We agree with the observations in the paragraph "We are unlikely to find…" and the Example on page 16, however consider that this explanation needs to be clarified and strengthened. We consider that a simplified description of the approach would involve AFCA: - collecting the information relied upon by the credit provider in their decision to approve the credit; - asking the complainant whether that information reflects what the complainant told the CP, i.e. is anything misstated or missing? - considering the information that the credit provider has provided and, based on the complainant's feedback, any additional information that AFCA considers the credit provider actually had ('useable information'). - based on the useable information, assessing whether the loan was affordable and/or met complainant's requirements and objectives. If not, the loan would be deemed unsuitable and AFCA would determine the remedy. If yes, AFCA would continue the process. - considering whether there was anything in the useable information that should have triggered the credit provider to make further 'reasonable' inquiries and verification? If not, then AFCA should find no breach. If yes, AFCA would continue the process. - considering whether collecting that additional information would have resulted in the loan being deemed unsuitable. If not, then no breach. If yes, then AFCA would deem the NCCP responsible lending provisions are breached and consider the remedy.
14.	15	**Section 3.2, "Taking further reasonable steps" example** As noted in item 7, where the credit provider is deemed to have used an incorrect figure in its assessment, the Approach should reinforce that the error must be considered in the overall context of the assessment. For example, did the credit provider's treatment of other shaving income or buffering expenses reduce the relevance of the error?
15.	17	**Section 3.3, "Assessing capacity to repay without substantial hardship"** The following comments relate to the step on page 17: "Where relevant, consider whether the financial firm has assessed the complainant could reasonably reduce their outgoings without substantial hardship".

		We note that our Members consider this to be beyond the expectations as set out by the court in the ASIC v WBC case (which considered the straightforward use of an expense benchmark by the credit provider). Notwithstanding that observation, we also consider the step to be too broad and impractical. At a minimum, it should be clarified to focus only on significant expenses that are difficult to reduce (or directly point to the commentary in RG209).
16.	17	**Section 3.3, "Assessing capacity to repay without substantial hardship"** As per our previous comments in item 7, if the process followed by AFCA results in adjusting any elements of the complainant's financial situation, the process flow should explicitly give the credit provider an opportunity to explain and unwind (if reasonable) conservative approaches to income shaving/expense buffering.
17.	17	**Section 3.3, "Reviewing use of benchmarks as verification tools"** We welcome AFCA's recognition that benchmarks can be a useful verification tool. However, we are concerned that the commentary in the draft Approach goes beyond the guidance in RG209 (e.g. as to using location-adjusted data) and consider this inappropriate. In relation to this important and complex situation, we consider that the Approach should take additional care to limit the commentary to reflect what is included in RG209. In that context, we consider that AFCA (whether in the Approach or in practice) must avoid assuming that all credit providers should use the same form of a relevant benchmark. The form of benchmark - e.g. whether or not income and location-adjusted – is a matter for the credit provider to assess based on its own processes and business. For example, a location-adjusted HEM benchmark requires a credit provider to incorporate at least 14 additional data tables into its processes. While some of the largest credit providers may have the resources to manage that additional process, it is not viable for all credit providers. It is up to the credit provider to determine which benchmark to use and to ensure that it is appropriate in the context of its overall responsible lending process. Finally, we note that the commentary in the draft Approach appears to assume that the benchmark expense figure *will* be incorporated into the responsible lending assessment. It is our understanding that many credit providers will (notwithstanding the ASIC v WBC case) use the higher of the benchmark figure and declared expenses. The Approach should reflect that if using that 'higher of' approach there is generally no requirement to make further enquiries (i.e. as that it the point of using the benchmark as a verification tool).

18.	19	**Section 3.3, "Inconsistent information about living expenses" example** As per item 11, this is an example of the 'if you have it, you must use it' rule and the same comments would apply. However, in respect of this example, we also question at what point is the credit provider expected to make further enquiries? For example, what if the bank statements showed expenses of \$5000? Or \$2500? If the credit provider is expected to make further enquiries whenever the total expenses shown on the bank statements was greater than the HEM or disclosed figure, then it effectively removes the point of using benchmarks as a verification tool.
19.	19	**Section 3.3, "Changes the financial firms could reasonably have foreseen"** *Retirement age* We consider that the commentary regarding customers reaching retirement age needs to be refined and limited. Theoretically, the commentary suggests that credit providers would need to consider the retirement plans of all customers over the age of 37 years old when assessing a 30-year home loan. This is simply impractical and an inefficient use of resources. It is likely that most 37 years old (and, likely 47-year-olds) would have put no real thought into their retirement plans. Expecting credit providers to take this step is of little use and an example of a tick-the-box approach to responsible lending. We recommend that the Approach temper this observation to only apply to customers approaching imminent retirement (where the credit provider determines what that reasonably means). We also note the additional feedback from AFCA in the roundtable held on 24 August that AFCA would ordinarily assume the relevant retirement age to be the age at which an individual can claim Centrelink benefits (i.e. currently 67 years old); however that AFCA may take a different approach depending on the industry in which the customer work, i.e. they may assume a lower age if the industry has high physical demands. We caution against this approach particularly for non-home lending products. *Buffers* (See also our commentary regarding the inappropriateness of applying the APRA buffers in item 4.) We generally agree that a credit provide should make allowances for fluctuations in a consumer's variable interest rate debt obligations. However, while the use of an interest rate buffer may be the most direct way of doing so, we consider that the Approach document should recognise that this is not the only way. For example, the allowance

		could be made by shaving the customer's income or other taking a conservative approach to other elements of the customer's financial situation. Further, we disagree that there is always a need to buffer variable rate debts. For example, a credit provider may reasonably take the view that there is no reason to buffer a short-term debt due on the basis that it is unlikely that significant interest rate changes will happen over the life, or remaining life, of that loan. While we recognise that AFCA's guidance on determining "an appropriate buffer" is not prescriptive, we have a fundamental concern that AFCA decision makers take in relation to that determination. The setting of an interest rate buffer is a key part of a credit provider's running of their business. The process utilises the expertise and experience of a range of experts within the business. We do not consider that AFCA can be expected to have that same level of expertise or understanding of the business of the credit provider. We consider that the Approach should reflect that, in relation to interest rate buffers, the role of the AFCA decision maker is to: • Identify whether a buffer has been applied (or whether other equivalent steps have been taken); and • Consider whether there is anything patently wrong with the basis upon which the credit provider has set their buffers (or other steps). As an example, the decision maker could question the logic of a credit provider maintaining a very low buffer in a high inflation environment. That is, the Approach should make it clear that the decision maker should avoid supplanting the credit providers own decision with what the decision maker would have done. In addition to the above, and as discussed in item 4, the Approach should be updated to explicitly limit the relevance of the APRA buffers to (i) ADI's only; and (ii) the assessment of home lending only.
20.	25	**Section 3.4, "Small surpluses may indicate further verification was required"** We consider that this commentary needs to be clarified. Small surplus do not necessarily mean additional verification required. For example, a small 'assessed' surplus may result from conservative income shaving/expense buffering. Rather than triggering a requirement for additional verification, the small 'assessed' surplus is a result of the credit provider taking an alternative approach to undertaking a more detailed verification process.

		We also note that this is a further example of the Approach placing an over emphasise on circumstances in which 'more' needs to be done. This section should take a more balanced approach and recognise that 'less' verification is required if there is a larger surplus.
4. How we determine fair out and calculate complaint loss		
21.	29; 36	**Section 4.1, "Dealing with secured assets fairly in the circumstances"** **Section 4.2, "Accessing how secured assets can be dealt with fairly"** **Section 4.2, "Keeping the family home"** We are concerned with the description of when AFCA will allow a customer to retain an asset over the longer term (particularly given the terms upon which this may be ordered, i.e. payment of an interest rate equal to the RBA cash rate). We recognise that there may be some very limited circumstances in which it may be fair for a customer to retain the asset due to compassionate reasons and, therefore, fair in all the circumstances (e.g. terminal illness; significant vulnerability). However, we consider the Approach creates far too wide a set of circumstances in which this could be *required* by AFCA. Allowing the customer to retain the asset in the circumstances listed creates a windfall for the customer and is, arguably, punitive to the credit provider. For example, the fact that the customer may "rely on their car to drive to work" (page 28) should be irrelevant to the outcome of the responsible lending complaint. If the loan was deemed unsuitable – and should never have been given – then the customer necessarily should never have had the car. Allowing the customer to retain the car (particularly at the RBA cash rate as suggested by the example on page 37) is not appropriate. Likewise, in the *Keeping the family home example*, the customer gains a windfall by being allowed to retain the new, larger home (while paying an uncommercial interest rate equal to the RBA cash rate). In this example, was there consideration of whether the customer could repurchase a house at a similar price to their original home (which would essentially place the customer in the position that they would have been but for the unsuitable loan)?

		(Of course, in helping the customer and credit provider coming to an acceptable solution, AFCA could *suggest* this as a potential solution that could be agreed by both the customer and AFCA; however, it should not be ordered by AFCA.) If AFCA considers that it is appropriate for the customer to retain the property in such wide circumstances, we consider that • the RBA cash rate is an unsuitable rate and consideration should be given to a fairer rate; and • clarity needs to be given as to the status of the relationship between the ongoing relationship between the customer and the credit. Is the relationship still dictated by the contract? What happens if the customer is not able to pay (i.e. do the ordinary hardship and collections processes operate)?
22.	31	**Section 4.2, "When complainants do not receive a benefit from the loan"** **Guide one, "Calculating loss from different credit products"** As starting point, we find the description of the loss calculation difficult to understand. We believe the Approach could benefit from having worked examples. We are particularly unclear regarding the relevance of capital gains vs capital losses and how this differs based on loan purpose (i.e. investment vs owner-occupier) and asset type (personal property vs real property). Overall, we consider that if AFCA is to recognise a capital loss suffered by the customer, it must equally recognise any capital gain (whether realised or unrealised). However, we are unable to clearly understand the approach taken to capital gains. Capital gains are referenced on page 31 and 33 (although only in relation to realised gains). However, are not mentioned in Guide one (and the *Keeping the family home* example on page 37 suggests there was no consideration of the capital gains on the larger house – or even the differential capital gains on the original house and the larger house). Similarly, we note that the examples relating to car loans on page 51 and 52 provide no recognition to the benefits received by the customer by driving the car.

<table>
<tr><td>23.</td><td>40</td><td>Section 4.2, “Reducing compensation due to complainant conduct”

We welcome AFCA’s recognition that the complainants conduct may be relevant to both whether the financial firm breached its obligations and when determining an appropriate remedy.

However, there is a strong concern amongst our Members regarding the balance that is given between credit provider and complainant responsibility (where that complainant has engaged in fraud). We also question the appropriateness of the outcome described in the example on page 41 as it appears to reward an individual who has deliberately engaged in behaviour designed to defraud the credit provide.

We expect that this issue would be a key consideration of stakeholders if our Key recommendation 4 is adopted.</td></tr>
<tr><td>24.</td><td>N/A</td><td>NEW – credit reporting impacts of responsible lending breach

Where AFCA has determined that a loan was not compliant with the NCCP responsible lending obligations, a key question is whether the information previously disclosed to a credit reporting body is “accurate, up-to-date, complete, relevant and not misleading”. If the non-compliant lending has resulted in the customer not being able to afford the loan and, accordingly, missed payments (or even a default) has been recorded with a credit reporting body, it is likely that that information should be corrected. However, the question of ‘how’ it should be corrected is more complex, e.g. should the repayment history be ‘corrected’ or removed? Or should the entire record of the loan be removed? What happens if the loan is adjusted (in order to be afforded) and otherwise remains on foot?

In determining an approach, it is necessary to consider the interests of the consumer (e.g. depending on the consumer’s performance, the inclusion of the information on their credit report may be beneficial to their credit health) and the practicalities of making those changes (e.g. are the changes supportable from a systems perspective; are they consistent with a credit provider’s obligations under the Principles of Reciprocity and Data Exchange and/or mandatory CCR obligations in the NCCP).

We note that during the roundtable on 24 August, AFCA recognised this issue and suggested that this matter could be subject to additional guidance in the near future. We support that suggestion and confirm that ARCA will work with its Members and other stakeholders to develop a proposal for consideration by AFCA.</td></tr>
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