To: Australian Financial Complaints Authority

AFCA APPROACH TO RESPONSIBLE LENDING

Financial Counselling Australia (FCA)
is the peak body for financial counsellors in Australia.

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About Financial Counselling

Financial counsellors assist people experiencing financial difficulty. Working in community organisations, they provide advice and support to people experiencing financial hardship. Their services are free, confidential and independent.

Financial counsellors need an in-depth knowledge of credit law, bankruptcy law, debt collection law and practices, industry hardship processes and government concession frameworks.

Financial Counselling Australia

FCA is the peak body for financial counsellors in Australia. FCA's member groups are the State and Territory financial counselling associations.

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1 INTRODUCTION

Thank you for the opportunity to provide feedback on the three AFCA Approach documents on responsible lending.

The “AFCA Approach” series are important documents as they provide guidance and set standards for both industry, consumers and consumer advocates. Financial counsellors use these documents regularly.

The documents are well written, clearly set out and the content is very useful. We also support further work on plain language.

We support having three approach documents. It is useful to have a general overview and two specific documents: consumer credit issues and legal principles/industry codes/good industry practice.

2 LEGAL PRINCIPLES, INDUSTRY CODES AND GOOD INDUSTRY PRACTICE

It would be useful for this document to refer to the other documents in the set. The internet can take people straight to documents and it is useful to flag that further specific guidance is available.
(All of the comments below are repeated for the other Approaches where relevant)

Who should read this document? (1.1)

The fifth dot point mentions guarantors. Guarantors should read this document but this document is not tailored to, or specific enough, for guarantors. This may mean they will be confused. We suggest developing a separate approach document for guarantors. This could cover the laws, code obligations, benefit and so on.

Summary of the AFCA Approach (1.2)

The use of the word “error” is problematic. From an industry perspective they will argue that there was no error and that their decision was based on their advice the law. As well, some examples of irresponsible lending may not be an “error” at law (because some of it is unsettled) but a failure to comply with good industry practice. It would be good to avoid these arguments and phrase this paragraph differently.

National Consumer Credit Protection Act (2.1)

It would be helpful to specifically flag that loans for investment properties are also included under the NCCP. This is mentioned further on in the Approach but it is good to be clear from the start.

National Credit Code (2.2)

The inclusion of this section as a standalone component is confusing. The NCC is a schedule of the NCCP. The NCCP is the main instrument that regulates credit transactions (and the NCC is part of that).

National Credit Code, ASIC Act (2.2 and 2.3)

These sections describe two possible laws that relate to unjustness/unconscionability and misleading conduct. The application of these laws can be confusing and the list, although concise and well written, does not really sort out the confusion. It might be better to list the type of complaint, for example – unjustness/unconscionability – say what it is, then list the relevant laws that may be considered. There is no reference to the common law which is also relevant.

Good Industry Practice (2.6)

This section is really well written and makes it very explicit as to how AFCA interprets and good industry practice. Specifically:

- ASIC RG 209 – including this as good industry practice makes it very clear. RG 209 is reviewed regularly by ASIC (and is being reviewed now) and it allows these standards to improve as needed to meet community expectations

- Making the point about codes setting the standard whether the financial firm has subscribed or not is excellent. One issue that may arise however is if two or more codes could apply and which one would be used. Another issue may be if there is an inadequate code in place that could allow a lower standard of good industry practice.

- We also support financial firms complying with their own internal policies.

Consumer Credit (3.1)

Consumer's Requirements and Objectives

ASIC is currently updating RG 209 and it is unclear how the detail on these obligations will be written. In FCA's submission on RG 209 we argued that far more detail is needed to adequately address a consumer's requirements and objectives. There are many loan arrangements that are a poor deal for the person as they would not meet their requirements and objectives. Examples include: transfer to high interest credit card; debt consolidation that considerably increases the amount to be repaid over time; moving ownership of the property to turn someone from a guarantor to an owner; where the benefit is small etc. The list is large and the concern is that the list at 3.1 does not flag all of this.

This section includes a list of four dot points that set out factors a financial firm should take into account in assessing requirements and objectives. We suggest adding an additional point about vulnerability generally. People can be vulnerable because of factors relevant to them as individuals (e.g. cognitive impairment, mental illness) or because of the situation they find themselves in (complex transactions).

Vulnerability is important and it could be useful to expand on this topic, either here or in a separate approach document. The ACCC released a guide on "don't take advantage of disadvantage" (https://www.accc.gov.au/publications/business-snapshot/dont-take-advantage-of-disadvantage). This is a key message to cover in responsible lending.

Consumer's financial position

We suggest adding education as an expense include. Education costs can be significant even for people who send their children to public schools.

Secondly and more importantly, this section and the AFCA Statement of Financial Position need to explicitly include a savings buffer. FCA released a report "Everybody needs a savings buffer" available at https://www.financialcounsellingaustralia.org.au/docs/everybody-needs-a-savings-buffer/. Chapter 4 specifically looks at responsible lending and the need for a savings buffer in determining living expenses. FCA has also included a savings buffer in its standard Statement of Financial Position (the expanded version).

A savings buffer is needed for several reasons (all outlined in detail in the report) including:

1. Without savings, people struggle with unexpected expenses
2. Building resilience
3. Encouraging savings
4. Consistent with financial literacy research
5. Creditors will benefit (from receiving payments that do not need to go to unexpected expenses)

To be specific, the approach should specifically mention a savings buffer as a living expense and the AFCA Statement of Financial Position should include an item for savings under living expenses.

When might a financial firm make fewer inquiries?

This section reflects the ASIC concept of scalability. This has caused a lot of problems as some financial firms took this to mean that their responsible lending obligations were substantially reduced. This section may be used to perpetuate some of these problems. A lot will depend on the approach taken by ASIC in RG 209.

What is the minimum amount of information a financial firm should request?

We recommend the following changes:

- Dot point 2 (self-employed people) – check bank account and tax returns. The bank account statements are often more illuminating then the tax returns.

- Dot point 8 – valuation – this is strongly supported as it will help in preventing this type of complaint.

- Dot point 9 – low doc – bank account statements are really useful at preventing irresponsible lending.

Credit provider reliance on finance broker information and verification

The Royal Commission exposed serious problems with the broker verification process. Finance brokers have been known to cut corners, fail to verify information, rig figures and dress up an application to get approval. They know exactly what the credit provider checks and does not check and they have a clear incentive to get the loan approved (as they are paid by the credit provider). The Royal Commission recommended fixing this major problem with conflicted remuneration but this has not been adopted.

Good practice in the industry is that credit providers should make sure the information being provided is accurate and verify it. It is not clear how RG 209, as it is currently drafted, can be construed as good practice following the issues exposed in the Royal Commission. AFCA should lead here and make it clear that auditing is not enough and set down a list of matters that must be verified to ensure people have a loan that meets their requirements and objectives and they can afford to repay.

Calculation of loss (4.2)

In our experience, compensation for loss is the most confusing issue for everyone and it is important that this section is clear.

There are a few issues that need further clarification:

Refinancing

The statement that there are circumstances where there is no loss as a result of refinancing will not always be correct. There is a clear responsibility in the NCCP to only go ahead with a loan if it is not unsuitable. Refinancing itself can be unsuitable. There are fees, possibly different interest rates, finance broker costs. Even if the principal debt remains the same it does not follow there is no loss. It has been well-recognised that churning is a problem. Some financial firms churn people through multiple loans to the detriment of the borrower.

The statement that there is no loss needs to be changed to recognise that there can be loss. The statement about “adversely affecting the borrower’s financial position” needs to be a lot clearer.

Business or investment purposes

This needs to make it clear that the treatment and laws around investments varies depending on whether the investment is in property or not. Again, there can be loss even if the risk of the investment is not taken into account. Predatory business lenders can have very high broker fees, costs and interest that need to be factored in as a possible loss.

Selling the family home

This is the issue about having to sell the asset. When it comes to the family home, people do not want to sell their home if at all possible. The Approach needs to cover how AFCA deals with this. There are definitely situations where the house does not need to be sold.

Finance brokers

This approach appears to be based on the way the former CIO considered these situations. This was problematic as it did not adequately recognise that finance brokers can and do contribute to loss for irresponsible lending.

The first dot point talks about the broker not benefitting from the transaction and so the commission paid by the credit provider to the broker is then paid to the borrower. It is correct that the broker should not benefit, but it is problematic to enrich the borrower with money they never lost. If the financial firm sues the broker for their commission back, they pay twice.

The second dot point is not all that clear. If the finance broker acted in breach of the NCCP the borrower should be entitled to compensation. Then it is a matter of determining the contributions to the loss of both parties.

Inability to pay the adjusted amount outstanding (4.3)

This is a major concern. There should not be two complaints. A financial hardship complaint is different from a complaint where the financial hardship was caused by the irresponsible lending in the first place.

The repayment arrangement must be part of the remedy for the breach of irresponsible lending. Turning this into two complaints will cause a lot of confusion and, even more worryingly, cause further stress for people running a complaint in AFCA.

3 CONSUMER CREDIT ISSUES

Role of finance broker (2)

This section takes us back to FOS (even BFSO) and before the NCCP even commenced and could be clearer. The role of a finance broker is very confusing. It is arguable that the role of the finance broker regulated by the NCCP (as a credit assistant) is different from their role in an unregulated loan. It would be a lot clearer to make this distinction clear.

Scenario 1 is confusing. Is there a better scenario to illustrate how things would work? Also, the remedy just concentrates on reliance instead of the broker's breach of the law that flows to loss.

Common errors in loan assessments (3)

This section only considers affordability and not requirements and objectives. It should give examples for both.

Assessment of loss (4)

This section is helpful but it does not deal with remedies when the loan was unsuitable as it did not meet the requirements and objectives of the borrower.

4 BUSINESS CREDIT ISSUES

It would be useful to cover what laws and codes apply in the introduction. For example, ASIC Act, common law, Codes etc.

Summary of the AFCA Approach (1.3)

The COBP is now the Baking Code of Practice (BCOP).

It would make a lot of sense to have an agreement with the ABA that where the COBP applies but AFCA's jurisdiction is exceeded, the bank agrees to AFCA hearing the matter. That agreement could then go in this Approach.

Not all finance providers are members of AFCA (1.5)

This should also mention situations where the credit provider is a member of AFCA, but the broker is not.

Common errors in loan assessments (2)

On pages 6 and 7 there is a case study but the discussion does not cover the remedy.