

Consultation Paper 115: Responsible Lending

Submission to the Australian Securities and
Investments Commission

October 2009



Australia and New Zealand Banking Group Limited ('ANZ') is pleased to provide comments on the Australian Securities and Investments Commission's (ASIC) Consultation Paper 115 (CP115) on Responsible Lending.

CP115 sets out ASIC's proposed guidance in relation to the responsible lending obligations contained in the *National Consumer Credit Protection Bill 2009*. The consultation paper sets out expected standards of behaviour of licensees when they offer customers a credit contract or provide assistance in relation to a credit contract.

ANZ supports ASIC's general approach in its guidance. We believe it provides sufficient guidance to licensees while allowing them to maintain flexibility in their credit assessment practices. In large part it reflects the existing practices of responsible lenders such as ANZ.

In the table beginning on page 3 of this submission, we have responded to the questions posed in CP115. We have only addressed those questions which raised particular issues or concerns for ANZ. We have also contributed to the development of the Australian Bankers' Association's submission and support the comments in that submission.

Our key concerns are that:

1. The proposed guidance, in some parts, does not reflect the reality of credit assessment processes. We are concerned that the guidance assumes that credit assessment is undertaken in person with the customer. However, often this is not the case. Credit providers receive applications online and over the phone. Customers use these channels because they are quick and convenient. For these applications it is not always necessary to speak to the customer or meet the customer in person to complete the assessment. This is problematic when we are required to make subjective assessments about the customer (eg in relation to their financial literacy).
2. It is not clear from the proposed guidance that the level of verification required will vary depending on the circumstances. We believe that a risk-based approach to verification should be permitted. When assessing a credit application it is usual business practice for a credit provider to take a risk-based approach to verification of data. The approach adopted is based on the risk of the customer and the product. This approach means that not all customer information is verified. For example, we often do not verify the information a customer provides on their expenses. Rather we use established benchmarks to determine whether their stated expenses are reasonable. The guidance should permit a risk-based approach to verification.
3. There is insufficient recognition of the role of information held as a result of an existing relationship with a customer. ANZ treats established customers differently to new customers when making credit assessments. This is appropriate given the information we have on established customers' financial performance over time. It is also what our customers would expect. More information based on actual credit

behaviour reduces risk in decision-making, as our analysis has shown, and is relevant to the concept of scalability. This source of information should be reflected explicitly in ASIC's guidance on responsible lending.

ANZ would be pleased to provide any further information about this submission as required, and can be contacted as follows:

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Question	Comments
B1Q1	<p>ASIC has proposed that the obligation to make reasonable inquiries is scalable ie what a credit licensee needs to do to meet these obligations will vary depending on the circumstances. We welcome this approach as it is consistent with the established and effective risk-based approach used by responsible lenders.</p> <p>Three factors have been proposed as relevant to the scalability of the reasonable inquiries obligation:</p> <ul style="list-style-type: none"> • potential impact on the consumer of entering into an unsuitable credit contract; • complexity of the credit contract; and • objectives and financial literacy of the consumer. <p>The consultation paper suggests that “more extensive” or “less extensive” inquiries will be required depending on the potential impact on the consumer and the complexity of the credit contract. We believe that the scalability approach means that ‘extensive’ (whether more or less extensive) inquiries will not be required in all cases. We would prefer that the levels of reasonable inquiries to be applied are described as a greater or lesser degree of inquiry.</p> <p>The third factor involves an assessment of the consumer’s financial literacy. It is very difficult for a credit licensee to assess the financial literacy of a consumer. There is no simple test available which determines a person’s financial literacy. ANZ has commissioned three National Surveys of Adult Financial Literacy in Australia (2003, 2005 and 2008). To answer a survey, respondents typically took 25 to 30 minutes. Responses then had to be analysed. The surveys showed that there are groups in the community with relatively low levels of financial literacy: the young (18-24 year olds), older people (65 years and above), those with low levels of education (to Year 10), the unemployed, those in semi-skilled work and those who speak a language other than English at home. It is not practical to ask a credit applicant to submit to a financial literacy assessment and we are concerned that reducing the requirement to an assessment based on demographic and other characteristics of a person would be potentially discriminatory and may not be accurate. Financial literacy is complex to measure as it involves not only knowledge but also skills and capabilities.</p> <p>Our view is that all lenders should ensure that their disclosure and other documents are clear and easy to understand. It is in their interests to do so, as where this does not occur, the result includes customer complaints, cases before the</p>

Question	Comments
B1Q1 (cont.)	<p>Financial Services Ombudsman and in some instances, court actions. Simple products and clear and concise disclosures are appropriate. ANZ also has staff who speak languages other than English in branches in locations where a significant proportion of the population is non-English speaking.</p> <p>Finally, ANZ notes that the financial literacy of the customer is not a concept apparent in the legislation.</p> <p>We believe Example 2 should be removed. It appears to impose a requirement on the credit provider to provide advice on the implications of contracts for the sale and purchase of property after the consumer has entered into the contracts. Furthermore, it relates to an error in the information provided to the customer and not a failure in the credit provider's obligation to make reasonable inquiries. Further discussion of this example is included in the ABA submission and we strongly agree with their comments.</p>
B1Q2	<p>We believe further guidance on reasonable inquiries is unnecessary.</p>
B2Q1	<p>In general we agree with the proposed approach to guidance about making reasonable inquiries.</p> <p>However, we note that CP115 does not draw a distinction between a new customer and an existing customer of a credit provider. We believe that the most appropriate credit assessment method differs depending on the stage of the customer's relationship with a credit provider. ANZ treats established customers differently to new customers. This is appropriate given the information we have on established customers' financial performance over time. The use of information based on actual credit behaviour reduces risk in decision-making and this should be reflected in ASIC's guidance on responsible lending.</p> <p>Assessment of customer-provided financial information is the most appropriate method to properly assess new applicants for credit where there is a lack of any other information held by the credit provider. Where ANZ has built up a profile of a customer's behaviour over time, automatic behavioural scoring is a highly reliable method for assessing credit applications, in particular where assessing capacity to repay. This is demonstrated by analysis we've previously undertaken comparing customer behaviour in the context of automatic and manual assessment.</p>

Question	Comments
B2Q1 (cont.)	<p>ANZ conducted a study in 2005 into the credit behaviour of a group of recently acquired credit card customers who were approved based on an assessment of their self-reported financial details compared with a group of existing customers who had accepted a credit limit increase offer and were assessed using ANZ's credit scoring methods. Over a six month period, 1.7 per cent of the first group of customers showed signs of financial stress (for this analysis, financial stress was defined as being 30 days late on a payment for one or more occasion). During the same period, only 0.6 per cent of those assessed by behavioural scoring displayed signs of financial stress. More rigorous assessment processes are unlikely to reduce this small group who experience financial stress.</p> <p>The proposed guidance places value only on verification of customer provided data. It does not appear to place any value on the data already held by credit providers on existing customers, particularly information about the customer's behaviour. We submit that at the very least 'reasonable steps' should contemplate reliance on existing data and behavioural scoring.</p> <p>We note that the Government has announced its intention to amend the Privacy Act to allow comprehensive credit reporting, including data on current balance for credit contracts. This will be an important tool to assist credit providers to meet their responsible lending obligations.</p>
B2Q2	<p>Paragraph 23(f) refers to the maximum amount to be repaid under the credit contract (including fees). Further clarity is needed about which fees should be included in this assessment. We would suggest that only fees which are required to be included in the comparison rate (as required under s 161 of the National Consumer Code) should be included. It is impossible to anticipate whether a consumer will incur any event-based fees throughout the life of the contract.</p>
B2Q3	<p>As discussed above, we would like the guidance to state that the nature of the customer's relationship (including credit contracts concluded and those currently in place) with the credit provider is a factor relevant to scalability.</p>
B3Q1	<p>ASIC has proposed that licensees should establish supervision and compliance processes that are appropriate to their business model and the type of credit activity they are undertaking. We agree with this approach to supervision and compliance. However, we believe the example of how this could be implemented in practice is not appropriate. The example suggests placing compliance staff at offices in various geographical locations, rather than only having compliance</p>

Question	Comments
B3Q1 (cont.)	<p>staff at head office. Provided effective policies, procedures and quality assessment are in place, this physical presence should not be necessary. Compliance testing can occur remotely (eg where documents are scanned). Technology enables compliance staff to have oversight of what staff in other geographical locations are doing.</p> <p>We have some concerns about ASIC's proposed approach to refinancing, which is referred to in paragraph 28. These concerns are discussed further below at C6Q1.</p>
B3Q3	<p>We believe further guidance on processes credit licensees should have in place to ensure they make reasonable inquiries is unnecessary.</p>
B4Q1	<p>In general we agree with the methods and process proposed for verification. However, it is not clear from the proposed guidance that the level of verification will vary depending on the circumstances. We believe that a risk-based approach to verification should be permitted.</p> <p>When assessing a credit application it is usual business practice for a credit provider to take a risk-based approach to verification of data. The approach adopted is based on the risk of the customer and the product. This approach means that not all customer information is verified. For example, we often do not verify the information a customer provides on their expenses. Rather we use established benchmarks to determine whether their stated expenses are reasonable and therefore do not require detailed verification. As discussed above, we believe this approach is effective and responsible. The guidance should permit a risk-based approach to verification where the level of verification required varies depending on the circumstances.</p>
B4Q2	<p>As discussed above, the obligations about verification of information are not consistent with current good business practice</p>
B4Q3	<p>If we are required to verify all information, we will need to employ additional staff in our assessments teams. It will also slow the credit assessment process for the customer.</p>
B4Q4	<p>Other than clarifying that credit providers can adopt a risk-based approach to verification where the level of verification required will vary depending on the circumstances, we believe further guidance on verification is unnecessary.</p>

Question	Comments
B5Q1	<p>On 11 September 2009, Minister Bowen announced that s 130(3) would be removed from the NCCP Bill. This question is no longer relevant. However, we believe ASIC should provide some guidance on the relationship between credit assistants and credit providers as discussed in the next question.</p>
B5Q2	<p>Section 130(3) would have allowed a credit provider to take into account information provided in a preliminary assessment by another credit licensee without further verifying the information.</p> <p>In all cases, ANZ undertakes its own credit assessment and does not rely on an assessment undertaken by a broker or other intermediary. However, we do rely on documents collected by a broker on a customer's behalf as part of completing the ANZ application form.</p> <p>Credit providers use brokers in this way to reduce the amount of time it takes to undertake credit assessment. If credit providers are required to re-request these documents, the cost of assessing customers who come through our broker channel will increase. This will put pressure on the commissions we pay to brokers and, therefore, reduce the viability of broker operations. It will also be frustrating to consumers who engage a broker to complete the application process but who are then asked to provide documents again.</p> <p>The purpose of the NCCP Act, as we understand it, is to protect consumers from unscrupulous lenders who may attempt to lend irresponsibly not to prevent fraud. Licensed intermediaries must ensure they are responsible in recommending credit contracts to their customers. Knowingly providing fraudulent documents to a credit provider should be a breach of the responsible lending obligations imposed on intermediaries. Credit providers should not be required to police intermediaries, which ASIC has licensed, by re-verifying all documents provided by a broker.</p> <p>The legislation requires credit licensees to undertake reasonable inquiries to verify the information provided by the consumer. Whether this information is provided directly from the consumer or through an intermediary the standard should not change. ASIC's guidance on responsible lending should make it clear that a credit licensee always needs to undertake their own assessment of unsuitability. However, in doing so, they should not be required to verify the authenticity of every document provided by another credit licensee. Rather, it should be sufficient to use the approaches proposed in paragraph 35 to ensure that documents provided by third parties are reliable.</p>

Question	Comments
C1Q1	Yes, the proposal on guidance for forming a view that the credit contract is 'not unsuitable' is a restatement of the requirements of the NCCP Bill 2009.
C1Q2	<p>In relation to reasonable inquiries about a customer's financial situation, the changes to existing processes will be small. However, in most instances, reasonable inquiries in relation to a customer's requirements and objectives will result in significant changes to existing processes and systems.</p> <p>Currently, we seek to provide customers with credit products which are suitable for their requirements. However, we are under no positive obligation to ensure that the customer makes an appropriate choice. Nor are we required to make detailed enquiries about the customer's objectives which may render a product unsuitable. Where this is discussed with the customer, we do not record the information. To comply with this obligation we will need to change systems to enable this information to be recorded. We will also need to change procedures and train staff to ensure the information is recorded and that customer applications are declined where they have sought an unsuitable product, notwithstanding the customer's ability to meet the repayments.</p>
C1Q3	We believe further guidance on forming a view that a credit contract is not unsuitable is not necessary.
C2Q1	Yes, we agree with the proposed approach to guidance about determining the customer's financial situation and capacity to repay. However, as stated in our response to B2Q2, in considering all costs of the contract, we should only be required to take into account fees which are included in the comparison rate. Event based fees cannot be anticipated at the time the customer takes up the loan. In the case of refinancing, some event based fees such as break costs can be anticipated. Our view on how these should be taken into account is discussed at C6Q1.
C3Q1	Yes, we agree with ASIC's proposed approach to guidance about financial hardship.
C4Q1	<p>In general, we agree with ASIC's proposed approach to guidance about determining the customer's requirements and objectives.</p> <p>The NCCP Bill requires licensees, before they offer a credit contract, to make an assessment that the contract is 'not unsuitable' for the customer. In most cases a borrower will approach a financial institution to apply for a specific product.</p>

Question	Comments
C4Q1 (cont.)	<p>This is frequently done online with no prior contact from the customer in-person or over the phone. In many cases, the application will be approved without the need for the customer to meet face to face with an ANZ representative. However, paragraph 63 envisages a situation where the customer approaches a bank with a list of requirements and objectives and the credit provider must then assess which products are 'not unsuitable' for the consumer and only put forward those products.</p> <p>For some credit products it may be difficult to identify specific customer requirements or objectives. For example revolving credit facilities, such as credit cards, are usually obtained for a range of purposes. In many cases the customer may have no specific purpose in mind at the time they apply for the contract or the purpose may change over time. For these products, we believe credit providers should be able to take a reactive rather than proactive approach to assessing unsuitability on the basis of the customer's requirements and objectives. If the customer states a specific purpose for which a credit card would be considered unsuitable, then an alternative product should be offered. However, if they do not state a specific purpose, it is reasonable to assume that it is for various purposes. In that case, provided they have the capacity to repay, the contract should not be considered unsuitable.</p>
C4Q2	As discussed at C1Q2, current business practice does not require active inquiry about the customer's requirements and objectives. It is a new mandatory requirement which needs to be built into our systems and procedures.
C4Q3	This is discussed at C1Q2.
C5Q1	Yes, we agree with ASIC's proposed approach to guidance about determining whether a particular credit transaction is fit for purpose.
C5Q2	See answers at C1 and C4.
C6Q1	In relation to switching and refinancing, CP115 proposes an obligation for credit providers to undertake additional analysis of a customer's situation. This would include assessing the terms of the existing credit contract and determining the extent to which the consumer will benefit financially from switching or refinancing. We believe that this strays into financial optimisation. This is not the aim of the national consumer credit protection regime. The NCCP Bill requires a licensee to assess that the particular credit contract being offered is 'not unsuitable'. The proposal would require a credit

Question	Comments
C6Q1 (cont.)	<p>licensee to assess the relative merits of one credit contract over another and determine whether one is more suitable than the other.</p> <p>Cost is not the only reason that a consumer may decide to switch or refinance, particularly between different financial institutions. For example, a consumer may be seeking to consolidate their banking with one financial institution, or they may be unhappy with their existing provider and seeking to end the relationship. In those cases a consumer may, by choice or lack of a cheaper option, refinance into a product which will not benefit them financially.</p> <p>We agree that some forms of refinancing are inappropriate. Clearly, there is a benefit in protecting consumers from unscrupulous lenders who may, for example, appear to be offering a consumer a way out of financial difficulty but in fact refinancing them into an unfavourable credit contract. However, in most cases, consumers should be free to switch between financial institutions without restriction, provided they are being refinanced into a product which is 'not unsuitable'. The guidance should envisage situations where there is a reasonable increased cost to the consumer of switching or refinancing and the product being offered is 'not unsuitable'.</p>
D1Q1	<p>We agree that the written assessment should include:</p> <ul style="list-style-type: none"> a) a summary of what the consumer told us in relation to their financial situation, requirements and objectives b) a statement that we have based the assessment on the information provided by the consumer; and c) a statement that we have assessed a particular credit contract as not unsuitable for the consumer.
D1Q2	<p>This is a new requirement for credit licensees. To comply with the requirement to provide the written assessment, ANZ will need to make changes to our systems to ensure that we can provide the information contained in the notice and can produce it within the required timeframe. We will also need to train all staff to ensure that in all cases they collect the information required to be included in the notice.</p>
D1Q3	<p>No, the written assessment currently includes all information which is held by the lender which is not commercially sensitive.</p>