Australian Banking Association

APPROPRIATE LENDING TO SMALL BUSINESS APPROACH

Australian Financial Complaints Authority

13 October 2023

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Key recommendations

The ABA recommends AFCA:

1. Consider an alternative option to the proposed Appropriate Lending to Small Business Approach (**proposed Approach**), such as a principles-based approach.
2. Reduce the level of prescription in the proposed Approach, particularly in relation to the list of relevant factors or information a lending assessment may include (pages 19-20 of the proposed Approach), and the list of possible inquiries banks may need to make (pages 24-26 of the proposed Approach), for reasons noted in this submission.
3. Revise the case study examples provided in the proposed Approach, noting the potential impacts of existing examples on small business' access to credit, timeliness of credit, banks' ability to use automated decisioning, and the application of the 'diligent and prudent banker' standard under the ABA Banking Code of Practice.

Policy lead: Ellen Choulman, Director, Business Engagement and Policy, [redacted].

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

Australian Banking Association

ABA submission to AFCA's Appropriate Lending to Small Business Approach

1. Summary of ABA position

1.1 The draft SME Approach may impact small business' ability and speed to access credit

The Australian Banking Association (**ABA**) welcomes the opportunity to comment on the Australian Financial Complaints Authority's (**AFCA**) proposed Appropriate Lending Approach for Small Business (**draft SME Approach**).

The provision of credit to small business is critical to the success of the economy and the prosperity of Australians, and ABA members are committed to the success of Australia's small business sector.

The ABA acknowledges AFCA's work in developing a public approach to small business lending and understands that AFCA's intention in publishing its approach to small business is to aid small business borrowers and lenders in understanding how AFCA currently approaches its determinations. We also understand that AFCA does not seek, by so doing, to set out any new approach or establish a set of pseudo rules and regulations in relation to small business credit. However, there is a likelihood that the degree of prescription AFCA adopts in the draft SME Approach may have this effect and introduce a level of detail that goes beyond existing requirements under laws, standards, and codes.

We consider the existence of prescriptive documentation relating to small business lending will, for the reasons noted in this submission, constrict future innovation to support small business lending and result in less timely and more complex access to credit for small business, and potentially more loans being declined to otherwise sound businesses. In and of themselves, these factors are likely to contribute to a greater number of complaints being made by small businesses in relation to lending, beyond the typical number of complaints AFCA already receive.

We note the draft SME Approach includes a long list of factors of potential relevance to AFCA's consideration of lenders' credit assessments. While we agree that it would be difficult to set out precisely which of those factors will be relevant in any given case, failing to do so leaves open the possibility that all those factors could be taken to be relevant or that some irrelevant factors are considered, which introduces a greater level of ambiguity as to which factors will be relevant. This uncertainty could result in increased complaints being taken to AFCA where borrowers or their representatives see a gap in the list of factors applied in their case and believe they may succeed in a claim on that basis.

A prescriptive approach to small business lending could also reduce innovation in the sector and hinder advancements in small business lending currently adopted by banks, such as the use of automated credit decisioning, which has led to greater efficiency and timeliness in lending, accessibility to credit and better consistency in outcomes for small business borrowers. Conversely, we consider the draft SME Approach could impact on efficiencies gained through automated credit decisioning, and potentially make it unsustainable in the long term.

We note that in its current form, the draft SME Approach includes a reference to the ABA Banking Code of Practice (**BCOP**) 'diligent and prudent banker' obligation. As compared with other areas of banking, such as responsible lending to individuals, small business lending is underpinned by less legislation, regulatory guidance, and case law, in recognition of the flexibility required to let small business prosper. Any attempt to prescribe the diligent and prudent banker test in AFCA guidance is a substantive undertaking that could have broad ramifications on banks' lending processes and systems, and require significantly more lead time to consider, than the consultation period proposed. We also note AFCA has

previously stated it is not its intention, or within its remit, to establish new requirements beyond those that currently exist.

We also note that banks lend to tens of thousands of small businesses each year that are not subject to any complaints relating to their lending processes. By comparison, the draft SME Approach relates to issues experienced by a very small proportion of total lending cases. It is important that lenders learn from these cases. However, we consider that the document should acknowledge the limited data set from which the draft SME Approach draws, and that the release of the approach document, in and of itself, does not require a bank to change its lending processes where otherwise compliant with existing laws, codes and standards.

1.2 The ABA requests AFCA consider an alternative option to the draft SME Approach

The ABA acknowledges the guidance that AFCA provides to financial firms, consumers, and other parties regarding its approach to resolving key issues in the complaints it deals with. The approach documents that AFCA has published to date are helpful resources that facilitate a common understanding of all parties' rights and obligations.

The ABA is concerned that publication of an approach document for small business lending in its current form may negatively impact the flow of credit to small business for reasons outlined in this submission, and we encourage AFCA to reconsider whether a public approach document to small business lending in its existing form is appropriate.

A principles-based approach would reduce the risk of the draft SME Approach being interpreted as 'minimum requirements' or regulation for lending to small business. It would also better acknowledge the growth and opportunity presented by automated decision and omni-channel decision pathways, consistent with banks' individual credit policies, and permit lenders to evolve their practices and further support more consistent lending outcomes and efficiency in accessing credit.

In this regard, we note that while AFCA's draft SME Approach inadvertently places a significant emphasis on traditional credit assessments (via additional information, factors, and warning signs, etc.) to minimise and reduce risk, automated decisions and omni-channel decision pathways achieve similar and more consistent outcomes, as they rely on structured data. We note the two types of assessments are not binary, and there are times when a hybrid approach is taken. Introducing prescriptive guidance assumes one application over the other and hinders more complete and accurate assessments.

Should AFCA remain of the view that such a document should be published, we urge AFCA to adopt a principles-based approach based on established principles, standards, and requirements in small business lending, such as the BCOP, to ensure that lending to small businesses is not restricted and is consistent with existing requirements. We note that we are aware AFCA is currently considering the removal of prescription from the draft SME Approach and we are supportive of this change.

The ABA requests the opportunity to work with AFCA to provide further input on how a principles-based approach can be set out should AFCA proceed with this alternative and thank AFCA for engaging with the ABA at multiple points during this consultation process.

2. Response to AFCA consultation questions

The ABA provides the following comments in relation to AFCA's consultation questions on the draft SME Approach. We note that some of these comments relate to the approach document in its current form. It is our view that a principles-based approach would not require this level of detail or prescription.

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2.1 Section 3 – How we decide if a financial firm has met its lending obligations

Response to question 1:

Defining small business

AFCA's Rules at E.1 defines a "small business" as a business (or a group of related bodies corporate) with less than 100 employees. AFCA may exclude a complaint brought by a small business when the credit facility exceeds $5.425 million.

The BCOP definition of small business differs from that of AFCA. A business will not be covered by the BCOP unless it has "less than $3 million total debt to all credit providers" (noting we have announced an intention to increase the BCOP threshold to $5 million, and some BCOP subscribers already apply this threshold). While the draft SME Approach states that AFCA will apply industry codes 'where relevant', in our view the document could make clearer that codes are not relevant where their obligations do not extend to the business in question.

The ABA notes in consultative discussions with AFCA about the draft SME Approach, AFCA stated the technical BCOP provisions relating to guarantors will only be applied when BCOP applies, and not more generally as a reflection of good practice. We think this is an appropriate distinction and should be reflected in the draft SME Approach to ensure better alignment with existing compliance arrangements and processes.

Sections 3.1 – General obligations

AFCA states that in reviewing a financial firm's lending decision, AFCA will have regard to information that was reasonably available at the time, including about resources available to the small business.

Lenders have continued to advance their use of automated credit decision tools, where possible, instead of applying a traditional manual credit assessment and decision-making approach. The use of an automated credit decision tool cannot, in practice, consider the resources available or not available to a small business at the time. Rather, automated decisions led by sophisticated algorithms and structured data will rely on credit policies, regulatory requirements and other standards, which allow for better consistency in lending outcomes. Lenders will often supplement automated decisions with other inquires, which should not trigger the full list of additional considerations.

The ABA notes that the content of the draft SME Approach is weighted towards AFCA's approach to reviewing complaints about the approval of loans to purchase a business or start a business. A detailed approach document, as opposed to a principles-based one, would require more content on how AFCA will assess complaints about lending to existing customers who have established account conduct, and about lending approvals based on automated models. In this regard, we note clause 51 of BCOP, which contemplates the assessment of loans based on account conduct.

A detailed approach document also would require further guidance on the different considerations that would be applied by AFCA to credit decisions to rollover or extend existing facilities, in contrast to AFCA's approach where new credit is provided.

We also note the draft SME Approach in its current form goes beyond the intention of APRA to create a "flexible and scalable" approach[1] to allow financial firms the opportunity to develop their own detailed credit assessment processes in compliance with industry standards, such as the BCOP, and relevant regulatory frameworks and case law. We consider it critical that a scalable and flexible approach to

[1] Section 40, Prudential Standard APS 220 – Credit Risk Management.

lending be taken to enable an assessment of a borrower's credit risk to be taken that is proportionate to the nature, type and size of the exposure.

The ABA would also welcome the draft SME Approach include an explicit expectation that a borrower should act in good faith, being complete and truthful in all dealings with their lender and AFCA. We note the draft SME Approach, in its current form, appears to focus predominantly on the financial institution being accountable for its actions without a reference of the borrower's responsibility to act in good faith. While this does not preclude the need for lenders to verify statements made by borrowers, we encourage AFCA to also include any relevant obligations of the borrower in the document.

Section 3.2 – Information we request from the parties

Section 3.2 of the draft SME Approach states that AFCA may draw an adverse inference where information is not provided by a party to a complaint. We note that AFCA's Rules (A.9.5) state an adverse inference may only be drawn where the missing information *is of material importance*. We recommend this matter be clarified in this section of the document.

Section 3.4 – The purpose of the credit contract

AFCA expects a financial firm that is bound by the *Australian Securities and Investments Commission Act 2001* (Cth) to ensure the credit product is reasonably fit for the purpose of the small business. In addition, AFCA provides examples of where it may consider the loan not reasonably fit for purpose, specifically, where a credit facility requiring a monthly repayment is provided to a small business customer with seasonal income. Banks are broadly comfortable that lending practices require obtaining an understanding of the loan purpose and any circumstances that may apply or change.

However, we question the appropriateness of the example offered regarding a business with seasonal income and consider it should be revised. We also note that banks will often accept a generic purpose, such as "working capital".

The implications of the approach taken in this example would introduce a prescriptive nature to assessing loan purpose. It would also add process and product complexity, limit banks' ability to adequately monitor hardship and burden the customer with larger repayment amounts, acknowledging there are many variables in a customer's business model that can change. This section of the draft SME Approach may also impact small business customers by limiting access to funding, or customers with seasonal incomes, such as farmers, who often have a mix of monthly and annual repayments over different facilities.

Section 3.5 – Considering if the credit assessment was appropriate

Banks make lending decisions in accordance with regulatory requirements, as well as individual bank credit policies, and assess lending in accordance with a customer's size, risk, and complexity of the lending on a case-by-case basis. This means that lending may be based on, and will be proportionate to, the nature of the loan and the risk to the borrower. We suggest that omitting this important foundation point may mislead consumers and complainants about the level of verification that is required for their credit application in certain circumstances.

We request that AFCA explicitly reference this concept and explain how it is incorporated in its consideration of complaints.

Response to question 2:

Section 3.5 – Considering if the credit assessment was appropriate

The ABA has concerns with the level of prescription in this section of the draft SME Approach. While not AFCA's intention, in practice, the list of relevant 'factors or information' under section 3.5 that a credit provider may need for a credit assessment, and the detailed list of circumstances that may prompt an obligation to make further inquiries (section 3.6, pages 24-26), may provide a 'complaint checklist' for

small business borrowers to raise claims that may not otherwise have been made. These lists take the guidance in the direction of codification.

Automated credit decision-making

The non-exhaustive list of factors on page 19 of AFCA's draft SME Approach may not be relevant to an automated assessment.

There are significant and justifiable differences in the type and nature of information used in automated assessments, which are commensurate with the size, risk, and complexity of the lending, in comparison to manual credit considerations. For example, large and complex lending will proceed through manual credit assessments, while simple lending may proceed through automated assessments. Automated decisions use proxies for traditional considerations. The distinction between the two types of assessment is not binary. We recommend the approach document should address this and acknowledge the significant undertaking it would be for banks to align processes if the draft SME Approach remains its current form.

We note the approach developed by AFCA includes a few references to credit reporting as a valid means of checking a customer's existing liabilities. However, it does not include a reference to open banking. In addition, the examples that are provided heavily rely upon customer declarations and the forensic examination of transaction statements. In this regard, the recency of data used in the automated decision provides a more accurate reflection of the current business performance and capacity to repay loans, compared to historical approaches of obtaining financial documents which are increasingly becoming outdated. The ABA submits that draft SME Approach should refer to the fact that verification practices (and credit decisions practices) may reasonably change over time as the financial landscape changes or innovations are made. This should assist in extending the longevity of the document and reduce the risk that it becomes out of date or redundant.

Account conduct

AFCA states that financial firms must consider the circumstances reasonably known to them about the small business' financial position or account conduct when assessing whether the small business can repay the loan.

We note that it is difficult to formulate prescriptive guidelines relating to account conduct without a common and agreed industry-wide understanding of what is meant by account conduct. This is particularly important as account conduct is relied upon for automated credit assessments, and there is an inherent problem in saying that either manual credit assessment or account conduct will apply. There are times when a hybrid approach is taken, for example, the assessment will be based on account conduct, but other information is also obtained and assessed outside of the account conduct assessment.

Specialised professional advice

Some of the factors set out in the draft SME Approach may imply that bankers can provide business advice. Within the framework of the relevant regulatory regimes, bankers sometimes provide financial and credit advice, and tend to have knowledge on industry and market conditions. However, banks encourage small business customers to seek expert and specialised advice from trusted advisers, such as accountants, bookkeepers, and business consultants, to ensure they are making informed decisions regarding their business, and do not provide business advice in this regard.

We note there are instances where a banker may assess some factors that are relevant to the overall lending decision, regardless of a customer's reliance on advice from a specialised advisor. Some examples of these factors include:

- *The premises lease includes restrictions or obligations that are relevant to the assessment* – this factor would depend on the circumstances of the customer and how they planned to generate

revenue, such as the customer purchasing a hotel with a liquor licence. While this factor would be relevant in the case of this customer, in many cases, businesses are not dependent on a venue in a comparable way.

- *Independent valuation report of the business premises* – this factor and the report may not be considered if a small business is not using the premises as a security.

Expertise of the business operators

The capacity and expertise of the business operator is not an easily quantifiable measure. While banks will likely have procedures in place to consider the operator's expertise in the industry relating to the loan, many business owners that have less experience in an industry may seek business advice throughout the journey of their business' operations. As highlighted above, assurance that the business operator will make the decision to seek additional counsel in areas of limited expertise is encouraged by banks but ultimately lies with the small business. We encourage this point be clarified in the draft SME Approach and note it is important that innovation not be stifled.

Funding the owner's lifestyle

We query whether this is an appropriate criterion for the purpose of reviewing a credit assessment.

Banks assess the purpose of the loan for business requirements and perform serviceability and affordability assessment using structured data and credit strategy via automated decisions or using certain systems for manual assessments. Banks also consider the proposed drawings when reviewing proposed cash flows, acknowledging that drawings are circumstantial year-on-year and subject to change, as business owners can choose to use drawings for personal reasons or to fund other business investments or operations.

A customer can also adjust their lifestyle to accommodate their lending and avoid compromising their business. For example, if a business stops making money during a period, the business owner can restructure their business to support it during this period.

Regarding this criterion, the ABA also notes that for many lower value loans, cash flow projections are not provided by customers as part of the lending assessment.

Sale of assets

The ABA encourages AFCA to clarify that the sale of assets can be taken into consideration and account as an agreed source of repayments.

Response to question 3:

Section 3.6 – Considering if the financial firm should have asked for further information or clarification, and Section 3.7 – Other matters that may be relevant to our decision

'[redacted] and car wash' example

Banks generally make credit decisions using information provided by the customer about the business or potential business at a point in time, and for lower value loans, less information is obtained.

In the example provided involving [redacted] and the car wash at section 3.6 of the draft SME Approach, AFCA implies that lenders should consider matters such as site assessments that could reveal, among other things, the likelihood of competitors establishing nearby businesses in the future. A car wash is not a unique industry, and a competing car wash in proximity is not necessarily a cause for concern. Many car washes and common business types operate within proximity of each other in suburbs.

The ABA notes that banks may not be able to account for potential future competing businesses and considers this factor may relate to 'hindsight', which AFCA notes is not part of their deliberations in other sections of the draft SME Approach.

Banks may, however, rely on information that the customer did not provide where it relates to industry knowledge that a local banker would be expected to know, such as reviewing forward pricing and the forward market to assess fair values when considering the customer's revenue projections (such as in the case of agricultural banking). However, detailed analysis of business risk and due diligence is unlikely to be undertaken by banks, which we consider to be the responsibility of the borrower.

Businesses are vulnerable to changes in the business environment, both known and unknown. The ABA notes that AFCA's draft SME Approach does not comment on whether AFCA considered other factors that could have led to the business' failure after the fact.

We encourage the draft SME Approach clarify that business risk and due diligence regarding the business is the responsibility of the business owner and that they seek expert and specialised advice from trusted advisers in this regard.

Examples generally, and implications for the 'diligent and prudent banker' standard under BCOP

The 'diligent and prudent banker' standard in BCOP, in its application to small business lending, requires banks, when assessing whether a customer can repay the loan, to consider the appropriate circumstances reasonably known a bank, including the customer's financial position or account conduct. A broad obligation such as this can be flexibly applied to individual circumstances that arise in complaints made to AFCA.

The ABA notes that some of the examples of further inquiries that should have been made arguably go beyond what is expected under the diligent and prudent banker test (for example, that a financial firm should identify if there is a competitor opening on the street, or that one particular employee's wages are missing in a forecast). AFCA has also suggested that a financial firm may not comply with its obligations if it misses "hidden risks" in documents.

The ABA suggests that it should be found that a financial firm has omitted to make reasonable inquiries only if they are more obvious omissions, discrepancies or red flags. Comparatively, the examples provided in the draft SME Approach indicate that lenders must closely examine contracts and financial documents to scrutinise all possible information in intricate detail for each application.

We note the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry noted it did not favour altering the rules that govern lending to small business or imposing *National Consumer Credit Protection 2009* (**NCCP**)-type obligations on lending to small businesses.[2] This was in recognition of the need to ensure that small businesses have access to reasonably affordable and available credit.[3] We encourage AFCA to further consider this issue and the impact that extending the requirements under the diligent and prudent banker test (whether advertently or inadvertently) may have on lending to small business.

2.2 Section 4 – How we determine fair outcomes and calculate loss

Response to question 4:

The ABA notes AFCA's approach to calculating loss where the lender has breached their obligations but considers that a narrower approach could be adopted, focussing on the loan amount and applicable interest that triggers repayment difficulties, rather than the broad methodology proposed.

[2] Page 94, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry final report, https://treasury.gov.au/sites/default/files/2019-03/fsrc-volume1.pdf.
[3] Page 95, bid.

Section 4.2 – General principles we apply when assessing these complaints

Waiving the principal amount borrowed is generally not appropriate

AFCA states that in some circumstances, AFCA may determine that reducing or waiving the principal amount is fair.

Specifically, the first bullet point states that the principal may be waived where the small business borrower has not received the benefit or use of the loan funds. However, it is not clear whether this would only be the case if the financial firm was on notice that the borrower would not receive the benefit. The third bullet point mentions the possibility of principal waiver where the financial firm is on notice of lack of benefit. However, the omission of 'notice' from the other bullet point suggests AFCA may consider waiving loan principal where the borrower claims to have had no benefit or use of the funds, even where the financial firm was not on notice.

As an alternative to the examples, the ABA recommends the description of when the principal amount may be waived, and the three examples provided, be replaced by a clearer statement of principle and a case example.

We suggest that the statement of principle set out that any principal amount should only be lost where both unconscionable conduct is involved, and the financial firm could reasonably be expected to know that the small business would not gain any benefit from the principal amount borrowed. An example of absence of any benefit may be where the funds are known to be given from the borrower to a third party for the use solely by the third party.

Additionally, we note the concept of 'benefit' is widely construed, and a small business borrower may claim lack of benefit where the loan funds have been used in a way that ultimately did not benefit the business or the owner/director, such as a failed business decision. We encourage AFCA to define and/or narrow the circumstances where the loan principal may be waived.

Dealing with secured debts

AFCA advised that where it finds there has been inappropriate lending and the loan is secured, it will consider if the security should be released. The description of when a security for the facility may be required to be released should be further clarified. The reference to "improperly or negligently" obtaining security is unclear, and it is not considered that taking of security is ever likely to be negligent.

A financial firm takes security for its own purposes as a secondary source of loan repayment that may be enforced if the borrower is unable to repay the loan. If the borrower's complaint is about inappropriate lending and the affordability of a loan, it is unclear why AFCA would separately be reviewing how the financial firm had taken security.

We suggest that a statement of principle should make clear that:

- Breach of the lending obligations (i.e. inappropriate lending) alone will not result in security needing to be released.
- There must be some further conduct, e.g., unconscionable conduct, in relation to the taking of the security to justify the release.
- If such conduct is present, a release will not be required where the security is over an asset or a share of equity in an asset acquired with the borrowed amount.
- This also applies to continuing an amount of liability under a guarantee that is secured by a security given by that guarantor, where the borrowed amount has been used to acquire the asset of the guarantor over which the security is held or increase the equity of that guarantor in that asset.

A borrower being able to provide security for a loan should simplify the availability of credit, whereas the opposite is suggested in the draft SME Approach.

Repayment of an adjusted debt

AFCA states it will apply a flexible approach to deciding how an adjusted debt should be repaid. This may include reducing or varying the interest rate payable on any adjusted debt balance.

The ABA considers that any reduced interest rate to be applied should be set as a discount to the usual contract rate, and not by reference to rates such as the RBA cash rate. Requiring a financial firm to apply the RBA cash rate requires long term manual monitoring and implementation and does not reflect a commercial rate.

A detailed approach document would also require guidance on the obligations on a financial firm should a borrower seek to restructure or refinance a debt that has been adjusted by an AFCA Determination. For example, whether or not a financial firm may be able to charge interest at its normal rate for an adjusted debt that the consumer has asked to be refinanced or restructured.

Adjusted debts with no interest to be charged

The case study on page 31 (section 4.2) provides an example of an adverse finding against a bank and a determination that the debt should be adjusted. Additionally, in this example the bank was not entitled to charge interest going forward, and the debt could be repaid over the original loan term.

The ABA requests further information on the factors AFCA would consider in deciding whether an interest free debt should be repaid over the loan term and considers there should be limited circumstances in which this should occur.

Section 4.6 – Indirect financial loss and non-financial loss

The ABA encourages AFCA to clarify that it does not generally award non-financial loss to corporate entities. It may also be helpful to mention the compensation caps on non-financial loss and indirect loss (noting that they are amended due to indexation from time to time).

2.3 Other feedback

Response to question 5:

The ABA has provided feedback on the examples used in other parts of this submission.

More broadly, the ABA notes there are a number of case study examples in the document that are not about credit assessment issues. For example, the case study on page 34 relates to obligations when arranging a guarantee, and the example on page 39 relates to misleading conduct. We also note the guarantee case study does not refer to AFCA's published approach about guarantees or identify BCOP as the source of the various obligations referenced on this page.

Section 4.2 – General principles we apply when assessing these complaints

We may apportion loss between the parties

The ABA supports apportioning loss where the customer has contributed by providing false or misleading information. We consider an example case study would be helpful to show the factors that AFCA may consider and how it may affect the remedy.

Response to question 6:

We note that AFCA acknowledge that business lending is not regulated by the NCCP but, given there are other regulations that apply, the name 'appropriate lending' has been adopted by AFCA.

We are concerned that the use of the term 'appropriate lending' prima facie is further reaching and may extend obligations of banks in comparison to the 'not unsuitable' requirement of the NCCP. The term 'not unsuitable' in the NCCP places responsibility on the customer to prove that the loan was unsuitable. It does not extend the requirement to the lender to prove it was suitable. A loan will be deemed 'not unsuitable' if it meets the customer's needs and objectives, and the customer has the capacity to repay the loan without experiencing substantial hardship.

Potentially, the implication of AFCA's draft SME Approach could be that it places a burden on the lender to prove the loan was 'appropriate', as opposed to the borrower proving that the loan was 'not appropriate'. In addition, the use of an umbrella term such as 'appropriate lending' may encourage a misconception that there is a single objective standard to which lenders should be held.

Response to question 7:

In addition to the comments made above, the ABA makes the following comments with respect to other sections of the draft SME Approach:

Section 2.1 – AFCA's fairness jurisdiction

- AFCA's 'fairness jurisdiction' holds regard to the law, codes and standards of industry practice that were in place at the time of the conduct. This is a broad statement and does not consider that there are differences in the definitions used by these laws, codes and standards that vary in nature. We need to ensure that the definition of 'fairness' does not conflict with what is validated by other regulatory bodies in terms of appropriate origination practices and responsible lending. A more direct definition of fairness with greater links to regulation would be beneficial to align existing requirements with AFCA's approach.

Section 2.3 – Information about small business complaints AFCA can consider

- Page 9 has information about the effect of a prior Farm Debt Mediation on AFCA's ability to consider an inappropriate lending complaint. It is unclear what the second dot point is trying to convey, and we suggest this be clarified in the draft.
- AFCA could consider including information about the time-period to lodge complaints at AFCA under rule B.4.3 of AFCA's Rules.
- The ABA understands AFCA does not consider complaints about any agreements reached at Farm Debt Mediation and seeks confirmation of this point.
- We seek guidance on whether AFCA considers an invitation to Farm Debt Mediation to be enforcement or recovery action that is restricted by AFCA Rules while an AFCA complaint is open. We note the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry recommended Farm Debt Mediation occur at an earlier time in the process or as soon as the loan is classified as distressed[4], which may not align with AFCA's position if it considers Farm Debt Mediation to be part of recovery. The ABA requests clarity in this regard. The ABA notes the existence of existing material relating to Farm Debt Mediation via the Department of Agriculture, Fisheries and Forestry's National Better Practice Guide for Farm Debt Mediation.

Section 3.4 – Information about when AFCA may decline to rely on a Business Purpose Declaration

- The provision referred to in the NCCP is a 'criminal offence' provision. Given the complexity of the test, it would be helpful if commentary and any examples related to deliberate behaviour by a banker to misclassify a loan as opposed to error.

[4] Page 100, bid.

Section 3.1 – General considerations and section 3.6 – Considering if the financial firm should have asked for further information or clarification

- AFCA refers to 'warning signs' in these sections. It is the ABA's view that this term should be limited to matters the bank should reasonably be expected to know of these signs.