Inquiry into the financial regulatory framework and home ownership

AFCA submission to the Senate Economics Reference Committee Inquiry

October 2024

afca
Australian Financial Complaints Authority

Contents

1 Introduction

AFCA is the external dispute resolution (EDR) scheme authorised under the *Corporations Act 2001* Cth (Corporations Act) to deal with complaints about financial products and services from consumers and small businesses. AFCA welcomes the opportunity to provide a submission in response to the Senate Economics Reference Committee Inquiry into the Financial regulatory framework and home ownership.

2 Executive Summary

Access to safe and secure housing is foundational to a person's sense of personal security and the platform on which many Australians build their lives. The opportunity and security of home ownership is important at all life stages: from the choice of life partner or family formation, across a working life and into retirement and ageing. For these reasons, home ownership sits at the centre of important public policy debates across social, economic, housing, education, finance, tax and retirement policy portfolios.

There are a variety of policy levers and product design initiatives to deploy or recalibrate to respond to levels of home ownership in Australia. Some of these levers are specific references for this inquiry.

The primary touchpoint for AFCA in policy debates about home ownership relates to consumer credit and consumers' experience of the credit products they purchase to buy their homes.

AFCA recognises that there is always a balance to be struck to ensure consumers can access credit products that meet their needs, while mitigating the risks and downstream social and economic impacts of unsustainable debt.

AFCA is committed to playing its role, sharing our complaints data and insights to help inform policy makers, industry and regulators about the consumer experience and outcomes from consumer lending in Australia.

The focus of this submission is on data and insights AFCA can offer about the consumer experience of credit products issued under current settings and how that experience has changed over time. We respond to the Inquiry references relevant to this experience.

Insights from AFCA's consumer credit complaints data

The profile and composition of consumer credit complaints to AFCA shows that:

- Complaints about financial difficulty, including hardship, are growing rapidly (an 18% increase in the 2023/2024 financial year, following a sharp increase in 2022/2023).
- Home loans are the most complained about product for consumers in hardship.
- Complaints relating to home, personal and credit card lending are all rising.
- Complaints involving banking and finance are increasing year on year, up 27% in 2022/2023 and up a further 12% in 2023/2024.
- Within financial difficulty complaints, there is a particular increase in complaints where a hardship request has been declined or there has been a request to suspend enforcement proceedings.
- Combined, these factors suggest that any weakening of current regulatory settings for consumer credit, including responsible lending, could expose consumers to greater harm and further increase complaints to AFCA.

AFCA's key observations

- Many consumers are struggling to meet *existing* lending commitments.
- The regulatory settings for consumer credit, including responsible lending obligations (RLOs), have proven to be responsive to changing borrowing conditions, however, we still receive significant volumes of complaints where lenders have not met their obligations, resulting in in risky and unsuitable lending to their customers.
- The real-world impacts of poor lending practices and unmanageable debt on consumers can be devastating, often affecting highly vulnerable consumers.
- Urgent improvements, particularly in lenders' responsiveness to consumers in financial hardship, are required.
- AFCA is identifying, responding to, and reporting increasing numbers of systemic issues in relation to consumer lending.
- On balance, current regulatory settings are serving current and prospective borrowers well.[1]

Consumer credit complaints made to AFCA

Last financial year, AFCA received **104,861 complaints.** The majority of these complaints were in AFCA's banking and finance area and almost one third of these related to consumer credit. These complaints can be broadly categorised into three phases of the consumer credit life cycle:

[1] This is in line with Recommendation 1. of the Financial Services Royal Commission (FSRC)

- **product inception:** complaints relating to product origination, lending decisions, disclosures, sales conduct, impacts of credit reporting on access to credit.
- **product maintenance:** complaints relating to interest rates, fees and charges, maladministration or irresponsible lending, financial hardship (e.g. lenders' failure in providing an adequate response to a request for hardship assistance), lending impacts resulting from family violence and financial abuse[2], poor complaints handling, privacy breaches and credit reporting.[3]
- **product closure:** complaints involving refinancing, fees, representations and conduct of mortgage brokers, debt collection, enforcement proceedings and credit reporting.

To support the committee's assessment of regulatory settings and to inform its analysis across different economic conditions, AFCA provides:

- data on consumer credit complaints at AFCA, including analysis of trends over a two-year and five-year time series
- insights from AFCA's systemic issues work
- information about how we make decisions—including interpreting and applying lending standards in the credit law, regulatory guidance and relevant codes.

3 AFCA data and insights

AFCA is seeing a significant overall increase in banking and finance complaints. This is occurring across a number of areas and includes rising hardship complaints. Increases in hardship complaints indicate growing financial stress in the community. Recent trends in hardship complaints have seen a significant uptick in complaints in relation to the enforcement stage, suggesting more consumers are moving through the hardship process.

Responsible lending complaints remain relatively steady, with the RLOs and AFCA's Approach to Responsible Lending providing a framework for financial firms to ensure loans are affordable and to resolve complaints when they arise. While the complaints trend reduced from around 2020 following the Financial Services Royal Commission and the introduction of ASIC's RG209, AFCA has seen thousands of complaints from consumers alleging irresponsible lending since that time.

The following section outlines the types of complaints we receive and trends over time. In some cases, our complaints experience evidences lending conduct and customer service that can create or amplify existing consumer vulnerability that results in a person becoming homeless, without a vehicle that may be essential to

[2] See AFCA's recent submission to the Parliamentary Inquiry into the Financial Services Regulatory Framework in relation to Financial Abuse
[3] See AFCA's recent submission to the Review of Australia's Credit Reporting Framework

meeting employment or family obligations, or in a debt cycle that may take years to recover from.

The profile of consumer credit related complaints

Consumers will hold multiple credit products across a lifetime. The use and composition of the credit products consumers hold and the issues they may experience with those credit products also changes over time.

A home loan will generally be the largest and 'stickiest' consumer lending product a consumer will hold. Preceding their home loan and often alongside it, a borrower may also hold other credit products including a credit card, personal loan or BNPL product(s).

In times of financial stress, AFCA's experience is that consumers will prioritise their mortgage debt over all other debt to maintain their homes. They may also turn to other credit products including credit cards, payday loans and BNPL to manage living expenses. This means that AFCA may begin to see complaints about other lending products well in advance of any spike in mortgage lending complaints as consumers try to manage increasing levels of hardship whilst protecting their primary asset.

AFCA's complaints data identifies the credit product, and the issue involved, noting that one complaint may raise more than one issue. In consumer lending complaints, for example, AFCA may receive a complaint about credit reporting, but behind the presenting issue may be other issues relating to the original lending decision, the management of financial hardship or debt collection.

AFCA's data provides useful insights into issues and trends that reach the external dispute resolution stage. A comprehensive consideration of indicators including portfolio level performance data, profile of arrears and hardship indicators, refinancing data and complaints (at IDR and to AFCA) is also necessary to holistically understand the consumer experience and outcomes in Australia's home lending market.

AFCA members and complaints

At the end of FY 23-24, AFCA had 47,575 members.

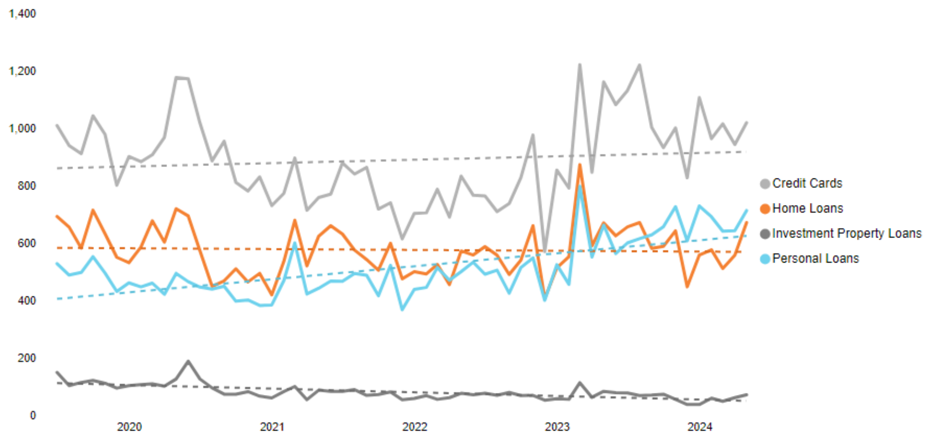
- 78% were Authorised Credit Representatives (ACRs also known as brokers)
- 22% were financial firms (including banks and other credit providers, general and life insurers, superannuation funds and financial advisers).

Complaints to AFCA are increasing. In FY 23- 24, AFCA received **104,861** complaints. This was up 8% on 2022-23. 17% of members had complaints made against them in 2023-24, up 3% on the previous year. In the past year, AFCA also saw a significant increase in complaints related to banking and finance (up 12% overall). This follows a 27% increase in banking and finance complaints on the previous year (2022-23).[4] This year, we have seen notable rises in online accounts (up 36%), personal transaction accounts (up 20%), credit cards (up 13%) and personal loans (up 19%). Concerningly, AFCA also saw an 18% increase in complaints related to requests for hardship assistance.

Key observations from AFCA's consumer credit complaints experience[5]

The following charts present AFCA consumer credit complaints data, first at the higher level by product, and across both a two-year (FY 2023-2024) and five-year (FY 2020-24) time series to show the products and issues generating complaints and to demonstrate changes over time.

Chart 1: Consumer credit complaints (product): FY 2019 – May 2024[6]



AFCA received **140,580 consumer credit** complaints in the last 5 years.

Chart 1 shows complaint trends by product type, with credit cards (38%), home loans (24%) and personal loans (22%) representing the most complained about products. Investment property loans (3%), line of credit / overdraft (3%) and BNPL (3%) are the next most complained about products.

Credit card complaints are increasing at a lower gradient relative to the sharp increases in complaints relating to personal loans. BNPL complaints have grown significantly across the time series, albeit off a low base, while home loan complaints appear relatively stable across this longer time series. Notably, BNPL complaints

[4] Banking and finance complaints | Australian Financial Complaints Authority (AFCA)
[5] We have excluded June 2024 results from trend charts, as AFCA transitioned to a new complaint system. This transition entailed a short outage, making June 2024 results atypical in terms of overall trends. We include June 2024 in our reporting of annual results as excluding them would mean underrepresenting financial year figures. Complaint numbers in this report are based on the latest data available at the time of compilation. As complaints progress and / or new information is received, they may be reclassified. For this reason, there will be small variances between the case numbers reported here and those reported in AFCA's annual report.

relate to voluntary members of AFCA and may not provide a full picture of BNPL consumer complaints.

Chart 2: Consumer credit complaints (product): FY 2022 – May 2024

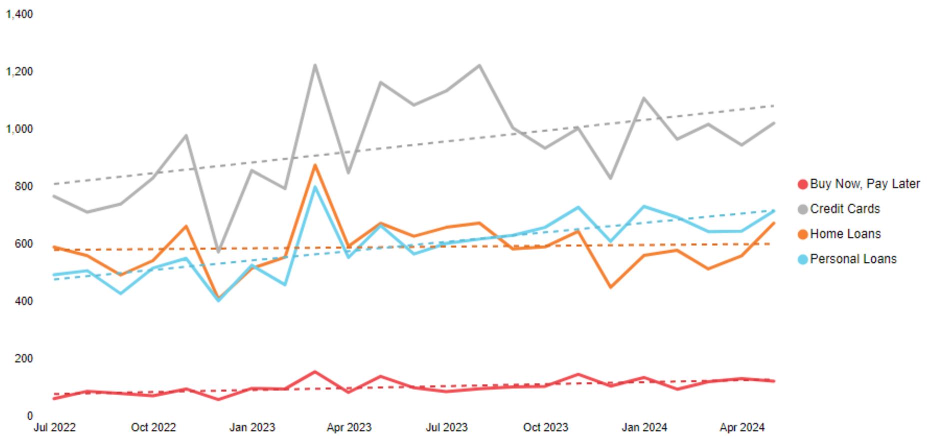
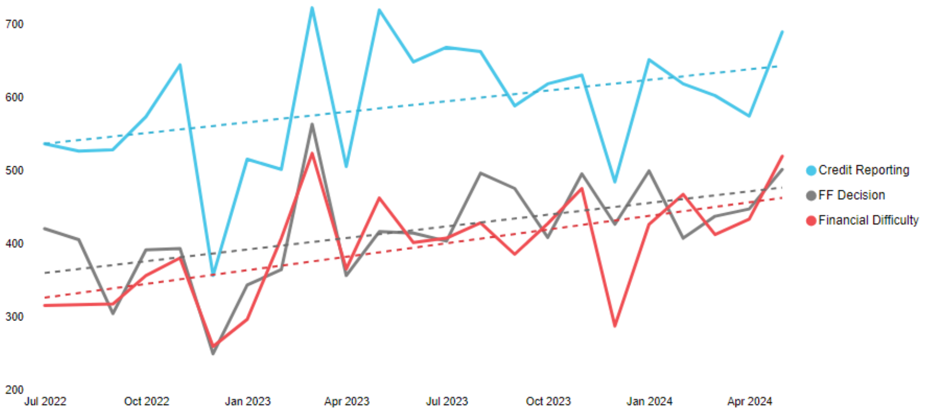


Chart 2 shows the complaint trends by product type over the past two years to May 2024. The data shows a material uptick in complaints across all product types including home lending, credit cards and personal loans in 2024.

Chart 3: Issues in consumer credit complaints: FY 2022 – May 2024



The top issues in these consumer credit complaints relate to financial difficulty, financial firm decisions (e.g. responsible lending, interpretation of terms and conditions) and credit reporting. These complaints are all increasing over time.

AFCA's financial difficulty complaints experience

AFCA has been reporting significant and concerning increases in complaints involving financial difficulty, a category that includes disputes over hardship assistance.[7] For example, in FY 23-24, AFCA reported an 18% increase in financial difficulty complaints on the previous financial year. This reflects the impacts of rising interest rates and cost of living increases affecting an increasing number of borrowers.

Chart 4: Financial difficulty complaints: FY 2022 – May 2024

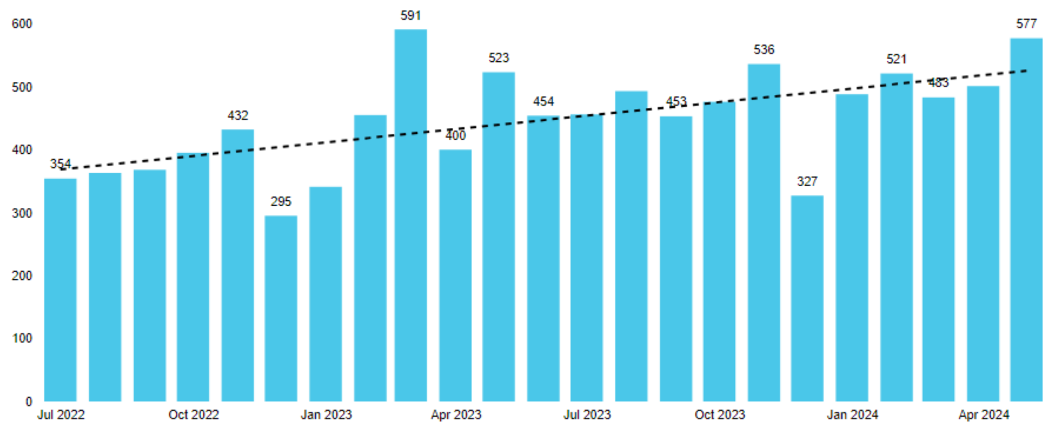


Chart 4 shows the increase in financial difficulty complaints over the last two financial years.

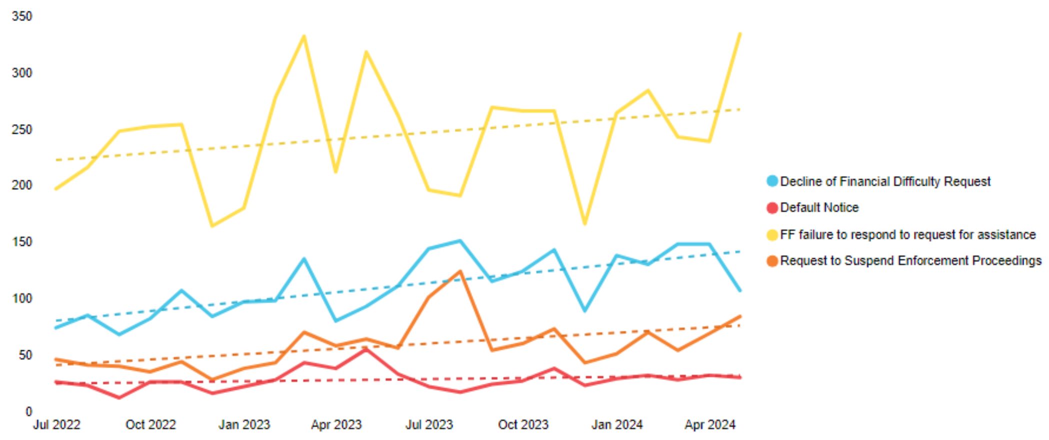
Chart 5: Financial difficulty: Top 7 products: FY 2022 – 2024

Product	#	%
Home Loans	3,428	32%
Personal Loans	3,320	31%
Credit Cards	1,596	15%
Business Loans	874	8%
Line of credit/overdraft	300	3%
Hire purchase/lease	258	2%
Buy Now, Pay Later	240	2%
Total	9,947	93%

Of the financial difficulty complaints received in the past two years, financial stress is evident across product types including home loans, personal loans and credit cards.

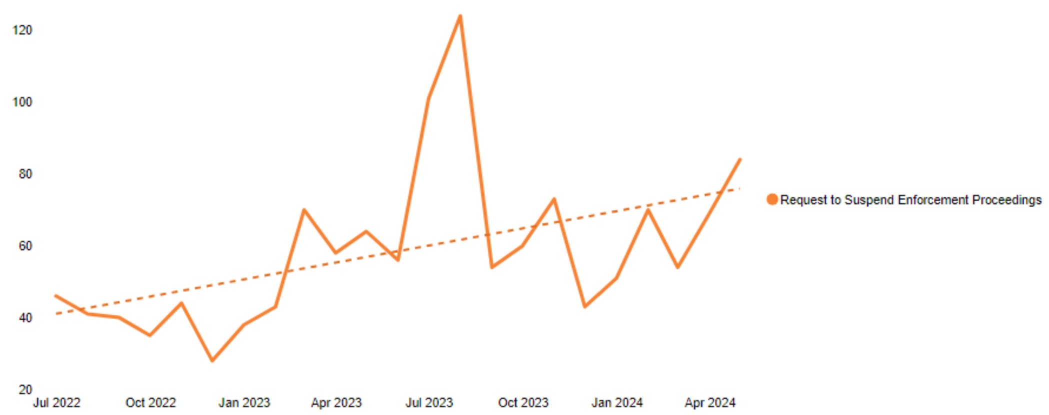
[7] AFCA worried by rising complaints over handling of hardship | Australian Financial Complaints Authority (AFCA) AFCA classifies financial difficulty complaints as complaints where a consumer becomes unable to afford loan repayments as a result of events which occur after the loan was provided (such as unemployment, illness, relationship breakdown, or financial abuse).

Chart 6: Issues in financial difficulty complaints: FY 2022 – May 2024



The most common issue in financial difficulty complaints is a financial firm's failure to respond to a request for assistance when a consumer reaches out for hardship assistance. That category has remained relatively stable, however, compared to increases in complaint types at the enforcement end of the hardship process. Indicators of financial stress are increasing, with a significantly increase in the number of complaints about requests to suspend enforcement proceedings and about the decline of financial difficulty requests.

Chart 7: Complaint issue type: Request to suspend enforcement proceedings: FY 2022 – May 2024



AFCA has a mandatory exclusion from its jurisdiction complaints that relate to a firm's assessment of the credit risk posed by a borrower or the security to be required for a loan unless the complaint is about: maladministration in lending, loan management or security matters; or the variation of a credit contract as a result of the complainant being in financial hardship.[8] AFCA does consider complaints that arise where the credit provider started or continued with enforcement action before it considered and responded to the request for assistance. For example, such a complaint may involve

[8] See AFCA Rule C.1.3

a request to vary a credit contract because of financial hardship, or to postpone enforcement proceedings where the credit provider does not agree to the request.

AFCA will classify these complaints under the issue type *Request to suspend enforcement proceedings*. Chart 7 shows that these complaints have increased by almost 100% in the past two financial years.

Chart 8: Financial difficulty complaints: 5 Year time series: FY 2020– 2024

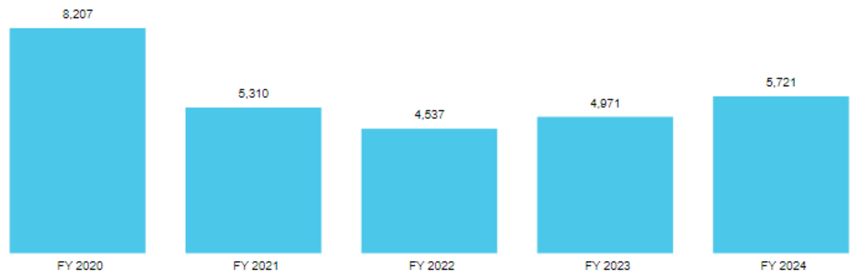


Chart 8 shows the trend line for financial difficulty complaints across the longer 5-year time series. AFCA holds concerns about the current upward trend in financial difficulty complaints (see Chart 5) and is keen to ensure that this does not continue to increase and return to the high pandemic levels of FY 2019-20.

AFCA insights into financial difficulty complaints

As evident in Chart 6, AFCA is receiving too many complaints relating to a 'failure to respond' by financial firms. This aligns to findings from ASIC's recent review *Hardship, hard to get help*[9] which highlighted critical issues with the accessibility of hardship processes.

Too many of these complaints relate to poor treatment or ineffective communication during the hardship process. AFCA often sees 'cookie cutter' responses—standardised replies that fail to address individual circumstances and needs. Lenders' compliance with existing obligations and more personalised customer service is essential to reduce the number of financial hardship complaints that escalate to AFCA.

Timely and effective hardship responses, particularly for home loan borrowers, can mean the difference between a borrower working constructively with their lender to resolve their hardship or falling into severe hardship and loan arrears. Such interventions may reduce the likelihood that a borrower needs to sell their home and potentially avoid the financial and personal costs involved. Where a mortgagee sale is required, a timely and fair process can help to mitigate costs to borrowers and to lenders, including debt collection and enforcement costs.

[9] Report 782: *Hardship, hard to get help: Findings and actions to support customers in financial hardship*.

As noted above in relation to Charts 6 and 7, we are seeing material increases in complaint types at the enforcement end of the hardship process. This suggests more consumers are moving through to the enforcement stage and facing critical financial stress and hardship.

Financial difficulty complaints by post code

As would be expected due to population distribution, the majority of financial difficulty complaints AFCA receives are from NSW and Victoria, comprising about 30% each per year. However, the top postcodes where those complaints arise from tend to be outer metropolitan suburbs of Australia's largest cities. For example, over years 2023 and 2024, the top 3 postcodes for the states of Victoria, NSW and QLD were as follows:

Victoria	
2023	**2024**
• **3030 cities**: Werribee, Point Cook, Werribee South, Cocoroc, Quandong • **3029 cities**: Tarneit, Truganina, Hoppers Crossing, Mount Cottrell • **3064 cities**: Craigieburn, Mickleham, Roxburgh Park, Donnybrook, Kalkallo, Woodstock	• **3029 cities**: Tarneit, Truganina, Hoppers Crossing, Mount Cottrell • **3030 cities**: Point Cook, Werribee, Werribee South, Cocoroc, Quandong • **3064 cities**: Craigieburn, Mickleham, Roxburgh Park, Kalkallo, Donnybrook, Woodstock
New South Wales	
2023	**2024**
• **2170 cities**: Liverpool, Moorebank, Casula, Prestons, Chipping Norton, Warwick Farm, Mount Pritchard, Lurnea, Hammondville • **2570 cities**: Camden, Oran Park, Cobbitty, Spring Farm • **2145 cities**: Westmead, Wentworthville, Greystanes, Pendle Hill	• **2170 cities**: Liverpool, Chipping Norton, Casula, Hammondville, Lurnea, Moorebank, Prestons, Warwick Farm, Mount Pritchard • **2145 cities:** Greystanes, Wentworthville, Westmead, Giraween, Wentworthville South, Pendle Hill • **2155 cities**: Kellyville, Kellyville North, Kellyville Ridge, Beaumont Hills, Rouse Hill
Queensland	
2023	**2024**
• **4209 cities**: Pimpama, Coomera, Upper Coomera, Willowvale • **4740 cities**: Mackay, East Mackay, Andergrove, Rural View, Slade Point, South Mackay, West Mackay, Beaconsfield, Blacks Beach, Habana, Mount Pleasant • **4670 cities**: Kepnock, Bundaberg North, Bargara, Bundaberg, Avenell Heights,	• **4209 cities:** Pimpama, Upper Coomera, Coomera, Willowvale • **4300 cities:** Springfield Lakes, Spring Mountain, Goodna, Brookwater, Camira, Springfield, Augustine Heights, Bellbird Park • **4503 cities:** Kallangur, Griffin, Dakabin

Avondale, Burnett Heads, Kalkie, Qunaba, South Kolan	

It is not surprising that a higher numbers of borrowers in financial hardship may be found in suburbs that are more affordable and accessible to first home buyers. This cohort of borrowers can be in a position of unique vulnerability, entering the housing market at a time of historically high house prices with high optimism, high debt and limited equity. These borrowers may also be at a time of partnership and family formation and incurring other new costs, such as childcare.

In AFCA's experience, these borrowers can be particularly exposed with less capacity to ride out tougher interest rate conditions and absorb inflationary pressures.[10] This aligns with evidence provided by the Commonwealth Bank in the House of Representatives Standing Committee on Economics public hearing for the Review of Australia's Four Major Banks that the outer suburbs of Melbourne represent a significant proportion of customers that are behind on their mortgage repayments.[11] The highest proportion of impaired home loans are based in Victoria (32 per cent), with New South Wales following closely at 30 per cent.[12]

AFCA's responsible lending complaints experience

AFCA classifies a complaint as a responsible lending complaint where a consumer raises concerns that their lender should not have provided them with a loan because the loan was unsuitable at the time of entry into the loan. Unlike financial difficulty complaints, the profile of responsible lending complaints to AFCA over the past two years is relatively stable, having reduced since 2020, with likely drivers including response to the Financial Services Royal Commission (FSRC) and introduction of ASIC's updated regulatory guidance in 2019. Despite this relatively steady stream of complaints, AFCA's data does reveal areas of concern, particularly in relation to personal loans (see Chart 9 below).

We are encouraged by the overall trend which follows the introduction of AFCA's Responsible Lending Approach in December 2023, which is based on existing regulatory settings including ASIC's RG209.[13] The development of AFCA's Approach followed extensive stakeholder engagement and consultation, as well as the commitment of time and effort by member firms to engage and participate in AFCA's training sessions to support the implementation of AFCA's Approach.

Recognising the significance of the responsible lending obligations, AFCA also prioritised internal training to ensure consistency and fairness in our decision-making processes. This, in turn, provides greater predictability for all stakeholders. We continue to engage directly with industry to address any identified issues, helping

[10] Home loans: Sydney, Melbourne outer suburbs have double the rate of mortgage arrears (afr.com)
[11] Economics Committee_2024_08_29.pdf;fileType=application / pdf (aph.gov.au)
[12] CBA FY24 Results Presentation (commbank.com.au) See page 83-85.
[13] AFCA issues its Approach to Responsible Lending | Australian Financial Complaints Authority (AFCA)

improve practices and foster broader industry learnings. AFCA remains committed to sharing our expertise and collaborating constructively on these important issues.

Chart 9: Responsible lending complaints: FY 2022 – May 2024

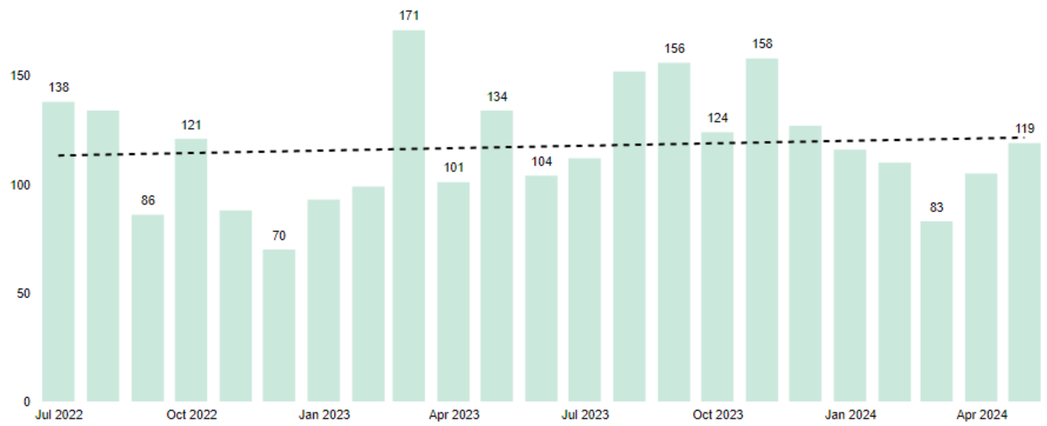


Chart 9 shows the responsible lending complaints data over the past two financial years. This has been a more stable trend than financial difficulty complaints, however it is significantly lower than complaints levels including, and up to, 2020.

Chart 10: Responsible lending complaints: Top 7 products: FY 2022 – 2024

Product	#	%
Personal Loans	1,289	46%
Credit Cards	491	18%
Home Loans	487	17%
Line of credit/overdraft	146	5%
Business Loans	87	3%
Investment Property Loans	80	3%
Hire purchase/lease	76	3%
Total	2,630	94%

Chart 10 shows however, that there are significant responsible lending issues in the personal lending sector, with these loans comprising 46% of responsible lending complaints to AFCA.

Chart 11: Responsible lending complaints: 5 Year time series: FY 2020 – 2024

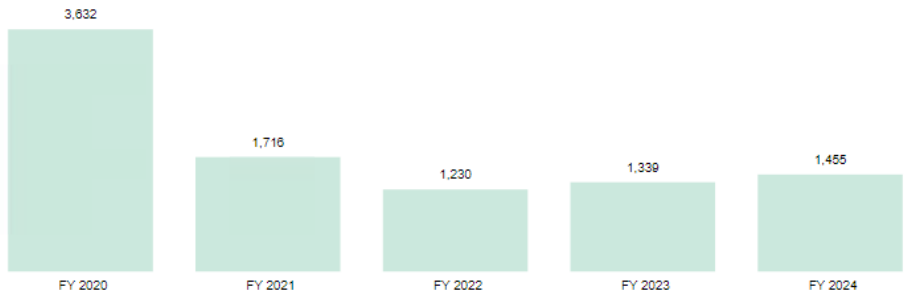


Chart 11 shows the number of responsible lending complaints received by AFCA across the same 5-year time series.

The spike in complaints in 2019 – 2020 was primarily a result of complaints lodged in AFCA's legacy jurisdiction established following the Financial Services Royal Commission.[14] The legacy jurisdiction allowed AFCA to accept consumer and small business complaints about financial firm conduct dating back to 1 January 2008. AFCA received a total of 1,749 legacy jurisdiction complaints, of which 906 were credit complaints. The main products involved were home loans, business loans, investment property loans, credit cards, personal loans and line of credit/overdraft. The main complaints by issue, driving the credit complaints, were responsible lending, unconscionable conduct, mortgagee sale and misleading product/service information.

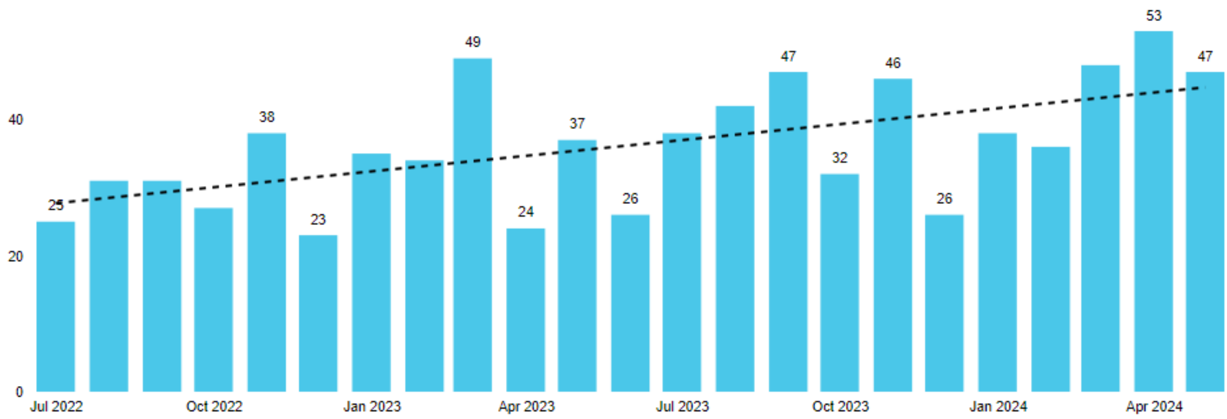
Despite the significant effort and uplift in standards that followed the Financial Services Royal Commission (FSRC) 2019 report, ASIC's updated regulatory guidance (RG 209) issued in December 2019 and the embedding of these standards by financial firms into their systems and processes, we are seeing increasing numbers of complaints relating to RLOs over the last three years.

Small business complaints

The RLOs do not apply to business borrowers and are not applied by AFCA in our complaints resolution role in small business complaints. However, in AFCA's experience, there often is not a clear delineation between a borrower's personal lending commitments and their business lending, which may be secured against a borrower's principal place of residence.

[14] 2019-20 Annual review (afca.org.au), p. 64 provides more detail about AFCA's legacy jurisdiction. We also note that AFCA began to receive the first covid related lending complaints in FY 20.

Chart 12: Business lending: 2-year time series: FY 2022 – May 2024



In line with financial difficulty complaints in consumer lending, AFCA's complaints data also shows increasing levels of financial hardship among business borrowers.

ASIC data reveals a 39% increase in companies entering external administration in 2023-24 compared to the previous year, surpassing pre-COVID levels.[15] This rise is mirrored by an increase in companies appointing small business restructuring practitioners. Given the current economic pressures, including high interest rates and increased costs, AFCA anticipates continued growth in small business financial difficulty complaints.

4 Consumer lending case studies and systemic issues

AFCA decision makers decide consumer credit complaints across the spectrum of consumer credit products. The following case studies show the types of issues that arise in these complaints.

Case study 1: A complainant, 60 years of age, sought a home loan to purchase an owner-occupied property. The bank provided two investment loans with 30-year terms. The bank later claimed to have not been aware that the property was intended as the complainant's residence.

Despite the complainant's age and the reasonable assumption that the complainant would retire within the first half of the loan term, the bank failed to adequately consider an exit strategy.

The complainant had effectively exhausted his superannuation for the purchase of the property, seemingly on the advice of the bank, and there was sufficient evidence to demonstrate that the loans were unaffordable once the complainant retired

[15] Annual ASIC insolvency data reveals increase in companies failing | ASIC

AFCA determined that the loans were unsuitable for the complainant and the bank breached its responsible lending obligations when it provided the loans. AFCA required the bank to compensate the complainant for both financial and non-financial loss with the complainant to repay an adjusted debt over time.

Case study 2: A bank breached its responsible lending obligations when it provided a home loan without making reasonable inquiries and verification of the complainant's financial information.

When assessing if the loan was affordable, the bank used the complainant's income protection insurance that could not reasonably be expected to be available to repay the loan over the 20-year loan term. Removing the income protection insurance, the bank had provided credit to the complainant that was unaffordable without substantial hardship. Alongside the stress and inconvenience of an unaffordable loan, AFCA also found the bank engaged in inappropriate debt collection activity.

AFCA determined that the bank should compensate both financial and non-financial loss. It required that the balance of the loan be reduced, and any default listing or reported missed or overdue repayment history information about the loan to be amended.

Case study 3: A bank provided two loans to enable the complainant to purchase land and construct a home. The complainant was close to retirement and intended to rent out the new property (when constructed) and continue to live in her existing home, in retirement.

Due to the financial hardship resulting from the loans, the complainant was forced to sell her existing home (in which she had planned to live in, in retirement).

AFCA found the loans were irresponsible and required the bank to allow the complainant to live in the newly constructed property under a life tenancy, with the adjusted debt to be repaid when she moved out or died.

AFCA's Systemic issues role

A systemic issue is an issue that is likely to impact one or more consumers, in addition to the complainant. Consumer complaints can serve as key indicators of underlying systemic issues within a financial firm.

AFCA's role in identifying and reporting systemic issues benefits consumers who have not lodged a complaint with AFCA but who may, nonetheless, have been impacted by a systemic issue. The early identification and resolution of systemic issues can reduce consumer complaints, help to minimise consumer harm and remediate affected customers in a timely way.

While AFCA is not a regulatory body, we function within the broader regulatory framework by providing relevant information to regulators as part of our obligations. We report systemic issues as required to ASIC, APRA, OAIC and the ATO.

Over the past 12 months, AFCA has observed a troubling increase in systemic issues related to financial difficulty. These include failures to respond to hardship notices, insufficient consideration of individual circumstances, and a lack of sensitivity towards vulnerable populations, such as those experiencing illness or family violence. Addressing these systemic shortcomings is vital to improving the support provided to all affected consumers.

Impact of AFCA's systemic issues work in FY 23-24

- Identified 1,574 potential systemic issues
- Referred 225 investigations into systemic issues to financial firms
- Investigated and addressed systemic issues, resulting in remediation for 159,051 consumers and small businesses
- Secured $44,706,897 in remediation and refunds for consumers
- Restored incorrectly cancelled general insurance policies and corrected credit and repayment histories on consumer credit reports
- Reported 97 systemic issues to regulators
- Resolved 77 investigations into systemic issues with financial firms
- Reported 137 matters under section 1052E(1)–(3) of the Corporations Act, including:
  - 9 serious contraventions of the law
  - 125 reports concerning financial firms' refusal or failure to implement AFCA determinations (73 related to potential Compensation Scheme of Last Resort claims)
  - 2 reports on settlements requiring further investigation
  - 1 additional reportable matter.

Systemic issues relating to consumer credit and financial difficulty

Systemic issues case study 1: Responsible lending obligations

AFCA considered that the financial firm's previous processes were inadequate to ensure it made reasonable inquiries and took reasonable verification steps with consumers during home loan applications.

As part of AFCA's investigation, the financial firm confirmed it identified 74 home loans that were unsuitable for its customers. The financial firm said that the root cause of these instances was banker error or banker misconduct.

The financial firm remediated the impacted customers and showed that since this time, it had made considerable changes to its responsible lending policies and processes. This case was reported to ASIC and APRA as a resolved systemic issue in June 2024.

Systemic issues case study 2: Responsible lending obligations

AFCA considered that a financial firm failed to meet responsible lending obligations when it provided short-term ‘interest only’ home loans to consumer customers. The loans were secured by a Principal Place of Residence or residential investment property and bank system limitations resulted in customers being unable to automatically rollover to a principal and interest loan after the interest only period ended, instead resulting in the borrowers needing to renegotiate terms.

AFCA’s view was that a home loan with an interest only component is unsuitable for customers purchasing or re-financing a home which is their principal place of residence (PPR). AFCA was particularly concerned if circumstances resulted in the only feasible repayment strategy being the sale of the principal place of residence at the end of the loan term. AFCA also communicated its expectations as to how the loans impacted by the rollover issue should be remediated.

Outcome: In response, the financial firm undertook some corrective measures including:

- Resolution of the ‘roll-over’ issue following system changes so that an IO home loan could be set up to automatically roll over to principal and interest repayments within a longer loan term after the initial IO period had expired.
- cessation of the offer of consumer loans comprising short IO terms unless there was a specific reason do so, such as bridging finance.
- assistance to affected customers to renegotiate remaining loans and refund fees associated with loans previously renegotiated.
- AFCA and the financial firm did not agree on the scope of the remediation steps and AFCA reported the issue to ASIC as unresolved.

Systemic issues case study 3: Financial hardship

AFCA engaged with a financial firm over multiple breaches of section 72 of the National Credit Code (NCC). These breaches included failing to identify and properly assess hardship requests and not issuing required notices in accordance with section 72. Recognising these failures as systemic, AFCA reported the matter to ASIC and the OAIC.

Outcome: In response, the financial firm undertook several corrective measures to address and prevent these issues:

- Revamped its template letters to ensure they meet the detailed requirements of section 72(4) of the National Credit Code.
- Established a daily review system to scrutinise rejected hardship requests, allowing for the correction of any erroneous decisions and proper management of hardship notices.
- Deployed a technology solution to limit the ability to reject hardship requests, enhancing decision accuracy.
- Created and delivered comprehensive staff training to address and prevent future compliance issues.
- The firm also identified and remediated affected customers. AFCA deemed the issue resolved, closed its file, and informed ASIC and the OAIC of the resolution.

Further examples of consumer credit issues identified in our SI work include:

- A financial firm (FF) setting unsuitable (high) credit limits that failed to meet its RLO, including customers' requirements and objectives. This occurred by customers applying for the 'maximum credit limit' online, and the FF failing to ensure this was appropriate, before approving.
- A financial firm (FF) that did not have adequate review mechanisms in place to identify red flags of financial hardship in its unsuitability assessments. The FF was not making reasonable inquiries about consumer requirements and objectives through the application process.
- Inappropriate lending practices where a financial firm offered and approved further credit to its customers through its redraw process, without taking steps to assess whether the additional credit was unsuitable for the customer.
- Reliance on a risk-based approach to verifying consumers' financial situations without the FF taking reasonable steps to verify information provided by consumers (who are identified as low risk) and assessing whether they have sufficient information to confirm maximum credit limits.
- A financial firm (FF) failing to comply with RLO by failing to obtain information as to the loan purpose from customers (efficacy of lender's controls to identify problem gambling red flags).

Appendix A

Consumer credit regulatory framework

Regulatory settings

Consumer credit is regulated in Australia under the twin peaks framework with:

- the Australian Prudential Regulatory Authority (APRA) responsible for the financial stability of lenders and prudential settings relating to lender governance, risk and controls at a whole of sector level; and
- the Australian Securities and Investments Commission (ASIC) responsible for the licensing and conduct regulation of consumer credit which is primarily set out the *National Consumer Credit Protection Act 2009* (the Credit Act), the National Credit Code (Schedule 1 to the NCCP) and the consumer protection provisions of the *ASIC Act 2001*.

Prior to the commencement of the Credit Act in 2010, consumer credit was regulated by the states. The Credit Act brought consumer credit product issuers (lenders) and distributors (mortgage and finance brokers) into a single national licensing framework, introduced responsible lending obligations (RLOs), consistent disclosure requirements and provided for specific consumer rights in the event of financial hardship. In establishing a single, national, harmonised consumer credit law, policy makers were responding to duplication, inconsistency and gaps in the state regulatory framework.

The Credit Act also established a harmonised dispute resolution framework, including requirements for credit licensees to have internal dispute resolution (IDR) processes and membership of an external dispute resolution (EDR) scheme (then operated by AFCA's predecessor schemes, until AFCA commenced in November 2018).

Together, these reforms (IDR and consistent access to EDR) and subsequent enhancements to scheme jurisdictions significantly expanded consumer access to redress. The passage of AFCA's enabling legislation in 2018 supplemented the existing systemic issues role played by EDR schemes (now AFCA) with enhanced regulatory reporting obligations.[16] This provided for greater scrutiny and oversight, resulting in improved standards and for rectification and remediation, as appropriate.

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[16] The *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth) (the AFCA Act) established AFCA as the single EDR scheme for the financial sector [Enabling legislation | Australian Financial Complaints Authority (AFCA)]

Other requirements, guidance and standards relevant to the conduct of lenders and other firms participating in Australia's consumer credit markets include:

- ASIC regulatory guidance:
  - ASIC Regulatory Guide 209: *Credit licensing: Responsible lending conduct* (RG 209), which provides principles-based guidance about how ASIC interprets the RLOs and outlines possible steps lenders can take to minimise the risk of non-compliance with the law.
  - Information Sheet 146 *Responsible lending disclosure obligations: Overview for credit licensees and representatives*, which sets out the obligations of licensees in relation to the issue, content and distribution of disclosure documents.
  - ASIC Regulatory Guide 234 *Advertising financial products and services (including credit): Good practice guidance*, which helps promoters comply with their legal obligations to not make false or misleading statements or engage in misleading or deceptive conduct.
  - ASIC Regulatory Guide 271 *Internal Dispute Resolution*, which explains what financial firms must do to have an internal dispute resolution (IDR) system in place that meets ASIC's standards and requirements.
- ASIC and ACCC Debt collection guideline for collectors and creditors.[17]
- Industry codes of practice, including the Banking Code of Practice (BCOP)[18] and the Customer Owned Banking Associate (COBA) Code of Practice.[19]
- Privacy obligations and credit reporting codes and standards.

Since the Credit Act was legislated in 2009 and commenced in July 2010, there have been a series of amendments to respond to new and emerging consumer issues and risks in the consumer credit market. These include:

- amendments relating to small amount credit contracts (SACCs) and consumer leases, which commenced in June 2023.
- amendments contained in the *National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020* which were considered by the Economics Legislation Committee in 2020 but did not proceed.
- amendments, currently before the Parliament, extending the application of the Credit Act to buy now, pay later (BNPL) contracts and to establish low-cost credit contracts (LCCC) as a new category of regulated credit.

Responsible lending requirements

The RLOs apply to credit that is wholly or predominantly for personal, domestic or household purposes, or for the purchase or improvement of residential investment

[17] ASIC and ACCC Debt collection guideline for collectors and creditors
[18] Banking Code of Practice
[19] Customer Owned Banking Code of Practice

property (regulated consumer credit). Lending that is predominantly for the purposes of a business (including a small business) is not subject to the RLOs.

The RLOs require licensees to ensure they do not provide a consumer with credit that is unsuitable for them. Licensees are required to assess whether a proposed credit contract is 'unsuitable' for a consumer by considering whether:

- the contract meets the consumer's requirements and objectives, and
- the consumer has the capacity to meet their financial obligations under the contract without substantial hardship.

Before assessing whether the credit contract is unsuitable for the consumer, a licensee is required to:

- make reasonable inquiries about the consumer's requirements and objectives, and
- make reasonable inquiries about, and take reasonable steps to verify, the consumer's financial situation.

AFCA's data and insights in relation to RLO complaints is set out at page 11 above.

Financial hardship obligations

Under the National Credit Code[20], the Banking Code of Practice[21], and the COBA Code,[22] banks are mandated to work collaboratively with customers to develop sustainable solutions for financial hardship. The hardship process is an essential protection for borrowers, providing an opportunity to work with the lender to see if they can work through their financial hardship.

In May 2024, ASIC published Report 782: *Hardship, hard to get help: Findings and actions to support customers in financial hardship.*[23] This report set out the findings of ASIC's review of the end-to-end policies, processes and practices of 10 large lenders in responding to home loan customers experiencing financial hardship. It found lenders were not doing enough to support their customers experiencing financial hardship.

ASIC found that that one-third of hardship applicants encountered so many difficulties that they abandoned the hardship application process. This finding is consistent with themes in AFCA's complaints, reflecting a broader problem of inadequate support for those experiencing financial stress, and remains a critical area for improvement. AFCA's data and insights about financial hardship is set out at page 7 above.

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[20] Customers can advise their lender of their inability to meet their obligations under a credit contract (a 'hardship notice'): see s72 of the National Credit Code (at Sch 1 to the National Consumer Credit Protection Act 2009 (National Credit Act)).
[21] Customers can contact their firm where they are experiencing financial difficulty: see Part D of the Banking Code of Practice which applies to both individuals, in addition to the hardship provisions under the National Consumer Credit Protection Act, and to Small Businesses.
[22] Customers experiencing financial difficulty can engage their bank under paragraphs 136 to 143 of the Code, which apply to an individual or Small Business who is either a customer or a guarantor of a customer.
[23] Report REP 782 Hardship, hard to get help: Findings and actions to support customers in financial hardship (asic.gov.au)

AFCA's jurisdiction

AFCA's jurisdiction to consider lending complaints is governed by our Rules (the Rules).

Generally, for AFCA to be able to consider a complaint, the complaint must:

- be brought against a financial firm that is an AFCA member - financial firms are required to be members of AFCA as a condition of holding an Australian Financial Services Licence (AFSL) or Australian Credit Licence (ACL)
- arise from or relate to a 'Financial Service' – the expression 'Financial Service' is defined broadly in the Rules and would include loans and other kinds of credit products, and
- fall within the monetary and other jurisdictional limits set out in the Rules.

The Rules provide that AFCA must exclude complaints about a financial firm's 'assessment of the credit risk posed by a borrower or the security to be required for a loan'. However, this exclusion is subject to an exception for complaints about 'maladministration in lending, loan management or security matters'.

The effect of the exception is that AFCA can consider complaints about credit risk and security as long as they raise a potential issue of 'maladministration'. The expression 'maladministration' is defined to mean:

> *an act or omission contrary to, or not in accordance with, a duty or obligation owed at law or pursuant to the terms (express or implied) of the contract between the financial firm and the complainant*

The effect of the Rules is to give AFCA a broad jurisdiction to consider lending complaints, including complaints where the borrower says they should not have been provided with the loan, as long as the complaint raises a potential breach of law or contract.

The manner in which statutory obligations are imposed on lenders under the credit legislation is therefore important to AFCA, as these obligations provide one source of our jurisdiction to consider lending complaints.

AFCA's role in resolving lending complaints

Under the AFCA Rules, when determining a lending complaint, an AFCA decision maker must do what is fair in all the circumstances having regard to legal principles, applicable industry codes or guidance, good industry practice and previous relevant determinations of AFCA or a predecessor scheme.

AFCA often considers complaints where a borrower claims that a lender erroneously concluded at the time of the loan assessment that the borrower could afford to meet their repayments without substantial hardship.

Under the lending standards in the consumer credit law (responsible lending obligations), where AFCA finds that the lender made an error in its assessment and should have concluded that the loan was unsuitable (in the absence of the error), we will conclude that the lender has breached the RLO by providing an unsuitable loan and provide a remedy.

A common feature of lending complaints is that they are often not lodged until years after the relevant conduct occurred – this means that, at any given time, AFCA may be dealing with complaints about loans made at various times over a number of years and governed by different regulatory regimes.

When investigating lending complaints, AFCA's role requires us to review the steps taken by the lender in assessing the loan and form a view as to whether the lender complied with its obligations, taking into account the factors outlined above. We review the lender's conduct based on the circumstances at the time, without the benefit of hindsight. We do not conclude that a loan should not have provided merely because subsequent events have caused the borrower to be unable to meet their repayments.