

13 September 2023

Ms Natalie Cameron  
Lead Ombudsman – Banking and Finance  
Australian Financial Complaints Authority

Via email only: [consultation@afca.org.au](mailto:consultation@afca.org.au)

Dear Ms Cameron

## Consultation on the draft Approach to Responsible Lending

The Banking Code Compliance Committee (**BCCC**) welcomes the Australian Financial Complaints Authority's (**AFCA**) consultation on the draft Approach to Responsible Lending document (the **Draft Approach**) and the opportunity to provide feedback.

This submission provides feedback on the Draft Approach's overlap with the responsible lending obligations in the [Banking Code of Practice](#) (the Banking Code). The Draft Approach provides comprehensive guidance on what AFCA decision makers will consider in a responsible lending complaint raised by an individual consumer. It also provides a clear assessment of how broader obligations, whether legislative, regulatory or industry code-based, can be practically applied to ensure fair outcomes.

Generally, the BCCC supports the Draft Approach and recommends the following further improvements:

- Section 3.1 - Specifically mention the diligent and prudent banker obligation set out in paragraph 49 of the current Banking Code.
- Section 3.2 – Specifically highlight a financial firm's responsibility to ensure the understanding and benefit of co-borrowers as well as for consumers generally.
- Section 6 – Reference the Banking Code.

### Banking Code Commitments on Responsible Lending

Under [Chapter 17 the Banking Code](#), code-subscribing banks, who are also AFCA members, commit to the following obligations:

- Paragraphs 49 and 50 – exercise the care and skill of a diligent and prudent banker when considering whether to provide new or increased credit – for individual customers this is done by complying with the law.
- Paragraphs 53 to 57 – for individual co-borrowers – if the bank concludes, on the information provided to it, that a co-borrower will not receive a substantial benefit from the new or increased credit, the bank will not approve the loan unless:
  - the bank takes reasonable steps to ensure that the co-borrower understands the risks associated with entering into the credit arrangement, and the difference between being a co-borrower and being a guarantor
  - the bank has accounted for the reasons the co-borrower wants to enter into the credit arrangement, and

- the bank is satisfied that the co-borrower is not experiencing financial abuse.

The Banking Code also contains obligations in respect to appropriate lending for small business customers.

As noted in the Draft Approach, the Banking Code's obligations are relevant to AFCA decision making both in the case of Banking Code breaches by code-subscribing banks and also as guidance on standards of good industry practice where AFCA finds it relevant and appropriate.

## **BCCC Approach to Responsible Lending**

The key responsible lending obligation in the Banking Code is paragraph 49, under which code-subscribing banks have committed to 'exercise the care and skill of a diligent and prudent banker' when considering whether to provide or increase credit to a customer.

When reviewing breach allegations from bank customers, we do not consider 'diligent and prudent banker' as a standalone obligation. As part of the Banking Code's overarching commitments and stated outcomes, we will consider a bank's commitment to exercise the care and skill of a diligent and prudent banker in conjunction with the bank's obligations under paragraph 10: engagement in a fair, reasonable and ethical manner, as well as the Banking Code's Guiding Principles to reach a holistic assessment of the bank's compliance with the Banking Code.

In addition, we also consider context-specific obligations such as protections for guarantors, accessibility or vulnerability, which we expect the bank to have considered when lending to the customer. The BCCC's approach to assessing banks' compliance with paragraph 10 and the Guiding Principles is found in [Guidance Note No. 2: Clause 10 – fair, reasonable and ethical behaviour](#).

## **Breach Data**

While banks endeavour to do the right thing, we have a unique insight into the causes, scale and impact when things go wrong, and banks fail to lend responsibly to customers. These failures can seriously exacerbate financial hardship and vulnerabilities. The financial and psychological detriment can be severe and long lasting.

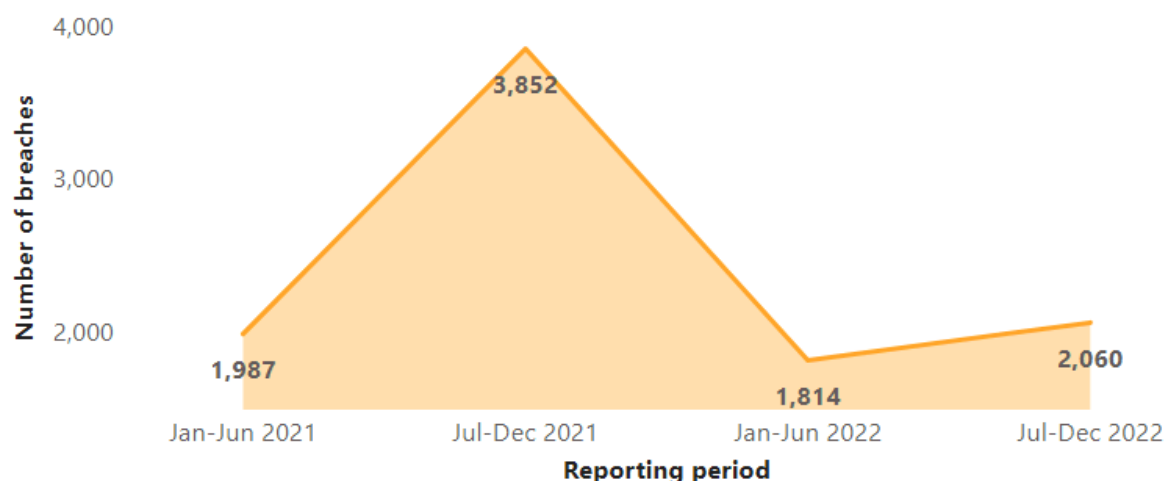
The BCCC requires code-subscribing banks to self-report breaches of the Banking Code every six months, published in de-identified form in our regular Compliance Statement Reports. Our breach data shows that for the previous two years (January 2021 – December 2022), over 12% of the 76,000 breaches reported to us by banks were breaches of the Banking Code's responsible lending obligations. In many instances, these breaches were accompanied by breaches of other obligations of the Banking Code such as Chapter 14 (vulnerability), Chapters 39 to 41 (financial difficulty) and Chapter 4 (training and competence).

According to our sample data for Banking Code breaches<sup>1</sup>, close to half of the 3,500 breaches reported by banks were attributed to human error. This indicates a reliance on manual lending decision-making and highlights the need for ongoing focus on staff training and awareness by banks to ensure their lending decisions are responsible.

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<sup>1</sup> Banks are required to report details of a sample of the total breach incidents reported by banks on the biannual Compliance Statement as detailed in Guidance Note 1: Breach Identification and Reporting.

## Chapter 17: A responsible approach to lending



We recognise that the Draft Approach's purpose is to detail the assessment process leading to AFCA decision making on individual concerns. Financial firms as well as consumers and their representatives will consider the Draft Approach. With this in mind, we believe that, by highlighting the nature of issues that can contribute or lead to financial firms not exercising the diligence and prudence expected of them when making lending decisions, the Draft Approach can play a part in reducing adverse outcomes for customers on an industry-wide scale.

This also aligns with AFCA's purpose to help improve financial firms' processes to minimise future complaints. Hence, we provide the following comments and recommendations to better integrate the Banking Code into the Draft Approach.

### Comments and Recommendations on the Draft Approach

Our specific comments on the Draft Approach focus on 'Section 3: How we decide if a financial firm has met its responsible lending obligations'.

We have not commented on loss and compensation as these matters do not fall with our remit.

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

The subsection 'Referring to laws, codes, good industry practice and past decisions' refers to applicable industry codes, including the Banking Code of Practice. We suggest this should be updated to specifically acknowledge that this includes consideration of the obligations under Chapter 17 of the Banking Code, including the obligation to 'exercise the care and skill of a diligent and prudent banker' in paragraph 49.

This will give transparency to the consideration of this obligation by AFCA decision makers, given the importance of this obligation in complying with the National Consumer Credit Protection Act and other relevant laws.

Further, highlighting the 'care and skill of a diligent and prudent banker' obligation in the Draft Approach is consistent with [AFCA's current draft Approach to Appropriate Lending to Small Business](#).

## **Section 3.2 – AFCA considers whether inquiries and verification steps were reasonable**

### **Substantial benefit for co-borrowers**

We acknowledge that AFCA decision makers already take into account the Banking Code's obligations around lending to co-borrowers, where there is no substantial benefit to the co-borrower, in relevant responsible lending determinations.

We also acknowledge that this is evident in the Draft Approach due to 'Quick Reference Guide 2: Information we may request from financial firms' and its section on 'If the complainant says they received no benefit from the loan'.

However, paragraphs 53 to 57 of the Banking Code, summarised above under 'Banking Code Commitments on Responsible Lending', form specific requirements that place the onus on code-subscribing banks to ensure that co-borrowers understand the contract they are entering into and its associated risks.

In our view, this onus should be viewed as good industry practice in line with a financial firm's obligation to make reasonable inquiries of the prospective borrower and undertake reasonable verification steps.

We have evidence through breach allegations of incidents involving co-borrowers where the bank did not discharge its obligation to ensure the co-borrower understood the nature of the loan arrangement and their role within it.

These include allegations where the parent of a bank customer was entered as a co-borrower on a construction loan with a major bank, where the bank did not obtain any financial information from the parent. The customer alleged that a bank staff member informed the customer that it wouldn't be necessary to inform the parent of the risks as 'it is the same as if you were a married couple'.

Our compliance reporting data from code-subscribing banks reveals similar instances. For example, we highlight a breach where the customer claimed that they had no knowledge of an increase to a loan, for which they understood they were a guarantor, not a co-borrower.

Cases like these indicate that the code-subscribing bank has failed to ensure that the prospective co-borrower understands the difference between a co-borrower and a guarantor before approving the loan, a key requirement of paragraph 54(a) of the Banking Code.

Concerningly, while the overall number of such breaches related to co-borrowers was small, all breaches in our sample data related to this issue were identified through customer complaints. This indicates that the customer would likely have been adversely affected or suffered a loss from the breach incident, leading them to make a complaint to the bank. It may also suggest that banks' monitoring frameworks are not effectively identifying these breaches, and banks are instead relying on customer complaints to identify these issues.

ASIC Regulatory Guide 209.85(e) also requires that, if a customer appears to have difficulty understanding a credit product they are entering in to, the bank must make further inquiries.

Therefore, we suggest that the understanding and benefit of co-borrowers should be highlighted in Section 3.2 of the Draft Approach as part of the steps a financial firm needs to take to make reasonable inquiries and undertake reasonable verification of the prospective

borrower. This should be separate from and in addition to the general consideration of consumers' capacity, understanding and benefit already outlined in the Draft Approach.

### **Question 14 – General feedback**

In section 6 of the Draft Approach on Useful Documents, we recommend that AFCA include references to the [Banking Code](#). This would assist customers in understanding the purpose and content of the Banking Code, which offers important protections for banking customers.

### **About the BCCC**

The [BCCC](#) is the independent body responsible for monitoring code-subscribing banks' compliance with the Banking Code. Our purpose is to monitor banks' compliance with their obligations under the Banking Code and drive best practice that leads to better outcomes for customers.

We thank you for the opportunity to respond to your consultation on the Approach to Responsible Lending and trust that our feedback will assist you in meeting your objective of providing fair outcomes for all parties.

Should you require any further information, please contact Jillian Pritchard at

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Yours sincerely

A handwritten signature in cursive script, appearing to read 'Ian Govey'.

Ian Govey AM  
Independent Chairperson  
On behalf of the Banking Code Compliance Committee