



29 September 2023

Mr David Locke
CEO and Chief Ombudsman
Australian Financial Complaints Authority
GPO Box 3
MELBOURNE VIC 3001

Submitted via email to: [REDACTED]

Dear Mr Locke,

Re: AFCA Approach to Appropriate Lending to Small Business

The Australian Finance Industry Association (AFIA) is the only peak body representing the entire finance industry in Australia.¹ We appreciate the opportunity to respond to the Australian Financial Complaints Authority (AFCA) consultation on the new *Approach to Appropriate Lending to Small Business* (the Approach).²

We represent over 150 members, including bank and non-bank lenders, finance companies, fintechs, providers of vehicle and equipment finance, car rental and fleet providers, and service providers in the finance industry. We are the voice for advancing a world-class finance industry and our members are at the forefront of innovation in consumer and business finance in Australia. Our members finance Australia's future.

We collaborate with our members, governments, regulators and customer representatives to promote competition and innovation, deliver better customer outcomes and create a resilient, inclusive and sustainable future. We provide new policy, data and insights to support our advocacy in building a more prosperous Australia.

¹ [Australian Finance Industry Association \(afia.asn.au\)](https://www.afia.asn.au).

² <https://www.afca.org.au/news/consultation/new-approaches/appropriate-lending-to-small-business>.

INTRODUCTORY COMMENTS

On [18 August 2023](#), AFCA released the proposed Approach to Appropriate Lending to Small Business (the Approach).

AFIA believes that external dispute resolution is an important part of a strong, accessible, competitive, innovative, efficient, and fair financial system. We support AFCA's ongoing commitment to help ensure high standards when it comes to the provision of credit to small businesses. As part of AFIA's self-regulation, AFCA membership is a mandatory requirement for our members who are signatories to our industry codes related to lending to small businesses.³

AFIA supports AFCA progressing with the recommendations of Treasury's review of AFCA, published in November 2021.⁴ A key theme arising from Treasury's review of AFCA considered if it was meeting its objective to resolve complaints in a way that is fair, efficient, timely and independent.⁵

We are proud to represent Australia's entire finance industry, including a significant cohort of our members who lend to small businesses.

According to the Australian Bureau of Statistics (ABS), Australia's total annual GDP is approximately \$2.3 trillion.⁶ Yet, the Reserve Bank of Australia (RBA) estimates total credit provided to Australian businesses and consumers is \$3.46 trillion.⁷ This means the total amount of credit in the Australian economy is equal to 150.43 per cent of Gross Domestic Product (GDP). Through providing credit, the Australian finance industry stimulates our economy and helps individuals and businesses to invest, thrive, achieve their aspirations and fulfill their dreams.

AFIA recognises that lending to small business is essential to growth and investment. As the Minister for Small Business, the Hon Julie Collins MP, recently said on 13 September 2023, 'small businesses are the engine room of the economy' and the Government is committed to 'help[ing] them prosper'.⁸

³ See our [Online Small Business Lenders Code](#) and our [Insurance Premium Funding Code](#).

⁴ [The Treasury \(24 November 2021\) Review of the Australian Financial Complaints Authority - Final Report](#)

⁵ Treasury review of AFCA, 'Delivering against statutory objectives', [page vi](#) (n 4). See also: [Australian Securities and Investments Commission \(ASIC\) Regulatory Guide 267 \(21 September 2021\) Oversight of the Australian Financial Complaints Authority](#), Part D: AFCA Compliance requirements, page 25.

⁶ Australian Bureau of Statistics (ABS), *Key National Accounts Aggregates* (September 2022), Table 1, Column CT: [Australian National Accounts: National Income, Expenditure and Product, June 2022 | Australian Bureau of Statistics \(abs.gov.au\)](#)

⁷ RBA, *Lending and Credit Aggregates* (September 2022), Table D2, Column H: [Statistical Tables | RBA](#).

⁸ The Hon. Julie Collins MP (Minister for Small Business), 'Albanese Government delivering new support for Australia's small businesses' ([accessed 18 September 2023](#)).

According to the Australian Small Business and Family Enterprise Ombudsman (ASBFEO):⁹

- There are 2.5 million small businesses in Australia, representing 98 per cent of all businesses.
- Small businesses employ 5.1 million people.
- Small business generates \$500 billion in economic activity annually, accounting for one third of Australia's total GDP.

Research by AFIA members further indicates that:

- For every \$1 million in small business lending, there is up to a \$4 million increase in GDP.¹⁰
- For every \$1 million in small business lending, up to 57 full-time equivalent jobs are created.¹¹

Financing small businesses helps entrepreneurs create and grow businesses, supporting themselves and their families and their workers. It also means businesses can employ more people. Small business need access to specialised products and services, which means that applying standardised or highly prescriptive rules will adversely impact on the cost and availability of credit to small businesses.

If access to small business finance is inappropriately restricted or unreasonably constrained, there will be fewer businesses, fewer jobs, fewer lives empowered through work, fewer goods and services provided across our economy, less economic activity, less growth, lower productivity, and ultimately less revenue to be collected in taxes and reinvested in government services that benefit all Australians. This is why AFIA opposes the Approach put forward

Furthermore, AFIA agrees with ASBFEO that overly onerous regulation limits lending to small business, which will inevitably lead to less finance for entrepreneurs, stifling the \$500 billion in GDP and over 5 million Australian jobs that come from the small business sector.¹²

AFIA also notes that, as many of our members have expressed in the firmest terms, small business lenders do not have an interest in lending money which borrowers cannot afford to repay, given small business lenders own business models require loans to be repaid.

The Approach proposed is fundamentally inconsistent with core aspects of Australia's existing legal framework for credit regulation. Specifically:

1. Small business lending is excluded from the Responsible Lending Obligations (RLOs), present in ss 128 to 132 of the *National Consumer Credit Protection Act 2009* (Cth), (Credit Act), by virtue of [regulation 28RB](#). Small business lending is also not included in the definition of credit under the [National Credit Code](#).¹³ Small businesses and entrepreneurs are, on average, more financially literate than consumer borrowers and capable of dealing with

⁹ ASBFEO, [Small Business Matters \(June 2023\)](#), 1.

¹⁰ Prospa, RFI Group and the CIE, [The Economic Impact of Prospa Lending to Small Business](#) (January 2019), 26.

¹¹ *Ibid*, 28.

¹² ASBFEO, [Small Business Matters \(June 2023\)](#), 1.

¹³ Section 5.

material business risks. Therefore, while it is appropriate to maintain 'fair' and 'efficient' and 'honest' standards of conduct, as is required under the *ASIC Act 2001* (Cth)(the ASIC Act), it is not appropriate to apply the more rigorous standards like RLOs.¹⁴

2. The Approach proposed contradicts the principles underlying Australian credit law, enshrined in the Explanatory Memorandum of the National Credit Code (NCC)'s injunction to pursue laws which are 'flexible' and 'non-prescriptive'.¹⁵ The Approach proposed is overly prescriptive and would impose risks on financial firms which go over and above the intentions of the document and risk confusion among parties (including financial firms and AFCA staff applying the Approach in practice).
3. The Approach proposed imposes stricter requirements on small business lending than even those which exist under the RLOs, from which small business credit is specifically exempt.¹⁹ As AFCA is a dispute resolution service, and not a regulator, it is crucial that the Approach avoids unintentionally creating new or additional legal standards. It is also crucial for the Approach to reflect industry practices of a modern finance industry, including advances in technology and the impact on the offer and distribution of products and services.
4. The Approach's inflexible approach to assessing credit decisions is inappropriately more rigorous than the principle of scalability under existing law and RG209.¹⁶ This is not appropriate, given RG209 does not apply to small business lending.

The detail of the above points is further outlined in **Attachment A**.

Furthermore, AFIA expresses specific concerns with the following aspects of the Approach:

1. The assertion that, in making determinations, AFCA can consider not only the matters specifically enumerated in the Approach but: 'any information [AFCA] consider[s] to be relevant'.¹⁷ This severely undermines the value of the Approach in providing certainty to financial firms regarding what the relevant considerations will be and, therefore, creates further and additional risks that may adversely impact on the cost and availability of credit to small businesses.
2. The use of the overly vague term of 'good industry practice', without clearer definition.¹⁸
3. The suggestion that industry codes could be applied inappropriately 'beyond subscribers' to those codes. We note industry codes are developed by particular industry associations and their members and reflects the nature, scale and complexity of the businesses of those financial firms, their target markets and customers, and other operational factors.¹⁹

AFIA believes it is essential that the approach taken by AFCA to business lending complaints is clear, easily understood, consistent, relevant, legally compliant, and scalable. For these reasons,

¹⁴ Section 912A.

¹⁵ Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth), 6.

¹⁶ [ASIC RG 209.87](#).

¹⁷ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 11.

¹⁸ *Ibid*, 16.

¹⁹ *Ibid*.

AFIA has significant concerns with the proposed Approach and recommends that it be amended in line with the proposals in **Attachment A**.

CLOSING COMMENTS

Thank you for providing the opportunity to respond to this consultation.

AFIA notes that small business lenders are not required to join AFCA. However, a number of financial firms, and AFIA members, see the value of AFCA in supporting external dispute resolution and achieving better outcomes for customers and financial firms. Our members look forward to collaboratively and constructively engaging with AFCA as the Approach is further developed.

AFIA would like the opportunity to discuss our recommendations and provide further information about the small business lending market, including latest industry developments, customer expectations regarding accessibility of credit, and how technology and the digitisation of finance is providing better customer and business outcomes.

In the meantime, should you require additional information, please contact AFIA Senior Policy Adviser, Sebastian Reinehr at [REDACTED]

Yours sincerely



Diane Tate
Chief Executive Officer

ATTACHMENT A – AFIA’S RESPONSE TO ISSUES RAISED IN AFCA’S SMALL BUSINESS LENDING APPROACH

Issue	Member Feedback
<p>1: Who is eligible?²⁰</p> <ul style="list-style-type: none"> • Small business is defined in the AFCA rules as businesses with less than 100 employees. • Stricter obligations may apply if the small business lent to meets definitions in other Acts, for example under the ASIC Act: <ul style="list-style-type: none"> ○ Less than \$25 million in annual turnover ○ No more than 50 employees. ○ Under \$12.5 million in assets. ○ The Approach does not apply to credit regulated by the NCCP. • AFCA can only consider complaints related to AFCA members. • AFCA cannot consider complaints where the credit facility exceeds \$5.425 million. <p>Examples of the types of products covered.²¹</p> <ul style="list-style-type: none"> • A non-exhaustive list of the types of products covered is outlined on page 5 of the Approach and includes: <ul style="list-style-type: none"> - Lines of credit - Business loans - Business credit cards 	<ul style="list-style-type: none"> • AFIA recommends that the Approach should not apply to any loans which were written prior to the Approach being finalised. • AFIA believes small business lending is fundamentally different to consumer lending. A risk decision is made by the business owner to borrow funds to ultimately benefit the business. There should be an onus on the borrower to make such an assessment and this should be reflected in AFCA’s Approach. • AFIA support AFCA’s alignment of the definition of ‘small business’ with that under s 128F of the ASIC Act, given its relevance to Unfair Contract Terms (UCT) regarding small business contracts. • AFIA recommends the list of the types of products to which the Approach applies be made exhaustive, to ensure clarity regarding exactly what aspects of the approach apply to what products. • Terms such as fairness and fair dealing are ambiguous – further consideration should be given to these concepts. • AFIA supports the limitation on damages claimable for indirect and financial losses of \$5,000, consistent with the AFCA Rules.²³ • If AFCA’s decision requires the financial firm to refrain from taking particular actions, prior to AFCA providing the final decision to the

²⁰ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 6-7.

²¹ Ibid, 5.

²³ Ibid, 40.

- Commercial leases
- Goods mortgages
- Hire purchase agreements
- Commercial bill facilities
- Insurance premium funding

2: How AFCA assess appropriate lending complaints

AFCA's Fairness Jurisdiction²²

- AFCA focuses on outcomes which reflect 'fair dealing, fair treatment and fair service'.
- AFCA can accept complaints related to both credit provision and credit limit increases.
- They can award remedies for direct and limited indirect and non-financial loss. They can also determine that a firm must do or refrain from doing specific things (p. 8).

AFCA considers the following sources of financial firms' obligations at the time the conduct occurred:

- The General Law - cases and status – i.e. contract law, negligence, equitable doctrines, negligence.
- Regulatory Guidance.
- Good industry practice and industry codes.
- Past decisions of AFCA and its predecessors.

small business, AFCA should consistently provide the financial firm with details of their proposed decision. AFCA should provide the financial firm with reasonable time to assess the impact of such a request and provide input on whether the suggested changes are possible based on processes, service standards and systems. If AFCA's proposed decision will result in unreasonable cost to the financial firm, AFCA should consider entering into consultation with the financial firm to arrive at an alternative action to achieve the same outcome.

- AFIA specifically supports AFCA strictly interpreting that such losses must only be awarded:
'Where a person has incurred an unusual degree or extent of physical inconvenience, time taken to resolve a situation or interference with the expectation of enjoyment or peace of mind, arising as a result of an error or breach of obligation by the financial firm'.
- AFIA recommends further clarification of the term 'good industry practice', which should be further defined.
- AFIA strongly recommends against industry codes being inappropriately applied 'beyond subscribers'.²⁴ It is key that the codes applied to particular products be relevant to those products specifically.

²² AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 7.

²⁴ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 16.

- AFIA further recommends:
 - AFCA be transparent and clearly set out with both financial firms and complainants, their basis for determining industry good practice in each case and provide accessible material to parties to refer to that explain how AFCA has reached its decision.
 - AFCA be clear that where an industry code has been developed, this code will be applied for those subscribers as relevant for their customers, products and services, and business models.
 - It is important to note that non-bank lenders, whilst not bound by specific industry codes, are subject to the ASIC Act and rely on ASIC Regulatory Guides. It is unreasonable for ASIC to impose additional non-legislative obligations on non-code lenders.
 - In AFCA's webinar on 4 September 2023, Suanne Russell, AFCA's Lead Ombudsman for Small Business, verbally stated that non-subscribers would not be bound by industry codes. The Approach needs to be clarified in this regard.
- Consistency with past **AFCA** decisions is only appropriate if those decisions are themselves consistent with the law and relevant industry codes as they applied at the time of the relevant conduct.

Section 3: How AFCA decide if a financial firm has met its lending obligations?²⁵

Overview of factors in making a determination:²⁶

On page 11 of the Approach it is outlined that – in determining if a financial firm’s lending decision was appropriate, ‘AFCA will have regard to’:

- the financial firm’s obligations at the time of the lending decision
- the financial firm’s process for reviewing a proposal and the factors it considered
- information that was reasonably available at the time, including about resources available to the small business
- if the financial firm should have known information or sought further information because the application included circumstances or information that should have prompted further inquiry, and
- the financial firm’s lending policies, if relevant.

Overview of AFCA decision-making process:²⁷

AFCA has indicated that to assess if a loan was appropriate, they normally take the following steps:

1. **Gather information** from the parties provided in the lending process
2. Consider the financial firm’s **obligations and good industry practice**
3. Consider the **purpose and requirements** of the credit facility

Consultation Question 1 - Do you have any comments about our proposed approach to assess whether a small business loan is appropriate

- It is AFIA’s view that the level of detail in the proposed Approach goes far beyond what is required under law of financial firm’s lending to small business customers, is overly prescriptive, does not reflect how business lending operates and customer expectations, and doesn’t recognise the digitisation of finance.
- Firstly, small business lending is specifically excluded from the Responsible Lending Obligations (RLOs), present in ss 128 to 132 of the *National Consumer Credit Protection Act 2009* (Cth), (Credit Act). Small business loans are exempt from the definition of credit in the [National Credit Code](#) (NCC). Therefore, RLOs do not apply.³⁹ This understanding of the law is reinforced in [regulation 28RB](#) of the Credit Act Regulations.
- Therefore, principles similar to those in the NCC should not apply, given the average level of financial sophistication among business borrowers, compared to consumer borrowers.
- However, this Approach does not just seek to apply principles similar to the NCC to small business lending, it goes further than that. Under the NCC, credit laws are meant to be ‘flexible’ and ‘non-prescriptive’.⁴⁰ This Approach contains 15 factors to be

²⁵ Ibid, 11-29.

²⁶ Ibid, 11.

²⁷ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 12.

³⁹ Section 5.

⁴⁰ Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth), 6.

<p>4. Review the financial firm's credit assessment</p> <p>5. Consider if there were warning signs or unusual circumstances that required the financial firm to make further inquiries or request further information</p> <p>Important factors to note:²⁸</p> <ol style="list-style-type: none"> 1. If a party does not give requested information to AFCA may cause an 'adverse inference'. 2. Where a financial firm claims information is 'commercial-in-confidence', AFCA may not rely on this in their decision making. 3. If a loan is 'system approved' and an industry code applies, AFCA expects firms to 'explain' how the firm's 'system' assessed the 'circumstances of the small business' to determine its 'capacity to repay' <p>Detailed Legal Obligations that Apply:²⁹</p> <ol style="list-style-type: none"> 1. Case law, applicable legislation, equitable doctrines like unconscionable conduct, contract law and misleading and deceptive conduct. 2. Financial firms that provide credit to small businesses may be subject to certain obligations under the ASIC Act, such as: 	<p>considered when AFCA decides whether or not a loan was appropriate on page 19. Furthermore, there are another 16 factors and 15 subcategories starting on page 24 where it could be held a lender should have sought more information. This goes far beyond what is legally applicable to small business lending, which is excluded from the Credit Act.</p> <ul style="list-style-type: none"> • Instead, AFIA believes AFCA should limit its consideration of lenders conduct to finance risks, not business risks. The list on page 19 to 24 should be removed and replaced with more focused considerations that relate purely to finance risks, not business decisions. Limited appropriate considerations would include: <ol style="list-style-type: none"> 1. was the type of loan fit for purpose? 2. did the lender mislead the borrower? 3. was the likelihood of financial failure obvious? For example, was the loan so 'manifestly unaffordable' that 'no reasonable lender would have approved the loan'? 4. does the loan operate unfairly? 5. was any discretion of the lender exercised unfairly or without reasonable basis? • Furthermore, the leading authority interpreting the RLO provisions, from which small business lending is excluded, is the <i>Australian Securities and Investments Commission v Westpac (2020)</i>¹⁸ ('ASIC v Westpac'). In that case, Justice Gleeson, then of the Federal
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²⁸ Ibid, 12-13.

²⁹ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 13-15.

- The statutory warranty to provide services with 'due care and skill' (s 12ED(1)(a)).
- The statutory warranty that financial services provided will be 'reasonably fit for purpose' (s 12ED(2)).
- The prohibition on unconscionable conduct (s 12CB(1)(a)).
- The prohibition on misleading and deceptive conduct (s 12DA(1)).
- Provisions related to unfair contract terms (ss 12BF-BL).

Industry Codes and Good Industry Practice:³⁰

- May consider whether the credit assessment complied with requirements set out in industry codes or 'good industry practice'.

Example Codes:

- Australian Banking Association's Banking Code of Practice (ABA BCOP)
- Customer Owned Banking Association's Customer Owned Banking Code of Practice
- Australian Finance Industry Association's Online Small Business Lenders Code of Practice
- Australian Finance Industry Association's Insurance Premium Funding Code of Practice
- May apply codes reflecting good practice 'beyond subscribers'.
- Only has to be 'good industry practice' not 'best' practice.

Court of Australia and now of the High Court of Australia, held that lenders bound by the existing RLOs can:

*'[D]o what [they] want in the assessment process...what [they] cannot do is make unsuitable loans.'*¹⁹

- Therefore, the Approach, as currently framed, imposes onerous and prescriptive obligations upon small business lending, which exceed even those applied to products covered by RLOs. This is despite the fact small business lending is excluded from the responsible lending regime.
- Moreover, a rigid or inflexible approach to assessing credit decisions goes further than the principle of scalability under existing financial services and credit laws. ASIC recognises that, in applying the RLOs consistent with the *Westpac* decision, one of the core concerns is:

*'The risk [emphasis added] or likelihood that a consumer will be harmed by taking on new financial obligations.'*⁴¹

³⁰ Ibid, 15-16.

⁴¹ [ASIC RG 209.87](#).

- Key question – there must be a credit assessment that forms a ‘reasonable view’ the borrower had ‘capacity to repay’.³¹

Purpose of a Credit Contract:³²

- Firms bound by ASIC must ensure a credit product is ‘reasonably fit for purpose’.

Examples of ‘fit for purpose’ considerations³³

- Is a product with monthly repayments ‘fit for purpose’ for a farmer with highly seasonal income?
- Is a loan term with exceeds the length of a given lease or franchise agreement ‘fit for purpose’?

Business Purpose Declarations (BPDs): that a loan is ‘wholly or predominantly’ for a business purpose, and therefore not covered by the NCCP may be **ineffective, if:** knew or had reason to believe, or would have known, or had reason to believe, if it had made reasonable inquiries about the purpose for which the credit was provided, or was intended to be provided, that the credit was in fact to be applied wholly or predominantly for a consumer purpose, or the business purpose declaration is not in the correct form

- AFIA strongly recommends that AFCA avoids:
 1. creating rules and practice expectations that do not recognise that small business lending is different to consumer lending, which is reflected in the policy decision not to include commercial lending under the NCC, and
 2. imposing rules and practice expectations that are highly prescriptive and/or are inconsistent with and/or exceed the overall policy intent of our existing laws and regulations as outlined above.
- AFIA has concerns that the term ‘good industry practice’ is vague which could lead to it being applied inconsistently.⁴² It should either be removed or further defined in consultation with industry.
- AFIA recommends industry codes should not be applied ‘beyond subscribers’, where they are not relevant to business models.⁴³
- Consistent with our concerns expressed above, the elements of the Approach related to the purpose of a contract could, in certain circumstances, exceed legal authority by applying a test similar to the ‘requirements and objectives’ test in [s 130\(1\)\(a\)](#) of the Credit Act to the provision of credit which is specifically excluded from those obligations via the definition of ‘credit’ in s 5 of the NCC and [regulation 28RB](#).

³¹ AFCA, 18.

³² Ibid, 17-18.

³³ AFCA, 16.

⁴² AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 16.

⁴³ Ibid.

- AFIA believes that both examples provided in the Approach of 'fit for purpose' considerations are problematic. Many franchise owners take lending facilities for terms far longer than the franchise agreement and successfully make all their repayments. Many farmers repay all kinds of credit facilities on monthly repayments without issue even though some or all of their income is seasonal. Unique circumstances apply to leases regarding monthly repayments.
- It is common to conduct small value credit assessments using a 'scorecard' methodology. AFIA seeks clarification of how this fits with AFCA's views on whether a financial firm has 'formed a reasonable view that there was capacity for the borrower to repay'.
- Scorecard assessments may not incorporate minimum financial information from the applicant to enable the financial firm to conduct a capacity calculation. A requirement to calculate a debt servicing capacity for small value transactions will negatively impact funding availability to small business due to the unscalable nature of the credit assessment process and resourcing costs incurred by financial firms.
- The nullification of legitimate BPDs proposed in the Approach should be amended. AFIA recommends the element of constructive knowledge be removed. A BPD should only be void if the lender 'in fact' knew the credit was for a consumer purpose or was 'negligent' in failing to realise the credit was for consumer purposes.⁴⁴

⁴⁴ The principles are applied should be consistent with s 13(3) of the NCC.

What Type of Assessment is Needed?³⁴

1. When considering a financial firm's assessment process, AFCA will consider
 - I. the type of financial firm
 - II. the type of credit product, and
 - III. the characteristics of the borrower
 2. There is a list of 16 factors to be considered when reviewing 'all the circumstances' of a particular credit applicant. AFCA notes this is just a 'guide' and not 'exhaustive'. Factors include:
 - I. The amount of the loan
 - II. If the loan is for a new or existing business and the circumstances of that business.
 - III. The income and resources of the business
 - IV. Whether the loan is to acquire income-producing capital
 - V. The expertise of the business operators
- All 16 possible factors are outlined on pages 19 to 20 of the approach.
 - AFCA will also consider if firms have applied 'appropriate buffers' for different scenarios.³⁵

- AFIA recommends removing the Approach's presumptions in favour of drawing an adverse inference where a firm does not provide certain information.
- The presumption against relying on claims of commercial confidentiality should be removed, as should the requirement to explain internal systems, which may themselves be commercially sensitive. This is necessary to protect the proprietary interests of financial firms who rely on complex and highly technical models to differentiate themselves in a competitive market.⁴⁵
- Further on adverse inferences, there may be legitimate reasons why information cannot be provided to AFCA, for example:
- Due to restrictions of other laws, such as in the context of the anti-tipping off provision in s 123 of the *Anti-Money Laundering Counter Terrorism Financing Act 2006* (Cth)(AML/CTF Act), OR;
- If phone recording is requested but unavailable due to a system error, AFCA could inappropriately draw an adverse inference.
- Therefore, if the adverse inference presumption is not removed, it should be rebuttable by a reasonable explanation, like the above.

³⁴ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 18-21.

³⁵ Ibid, 21

⁴⁵ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 12-13.

Firm Policies and Information:³⁶

1. **AFCA will consider if a firm applied its own internal policies in making an assessment.**
 - I. If a firm breaches its own policy, AFCA will consider if this breaches appropriate lending.
 - II. Compliance with internal policy is not sufficient to show credit was appropriately provided.
 - III. Non-compliance does not mean a provider has not complied with appropriate lending.
 - IV. A firm can use 'commercial judgment' to approve a loan that does not comply with policy,
 - V. Where it does, AFCA will examine if the policy provided for discretion and for explanation.
 - VI. Unique considerations apply to interest only loans, per page 22.

Consultation Question 2 - Do you have any comments about the non-exhaustive list of factors on page 19 that we may consider were appropriate for a financial firm to obtain or consider during their lending assessment?

- For the reasons expressed in response to consultation question 1, we believe the non-exhaustive list of factors is overly prescriptive insofar as it goes beyond the relevant legal requirements for small business lending given the exclusion of small business lending from the Credit Act via regulation 28RB and the definition in s 5 of the National Credit Code.
- The list of 15 factors, commencing on page 19, is both excessively detailed, going beyond the legal requirements outlined above. Yet, also vague as this detailed list remains 'not exhaustive' and 'only a guide'.⁴⁶
- Many of these criteria would require skills and abilities not expected of loan underwriters. For example, the ability to review contracts for potentially detrimental clauses in lengthy leases or business sale agreements would seem to require substantial legal training, for a risk that should be managed by the applicant's legal adviser.
- Under the proposed model, lenders can't lend safely without investing more time, and more skills in loan assessment which will delay access to capital and increase costs for borrowers.

³⁶ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 23-26.

⁴⁶ Ibid, 19.

Requirements to obtain information through reasonable inquiries:³⁷

2. If there are 'gaps or inconsistencies' in the 'information' provided to AFCA in their assessment they may consider if providers 'should have made further inquiries.' AFCA provides a list of indicators of this across 16 categories and 15 subfactors on pages 24-26.

- Some of the factors to be considered include:
 - I. The level of business experience of the owners/managers
 - II. The size of the businesses client base
 - III. Consideration of the nature of the suppliers upon whom the business relies
 - IV. The capital level of the small business
 - V. If one operator is managing multiple sites
 - VI. The level of detail included in the accountant's report
 - VII. Whether cashflow projections are realistic

3. Financial firm's must also consider:³⁸

- I. Were cashflow projections of a small business (and underlying assumptions) reasonable.
- II. If a firm would have made the loan whether or not it sought further information, AFCA will consider its reasons for that decision.

- AFIA recommends that this list be replaced with high-level principles, consistent with the NCC's objective of promoting credit laws which are 'flexible' and 'non-prescriptive'.⁴⁷
- The list on page 19 risks becoming a "checklist" used by AFCA case managers when assessing a complaint, which will potentially undermine lenders who have legitimately assessed the appropriateness and suitability of a loan but have not considered every single factor on page 19.
- The extensive checklist approach as proposed will have a chilling impact on small business lending. It renders lending materially less safe for lenders by creating a wide range of criteria for AFCA intervention.
- AFIA recommends any references to 'buffers' must be removed as this is a prudential term relevant to the banking sector, and not appropriate to the unique considerations of bespoke small business lending.⁴⁸ Introducing the expectation of buffers will restrict access to small business credit and drive up the price of funds.
- AFIA recommends that AFCA carefully consider their expectation for financial firms to provide explanations of their policies, where doing so may compromise commercially sensitive information.

³⁷ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 24-26.

³⁸ Ibid, 27-28.

⁴⁷ Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth), 6.

⁴⁸ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 21.

- III. The type of credit – different considerations for credit cards of discounted invoicing
- IV. A financial firm’s understanding of business decisions ‘knew or should have known’ provision of credit was ‘risky/’likely to cause loss’ by being ‘sufficiently informed of intended use’.

- Reference to a balloon exit strategy on page 20 introduces a consumer requirement to small business lending. It should be removed.
- Similarly, the requirement to consider whether the business received advice or should have received advice applies a consumer lending lens inappropriately.
- The concept of scalability hasn’t been explained in the context of the list of factors on page 19 and 20. There should be a way to distinguish between the loan purpose and type of loan and the factors to be considered. Whilst it is understood this is likely to occur when the complaint is made and being assessed, good guidance would provide this level of information.

Consultation Question 3 - Do you have any comments about the list of common warning signs on page 24 that AFCA may consider should prompt a financial firm to make further inquiries during the credit assessment process?

- Whilst the list of categories is suggested to be scalable the concept needs to apply within each of the categories as well.
- Consistent with our feedback in response to consultation question 2, we believe that these excessively detailed factors go beyond the relevant legal requirements.
- Consistent with our recommendation in response to consultation question 2, we recommend this list be removed entirely and replaced with a principles-based approach, consistent with the

	<p>underlying objective's of Australia's credit laws towards a 'flexible' and 'non-prescriptive' approach.</p> <ul style="list-style-type: none"> • If a more principles-based approach is not adopted, then AFIA recommends in the alternative that it be made expressly clear when each of the factors on pages 24-26 will apply to specific product classes, to provide clarity for financial firms. • If the list on pages 24 to 26 is kept, AFIA recommends that the considerations should be reframed to be in general or neutral terms, rather than in loaded or negative terms. For example, the factor '<u>minimal</u> business ownership/management/industry experience' should read '<u>level</u> of business ownership'.⁴⁹ • AFIA has concern with the ambiguity statement on page 24 that: <i>'AFCA is not suggesting that a financial firm must make further inquiries every time the application process reveals the circumstances listed below. However, we may determine that a loan is inappropriate if these circumstances are present, and we are satisfied that the financial firm would have discovered the loan was inappropriate by making further inquiries about the circumstances.'</i> • The net effect of this statement is to highly incentivise extensive, exhaustive investigation of whether the business owner has effectively managed their business risks. This level of investigation comes at a significant cost. • AFCA appears to expect underwriters and assessors to effectively step in as business consultants/accountants and lawyers to assess the viability of the business before approving a loan, or risk overlooking detrimental clauses in a lease or business sale
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⁴⁹ AFCA, 24.

agreement which should be brought to the customers attention and negotiated with the assistance of a legal representative.

This is not the proper role of small business lenders. AFIA has concern with the statement on page 28 that:

'AFCA will consider if a financial firm provided funds in circumstances where they knew, or should have known, the use of funds was risky or likely to cause the small business loss'.

Businesses can perform internal risk assessments. A lender should not be expected to take the role of a business/financial advisor.

- With respect to the factors to be considered many of the factors considered are business risks to be borne by the borrower, not finance risks to be borne by the lender. For example, we believe the following should properly be classified as business risks, not finance risks, thus not considered when deciding if a loan is unsuitable:
 1. the small business is lacking capital
 2. Cash flow projections show a negative position when revenue and variable costs are sensitised
 3. Cash flow projections are without assumptions, or based on unreasonable assumptions, but only if this would be obvious to a reasonable lender
 4. Inconsistent cash flow which may not match payment obligations
 5. The borrower or personnel involved in the business have poor credit histories
 6. Historical financial data is lacking for an ongoing business

	<p>7. Business transaction account features poor conduct, dishonoured drawings, fluctuations, deterioration of balance, late repayments etc.</p> <ul style="list-style-type: none">• Further clarification is required regarding what the term ‘vulnerable’ means in a small business lending context.⁵⁰• It is unreasonable to expect lenders to make further inquiries if a lender identifies the use of funds is high-risk. This expectation from AFCA shifts the burden of responsibility from the borrower to the lender with respect to making sound business/investment decisions. The lender’s responsibility should not extend beyond undertaking a credit assessment to determine the appropriateness of the loan.⁵¹• It is not realistic for lenders to know every aspect of the supply chain of their borrowers.⁵²• Expertise of a business operator can be subjective and it is inappropriate to ask lenders to infer this.⁵³• Greater emphasis needs to be placed on requirements for borrower’s to be open and forthcoming in the information they provide to lender’s, not expecting unreasonably exhaustive inquiries by lenders.
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⁵⁰ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 20.

⁵¹ Ibid, 28.

⁵² Ibid, 19.

⁵³ Ibid.

- The example given on page 19 expects an unreasonable level of enquiries by the lender. The example includes factors that may not have reasonably been known to the lender. In the example provided, the lender puts a significant amount of reliance on the security provided being the primary residence. The issues that need to be address is the use of a primary residence as security in situations where the lender would not otherwise lend the money.
- In the example on page 14, AFCA uses a high interest rate as an example of ‘unconscionable conduct’. The Australian Competition and Consumer Commission (ACCC) indicates:
*‘[T]here is no precise legal definition of unconscionable conduct as it is a concept that has been developed and considered on a case-by-case basis by courts over time’.*⁵⁴
- AFCA should provide a benchmark, ceiling or range of interest rates which they may consider unconscionable in certain circumstances, to provide greater clarity for financiers.
- AFIA strongly recommends that any reference to lenders assessing if customers businesses ‘assumptions’ are ‘realistic’ should be removed, given the inherently prospective and highly variable nature of starting a small business.⁵⁵ Furthermore, requirement to assessment such assumptions is arguably inconsistent with another section of the Approach, which says a ‘financial firm is not liable for loss caused by business decisions’.⁵⁶

⁵⁴ ACCC, [Unconscionable Conduct](#) (accessed on 18 September 2023).

⁵⁵ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 24.

⁵⁶ AFCA, 30.

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| | <ul style="list-style-type: none">• Referring to the example on page 27:<ul style="list-style-type: none">- Loan applications do not always capture the number of employees.- A lender may not have visibility of all the assets of a business that could be sold to meet existing commitments.- Business loans may be approved based on accountant projections and actual turnover rather than from a profit and loss perspective or lodged financials.- If a set list of inquiries that AFCA deem to be reasonable are not made, it will become an AFCA expectation that lenders provide an explanation as to why they were not made and whether the lending decision would have been different if they were made. |
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Section 4: How AFCA determine fair outcomes and calculate loss?⁵⁷

AFCA's Remedies:⁵⁸

The remedies which AFCA may provide are outlined in AFCA's Rules and summarised on page 28 of the Approach, they include:

- the payment of money
- the forgiveness or variation of a debt
- the release of security
- the repayment, waiver or variation of a fee or other amount paid to (or owing to) the financial firm, including any variation in the applicable interest rate on a loan
- the reinstatement, variation, rectification, or setting aside of a contract
- the meeting of a claim under an insurance policy by, for example, repairing, reinstating or replacing items of property
- when the complaint relates to a privacy breach, correcting, adding to or deleting information pertaining to the small business
- in relation to a default judgment, not enforcing the default judgment under some limited circumstances, and/or
- an apology.

Consultation Question 4 - Do you have any comment about our proposed approach to calculating loss and determining fair outcomes?

- AFIA notes that as the loan should not have occurred, the complainant needs to be put in the same position they were in before the loan.
- AFIA does not agree with the principle of removing all interest charges when calculating loss. AFA should consider applying the common law principles of determining loss, instead of the formula on page 35.
- AFCA's proposed list of possible remedies on page 29 suggests that where a 'default judgment' has been awarded, AFCA can 'not enforce the default judgment under some limited circumstances'. This appears to improperly give AFCA the power to supersede court decisions, which is inconsistent with AFCA rule C.1.2(d).
- The authority of AFCA to dictate repayment terms once an inappropriate loan has been identified raises significant concerns.
- An extended offer to repay will impact the security which may lessen in value over time and put the customer in a worse financial position.
- AFIA members have indicated they do not believe AFCA properly has the authority to determine interest rates or repayment terms, and effectively re-write a loan.

⁵⁷ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 29-40.

⁵⁸ Ibid, 29-30.

Calculating Loss – Principles:⁵⁹

1. The principles for calculating loss under the Approach:⁶⁰

- If a financial firm fails its obligations but no loss is suffered, AFCA may refuse compensation.
- If a small business has re-financed with a better interest rate, AFCA may consider no loss.
- AFCA may award no compensation if a firm fails to make reasonable inquiries but would have made the loan anyway if they had done so.
- If a firm charge's higher rates than the previous lender, AFCA may view that as 'part of the loss'.
- If a firm provided a small business with additional funds compared to an older loan, AFCA may consider if there was loss flowing from the small business being in a 'worse position overall'.

2. The impact of business decisions as a factor mitigating liability:

- If a small business incurs loss from a failed investment/business decision funded by a firm, AFCA considers 'what loss, if any, was caused' by the inappropriate credit facility'.
- Even if AFCA determines the credit facility was inappropriate, they do not 'generally take into account business or investment performance when deciding a fair remedy'.

- Some NBL lenders may also have funder restrictions on terms and/or repayment arrangements.
- AFCA's proposed calculation of loss and subsequent actions does not appropriately consider the situation and the benefit the small business received from the provision of credit. The secured loan example on page 36 extends further than similar responsible lending situations and is not in any way supported by legislation.
- AFCA's proposed calculation methodology is further unfair insofar as: It does not recognise that the price paid for those assets is a fair estimate of the benefit derived from the loan, whether or not the assets have held their value.
- Adopting as a general approach the view that interest should be repaid and forgiven in all cases where the loan may be inappropriate. Interest is not a measure of profit, interest includes a lender's cost of funds.
- Docking interest without regard to the circumstances is punitive, and AFCA's charter does not include punishment.
- AFIA members believe that there needs to be greater consideration as to the depreciation of an asset in the course of providing remedies for car loans.
- Similarly, the 'benefit' obtained by the complainant should take into account the benefit that has derived from the complainant having possession of, for example, a vehicle for the time of the loan at the date of the complaint.

⁵⁹ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 30-33.

⁶⁰ Ibid, 30-33.

3. May apportion loss between the parties:⁶¹

- If a small business ‘contributed to their own loss’ AFCA may apportion losses between the parties.
- For example, if a borrower provided ‘false or misleading information or knowingly failed to disclose relevant information’.

Calculating Loss – Specific Rules:⁶²

1. Waving the principal amount borrowed is generally not appropriate:

- Often it is not appropriate to waive the principal amount borrowed as the business has benefited from it. However, this is subject to exceptions if:
 - The small business received ‘no benefit’ from the funds.
 - The financial firm ‘engaged in unconscionable conduct’.
 - The financial firm had information which put it ‘on notice’ that the funds did not benefit the small business.

2. Dealing with secured debts

- AFCA may order that a security be released if AFCA determines the firm acted ‘improperly or negligently in taking the security’.
- If a guarantee was provided in support of an inappropriate loan, then AFCA will generally ‘consider the guarantee to be unenforceable’.

- AFIA recommends these two factors be considered in greater detail, given their significance to determinations surrounding motor vehicle finance.
- On page 30, the terms ‘appropriate inquiries’ and ‘reasonable inquiries’ are used. Both these terms are subjective and would need to be defined.
- On page 37, AFIA members seek further information on how AFCA calculates the ‘fair amount for benefit of use’ on a commercial lease? In the example provided (page 38), there is no information on how the \$4,800 has been derived.

⁶¹ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 32-33.

⁶² Ibid, 33-35.

Calculating Loss – Loans:⁶³

- AFCA calculates loss on commercial leases in accordance with the following principles:

Where a financial firm provides an inappropriate loan to a small business, we require it to compensate the small business for their loss. We calculate loss by deducting the principal amount borrowed (the benefit the small business received from the loan), from the total amount borrowed plus interest, fees and charges paid to date.



- This formula can be adjusted where the benefit received is greater than the loss incurred – known as an ‘adjusted debt’.⁶⁴
- AFCA can vary the interest rate, loan term or contract of adjusted debts.⁶⁵

⁶³ AFCA, Draft Approach to Appropriate Lending to Small Business (August 2023), 35.

⁶⁴ Ibid, 35.

⁶⁵ Ibid.

Calculating Loss – Commercial Leases:⁶⁶

- AFCA calculates loss on commercial leases in accordance with the following principles:
 - calculating the total repayments made up to the return date (A)
 - calculating the portion of the total repayments that represents a fair value for the use of the asset to date (this is the benefit the small business received from the lease) (B), and
 - calculate the difference between repayments and the benefit (A – B).

If A – B is greater than 0 (repayments are more than the benefit of use), the lessor must pay the difference to the small business lessee. If A – B is less than 0 (repayments are less than the benefit of use), the lessee must pay the difference to the lessor.



Indirect or Non-Financial Loss and Loss from Misleading and Deceptive Conduct (MDC):

1. For MDC - ask if any loss has been suffered due to the promise. Remedies for misleading and deceptive conduct in a Small Business Lending context will be worked out in accordance with AFCA's [Approach to Misleading Conduct](#).
2. Indirect and non-financial losses – claims of this nature are limited under AFCA's Rules to \$5,000 (see [page 40](#) of AFCA's Rules). To claim such losses, a small business must have:⁶⁷

- AFIA makes the following comments with respect to the calculation of loss for commercial leases:
 1. The formula does not acknowledge the distinction between financed and non-financed components that make up commercial lease repayments.
 2. There does not appear to be any methodology for determining what 'fair amount for benefit of use of the asset' may be. In particular, how is benefit assessed and how will the methodology account for the fact that depreciation affects a leased asset at a sliding scale and is the highest at the start of the lease and that use of a brand new asset is clearly different to use of an old and used asset; and
 3. The formula appears to put commercial leasing in the same budget as car hire, even though such products are very different.
- There is a risk that AFCA's proposed approach would be too costly for lenders and could incentivise lenders to establish entities without an Australian Credit License to engage in non-code lending to avoid AFCA oversight.

⁶⁶ Ibid, 37.

⁶⁷ Ibid, 40.

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| <ul style="list-style-type: none">• '[I]ncurred an unusual degree or extent of physical inconvenience, time taken to resolve a situation or interference with the expectation of enjoyment or peace of mind, arising as a result of an error or breach of obligation by the financial firm.' | |
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