

*National Consumer Credit Protection Bill 2009
and National Consumer Credit Protection
(Transitional and Consequential Provisions) Bill
2009*

Exposure Draft

Submission to the Treasury

May 2009



INTRODUCTION

Australia and New Zealand Banking Group Limited ('ANZ') is pleased to provide comments on the *National Consumer Credit Protection Bill 2009* ('the Bill') and the *National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009* ('the Transitional Bill').

The Bills establish national regulation of consumer credit. They also make a number of changes to the current regulation of consumer credit, including introducing a national credit licensing regime for anyone providing a credit service. A range of obligations are imposed on licence-holders including responsible lending obligations. The responsible lending obligations set in place expected standards of behaviour of licensees when they enter into consumer credit contracts or where they suggest a credit contract to a consumer or assist a consumer to apply for a credit contract.

These Bills will have a major effect for the way anyone who provides credit services does business. ANZ has a number of concerns about the way the legislation will operate in practice. We will also need to make changes to comply with the legislation. A longer transition period is necessary to enable ANZ to do this.

1. TRANSITIONAL ARRANGEMENTS AND TIMEFRAMES

LIC150 of the Bill and Schedule 1 of the Transitional Bill set out a two-phase licensing process. Credit providers will need to register with ASIC before 1 January 2010 and then must apply for an Australian Credit Licence (ACL) by 30 June 2010. Our interpretation of the Bill is that, from 1 January 2010, ANZ would need to comply with all the obligations of a licensee. In addition, from 1 November 2009, all credit providers must comply with the National Credit Code, which extends the Uniform Consumer Credit Code's coverage to residential investment loans.

This legislation has been in development for some time and there has been involvement from some key stakeholders. However, confidentiality agreements have prohibited discussion with ANZ's businesses about the Bill's effect on specific credit products and processes. The first opportunity to do this was when the legislation was released on 27 April 2009. The short timeframe for public comment has made it difficult to consider all the implications of the legislation for ANZ.

Furthermore, the two-phase process announced by the Minister for Superannuation and Financial Services suggested that credit cards would be dealt with in the second phase. The Bill has significant implications for credit cards, which is a widening of the scope of the Bill from what we had expected.

The wider scope and short timeframes will present significant challenges for ANZ. There are a range of areas where ANZ will need to make changes or fulfil requirements to enable compliance with the full range of licensing obligations.

i. Systems and process changes

ANZ will be required to undertake major systems and process changes to:

- change existing forms and documents (including system generated forms and documents as well as printed and online versions) and develop new forms (such as the direct debit failure notice) for all our consumer credit products;
- meet record-keeping obligations;
- collect new information from customers (eg their requirements and objectives) and ensure this is appropriately recorded and retained on our systems (as you would appreciate our systems do not currently include fields where this information can be clearly captured);
- cover new products: residential investment property loans and margin lending (which is covered in a separate bill but nevertheless has the same timing as this legislation);
- revise contract documents (letters of offer which are system generated and printed terms and conditions booklets) for residential investment properties to ensure they meet the new obligations in the National Credit Code. Changes to IT systems for system generated documents will need a reasonable lead time; and

- train our staff so they are aware how to carry out an 'assessment' that a credit product is 'not unsuitable' for the customer (particularly in relation to the review of requirements and objectives) and when it is reasonable to request additional information.

It will be impossible for ANZ to make these systems and process changes before 1 January 2010. In particular, this is made more difficult by the need to freeze any systems changes in from December to mid-January to ensure we can meet additional seasonal demands on those systems over the Christmas/New Year period.

ii. Training

ANZ will need to ensure that its representatives are adequately trained and are competent to engage in credit activities. A large number of ANZ staff who provide 'credit assistance' would need to be trained. Initial estimates suggest that we would need to train at least 2,500 staff, which will include branch staff located in metropolitan as well as regional and rural areas. This would take at least 9-12 months.

A further issue is that the standard of training is yet to be determined by ASIC. It is difficult to advise on the extent of the impact of this measure without further guidance on the expected level of training. This advice should be provided as soon as possible after consultation with key stakeholders. We consider it is not necessary for representatives for credit purposes to have the same level of training as is required under the FSR regime. They are completely different activities with different incentives, risks and skill requirements. We do not believe Tier 1 level training is required in this case.

iii. Other requirements likely to impact on timing:

There are also a number of other factors which will affect ANZ's ability to meet the proposed timeframe. These include:

- Risk assessment and contractual arrangements for intermediaries (brokers/franchisees etc) which ANZ may wish to appoint as credit representatives. ANZ has relationships with 80 home loan brokers (aggregated groups), 240 franchisees (for example, mobile lenders), 300 car loan brokers and 350 car dealers who sell ANZ car loans;
- Other new regulation with which we will also need to comply (eg margin lending, unfair contracts, the second phase of credit regulation); and
- Engagement of any additional staff we may require to undertake additional verification of customer's financial details.

Previously when similar legislative changes have been made (eg FSR, introduction of the UCCC), transition periods of two years have been provided. This allows licensees to make the changes necessary to comply with minimal disruption to business.

At this stage, ASIC guidance is expected to be provided on training standards and credit assessment. A transition period would ensure that this guidance is available and can be implemented and clarification sought where necessary. A timetable of expected guidance and when it will be provided by ASIC would be useful in transition planning. It would also be useful for there to be effective consultation with credit providers and other stakeholders in the development of the ASIC guidance.

Given the extensive obligations, the need to ensure all consumer credit products are compliant and the systems changes required, a two-year transition period should be allowed before the legislation comes into effect.

2. RESPONSIBLE LENDING

The draft legislation introduces new responsible lending provisions. This is a significant new legislative obligation for credit providers. Broadly, before a consumer enters into a credit contract (including a limit increase) or remains in an existing credit contract based on ANZ's advice, ANZ must:

- provide the consumer with a Credit Guide (unless the consumer has already received one)
- make an assessment as to whether the credit facility or increase in credit limit is not unsuitable for that consumer having:
 - o reasonably inquired about the borrower's requirements and objectives;
 - o reasonably inquired about the borrower's financial situation; and
 - o taken reasonable steps to verify the borrower's financial situation.

Credit must be deemed unsuitable (and must not be provided) if it is likely that the:

- consumer could not comply with all financial obligations of the contract or could only comply with substantial hardship; or
- the product does not meet the consumer's objectives.

The above process must include an assessment of capacity to repay. The assessment of capacity to repay must be made at the time of application for credit. In relation to residential investment loans, the circumstances in which ANZ can take into account anticipated rental income are unclear (noting that the UCCC did not extend to mortgages over investment properties). We believe it is appropriate to include rental income and our policy is to do so conservatively by taking into account a portion of the expected rent stream. Further, the implications of this assessment model where the consumer intends to negatively gear their investment property are also unclear.

The responsible lending obligations may affect ANZ's ability (and the ability of all other financial institutions) to offer certain credit products which may have a negative impact on the ability of some sectors of the community to access credit at a reasonable cost. For example, low documentation loans which are traditionally available to self employed persons will be affected because ANZ may be unable to satisfy obligations around "reasonable inquiries about financial situation" and "assessment of unsuitability". While documentation can be produced in respect of previous years' tax returns, this still would not, in our view, comply with the requirement to verify capacity to repay as previous income is no guarantee of future income.

It should not be assumed that all low documentation mortgage loans are of a lower credit quality or that applicants for such loans cannot comply with the financial obligations under the loans. ANZ's LoDoc60 loan, which is around 20% of our total

home loan book, requires a loan-to-value ratio of at least 60% (ie 40% deposit). This loan product had a 90-day delinquency rate of 0.28% compared with 0.4% for our total home loan portfolio as at April 2009. This lower delinquency rate has been a consistent trend for these loan products. For self-employed people, low documentation loans offer mortgage financing which may otherwise not be available or is available at higher interest rates or costs. ANZ's low documentation mortgage loans are offered on the same terms and interest rate as ANZ's standard variable rate home loans. It is not clear whether the Government intends these products to be removed.

ANZ's responsible lending promises

We believe that we are already meeting the obligations of a responsible lender. In 2005, ANZ was the first Australian bank to introduce responsible lending promises. These responsible lending promises are part of our Customer Charter, which sets out benchmarks for service to personal and small business customers. Our performance against these benchmarks is reviewed annually by an external auditor and the results published.

Under these responsible lending promises, ANZ credit card customers will not receive an unsolicited credit limit increase offer if they:

- Have repeatedly been overdue in making repayments or only made minimum payments in the previous six months
- Have an ANZ account receiving Government benefits (including Centrelink and Department of Veterans Affairs).

As a result of the introduction of these promises, the pool of customers who would have otherwise received a credit limit increase offer reduced by around 11 per cent.

Other promises we made about responsible lending are to:

- Provide information about easy and efficient ways to reduce your credit card limit
- Ensure the minimum monthly credit card repayment does not fall below 2% of the outstanding balance, unless the customer:
 - o Is in financial difficulty and we are assisting with reduced repayments
 - o Has accepted a special offer where for a specified period either no interest or a concessional interest rate is charged and no repayment is required
- With any credit card limit increase offer:
 - o Outline how much the minimum monthly repayment would increase if the offer was accepted
 - o Recommend the offer be rejected if personal circumstances have changed
 - o Include information about how to request a lower offer

- Explain in clear and simple terms how interest on a credit card or loan is calculated and charged, what fees may apply and when, and the consequences of late credit payment
- Respond within 48 hours to customers who have contacted us by telephone, and within five days to customers who have contacted us by letter, to advise us of financial hardship. We may also refer a customer to an accredited financial counsellor.

Our responsible lending promises are a practical response to research we undertook on financial literacy. This research found that there are three core factors which cause people to fall into financial difficulty:

- 'unhealthy' ways of thinking about personal finances;
- circumstances outside of people's control; and
- lack of financial skills and knowledge.

Financial difficulty is most often caused by a combination of these factors, however the first two dominate as the causes of financial difficulty. These attributes of the consumer are difficult to determine by asking them for more details about their financial status.

The Bill should impose limited additional obligations on responsible lenders such as ANZ. However, as drafted it is not clear this is the case. The credit assessment processes required under the legislation should reflect those of credit providers who are already responsible lenders.

Credit assessment methodologies

ANZ believes that the most appropriate credit assessment method differs depending on the stage of the customer's relationship with a credit provider. It should also be a judgement based on the risk of the customer and the product. We apply a rigorous process which results in many applications being declined. As an example, applying our credit assessment methods, in April 2009, 46% of credit card applications were declined.

We currently treat established customers differently to new customers. This is appropriate given the information we have on established customers' financial performance over time. More information based on actual credit behaviour reduces risk in decision-making and this should be reflected in the principles relating to responsible lending. The Bill, however, applies the same approach to all customers, whether they are new or established.

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. ANZ does not generally rely on behavioural scoring of a customer to assess capacity for a credit card limit increase offer until that score can be based on nine months of the customer's transactional and repayment

data. Where ANZ has built up information about a customer's credit behaviour over this timeframe, automatic scoring is a highly reliable technique to assess further credit applications. This is demonstrated by analysis we've previously undertaken as set out below.

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.

In 2005, we commissioned research, published by AC Nielsen, into financial difficulty (available at www.anz.com/about-us/corporate-responsibility/community/financial-literacy-inclusion/research/). This showed that financial stress is more likely to be related to unexpected changes in circumstances than inadequate assessment processes.

ANZ conducted a further analysis of the ANZ customer base in the ACT to assess the reliability of credit assessment based on financial information provided by a sample of customers.¹ The results of this analysis suggested that legislation in the ACT, which requires that all credit limit increase applications be assessed through manual assessment methods, has not reduced the rate of defaults.

ANZ's responsible lending commitment on unsolicited credit limit increase offers, as discussed above, does not involve the collection of additional financial information from our customers but instead adds to our standard credit assessment process which relies on the information held by ANZ and behavioural scoring. It does not require ANZ to obtain additional information directly from the customer in relation to a credit limit increase offer as the ACT's regulation does. As discussed above we believe behavioural scoring is a reliable way of measuring the likelihood that a consumer will get into financial difficulty and default on the credit contract.

ANZ uses two measures, the receipt of Government benefits and consumer behaviour over a period of time, as a proxy to identify the customers most vulnerable to financial difficulty. While this may not exclude all vulnerable customers, it represents the most reliable and effective measure available to us. Additional information sourced from the

¹ ANZ conducted the analysis on the ACT because in 2002 this Territory introduced obligations on credit card providers to ask existing customers for new information on income and expenditure to assess manually whether a credit limit increase could be granted, rather than relying on the automated behavioural scoring tool developed and used by banks (see section 28A of the *Fair Trading Act 1992* (ACT)).

customer is unlikely to identify vulnerable customers any further — such as those who may face future employment instability or other changes to their circumstances.

The Bill as currently drafted 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. We submit that at the very least 'reasonable steps' should include reliance on existing data and behavioural scoring.

Positive credit reporting

The process imposed in the legislation could be more easily implemented if 'positive' credit reporting were available. Australia has a 'negative' credit reporting system which basically collects information on whether a credit provider has sought a credit report in connection with an application for credit, and reports of default, court actions and bankruptcy.

While this information is useful in some instances, such as when deciding to approve a home loan, it may not add as much value as other sources of information, such as behavioural scoring, when approving a credit limit increase.

The Australian Law Reform Commission (ALRC) has examined the credit reporting system. In its report *For Your Information: Australian Privacy Law and Practice*, the ALRC recommended that 'there should be some expansion of the categories of personal information that can be included in credit reporting information held by credit reporting agencies' including:

- The type of each current credit account opened (eg mortgage, credit card, personal loan);
- The date on which each current credit account was opened;
- The credit limit of each current account; and
- The date on which each credit account was closed.

Such a system would enable credit providers to identify reliably a customer's existing liabilities and previous credit performance. We believe that the responsible lending obligations contained in the Bill should commence once the positive credit reporting system is available to lenders.

Credit assistance and credit providers

We are concerned about the application to credit providers of responsible lending conduct expected of credit assistants under Part 3-1 of the Bill. We believe these standards predominantly relate to brokers and other intermediaries. The application to credit providers does not reflect the way they conduct their credit business. In addition, given that the lender must comply with these obligations before the credit is provided in any case, it is not clear what value is gained by imposing these obligations earlier in the process. The assessment applied at this later time removes the need for a preliminary assessment to be done at the assistance stage. Licensees who are credit

providers should only be required to comply with the responsible lending conduct obligations under Part 3-2 of the Bill.

ANZ must make a preliminary assessment as to whether the contract will be unsuitable for the consumer prior to any credit assistance being provided. 'Credit assistance' includes assisting the consumer to apply for a particular credit product with ANZ. The product application form is the means by which ANZ collects information from the customer about their financial situation and may also collect information about the customer's objectives and requirements. The proposed requirement in R150 means that where a customer has deliberately chosen the product they want and wish to apply for it, our staff cannot assist the customer with the application until the assessment of unsuitability has been performed (ie the assessment must be performed at a time prior to having obtained the information in the application form which will allow the assessment to be made).

Additionally, given the types of queries received from customers and potential customers, we are concerned that some activities undertaken by our staff may amount to inferred or implied suggestions for a particular product which would constitute 'credit assistance'. For example, a person may request an indication of the amount they would be eligible to borrow in circumstances where they are not yet ready to make a formal application. As part of this process, the person may be given an indication of the likely repayments for that loan amount based on ANZ's standard variable rate at that time. This may amount to a suggestion that the person apply for the ANZ Standard Variable Rate home loan.

Online tools which recommend the loan that best suits the customer based on the preferences entered, would also constitute 'credit assistance' (an example can be viewed at <http://www.anz.com/aus/calculators/default.asp> then under the heading 'Help me select a home loan...'). In this situation, although information about the customer's objectives and requirements is requested in order to be able to make the recommendation, it is premature and unnecessary to collect information about the customer's financial situation. Often a customer will use these tools as a means of researching what is available and may not wish (at that point) to make a formal application (or have not yet chosen ANZ as their provider).

The use of tools such as these is initiated by the customer. The purpose behind these tools and the ease and simplicity of using them would be compromised if ANZ were required to collect information about the customer's identity and financial information and have to verify this information before the results from the tool could be provided. At the moment any person is able to use these tools as a reference and to do so without providing their name and details. We submit that the point at which a lender should make an assessment of the customer's financial information and unsuitability is once the customer has applied for a loan. To have to conduct a preliminary assessment earlier in the process confuses the role of lender with an intermediary.

Recommended credit assessment process

We believe reasonable steps to take in relation to capacity to repay for credit contracts should vary depending on the product and the customer, including the extent of the

customer's relationship with the provider. The differences in the way ANZ treats new and established customers are outlined above. These processes are effective and we do not believe the legislation should impose substantial additional obligations on responsible lenders such as ANZ. However, as drafted we believe it does, particularly in relation to the provision of 'credit assistance'.

A risk-based approach to credit assessment is appropriate and delivers good outcomes. Highly prescriptive regulation on credit assessment is unlikely to improve these outcomes as most defaults are associated with unexpected circumstances rather than inadequate assessment processes. It should be made clear in the Bill, or at least in the Explanatory Memorandum, that a risk-based approach is acceptable with the level of assessment undertaken based on both the risk of the customer and the risk of the product.

Furthermore, for established customers, behavioural scoring is a reliable way to determine capacity to pay. In fact, our research shows it is more reliable than additional checks on an individual because capacity to pay relates to how a consumer intends to use the product as much as the level of their income and other liabilities. Behavioural scoring provides this information. The Bill should make clear that behavioural scoring has an important role in assessing capacity to pay for established customers.

3. OTHER ISSUES

Direct debit failure notices

Credit providers will be required to give a debtor (and any guarantor) a one-off direct debit default notice (ie the first occasion of default for a particular credit contract) within ten days of the default occurring. ANZ's existing systems and processes currently intervene after 14 days. One of the main reasons for allowing more time is that in many cases the customer will self-correct the failure. A notice in these instances would be unnecessary. A notice period of 10 business days (or 14 days) would address this concern. It would also bring the notice period into line with other notice periods in the Bill.

Copy of assessment on request

A consumer has the right to request a copy of the assessment that sets out the determination that the proposed or existing credit contract is not unsuitable for them, and the grounds for that assessment. This can be requested up to 12 months after the credit contract expires and must be provided within two days of the request.

It is not clear from the draft legislation what information needs to be set out in the assessment documentation provided to the consumer. We would obviously not wish to disclose commercially sensitive information due to the increased fraud risk associated with providing this type of information to consumers.

It will also be impossible for ANZ to meet the two-day deadline. If a notice is posted it may take longer than two days for the consumer to receive it. A period of 10 business days would be achievable.

Dealing with intermediaries

Licensees are prohibited from dealing with unlicensed parties in relation to a credit contract. A criminal penalty, including imprisonment, or a large civil pecuniary penalty could be imposed for breaching this. Licensees need up to date information about changes in licensing of brokers and other intermediaries to be able to undertake checks and protect themselves from liability. To address this problem, ASIC should maintain a public licensing register. However, with the volume of transactions that ANZ undertakes with brokers, it would be extremely burdensome to check the register each time we deal with a broker. ASIC should ensure that licence revocations are widely publicised. Licensees should be able to register with ASIC to receive notifications of licence revocations and other changes.

Conflicts of interest

Licensees must have in place adequate arrangements to ensure that customers are not disadvantaged by any conflict of interest that arises in relation to its credit activities or those of its representatives.

We submit that there are some areas of uncertainty in relation to the operation of this proposed obligation, including:

- we note from the commentary that the intention is that this relates only to conflicts of interest that arise at law. This limitation is not reflected in the provisions as they are currently drafted;
- a person can be a lender's representative if it can be said that they are *acting on behalf of* that lender (licensee). This could be the case in respect of one aspect of the credit activity, for example, performing the customer identification for the lender. But in all other respects, the person is the agent of the customer. In this situation, if the person is a licensee in their own right, both this person and the lender as licensees would have to comply with the conflicts obligation. The practical application of this obligation is unclear in these circumstances for the lender. For example, is the person taken to be the representative of the lender generally (despite also being the customer's agent) so that the lender needs to ensure that all aspects of the person's relationship with the customer do not lead to disadvantage or conflict for the customer; and
- it is not clear whether it is intended that a licensee can be the *representative* of another licensee (the 2nd licensee) by virtue of that first licensee *acting on behalf of* the 2nd licensee.

Further to this, variations in commission structures received by intermediaries from different lenders may also be regarded as a conflict with the interests of consumers. Again, given the broad wording of 'acting on behalf of' which appears in the definition of 'representative', it may be that an intermediary will be held to be ANZ's representative. In this case, ANZ is not privy to commissions a broker may receive from other lenders. This makes it very difficult to ensure a customer has not been affected by a broker's conflict of interest.

Securitisation

DEF 9 provides that an assignee of a credit provider, lessor, etc is itself a credit provider. This means the assignee would need to be licensed and because of R232 provide a credit guide.

Securitisation and other financial techniques involve assignments of beneficial interests. It should be made clear that DEF 7 only applies to legal assignments (ie where the lender of record changes). Unless this change is made, securitisation and other funding arrangements will be compromised and consumers will receive many confusing notices.

4. PENALTIES

The proposed penalties for breaching the legislation are significant:

- criminal penalties, including imprisonment for up to 5 years; and
- fines, and compensation to consumers for loss or damage suffered.

These are in addition to the remedies and penalties applicable under the Code.

Imprisonment is available as a penalty for many of the criminal offences. Some of these include failures to provide information or notification to ASIC. We believe a penalty of imprisonment is too severe for such offences. There is likely to be little public harm associated with an offence of that nature. For example, failing to notify ASIC of an authorised representative is unlikely to directly cause major public harm. A criminal penalty, which has significant effect beyond just the imprisonment or monetary fines imposed, is unnecessary to protect the public.

We believe it is important that, as part of the licensing regime, licensees meet certain obligations. We are not opposed to this happening where it results in improved regulatory outcomes. A large civil penalty should be a sufficient deterrent to obtain this outcome in relation to failures to notify or provide information.

There are examples where criminal penalties may be appropriate. These should be limited to instances where a credit provider has knowingly or intentionally offered a consumer a credit contract which is detrimental for that consumer. For example, a property investment adviser who sells properties and provides finance, knowing they will benefit from fees associated with the credit contract and then repossess the house when they can no longer pay.

LIC275 includes a strict liability offence for which imprisonment is available. This is inconsistent with standard penalty practice and should be revised to a more appropriate penalty.

5. CONCLUSION

ANZ supports regulation in areas where regulation has been unsatisfactory eg mortgage brokers, fringe lenders. The Bill as drafted currently has major implications for the way ANZ conducts its credit and lending businesses.

We will need further clarity on some provisions. In some cases this will come in ASIC regulatory guides. The legislation and regulatory guides will require changes to ANZ's systems and forms, additional training for a large number of staff and various other transitional adjustments. A two-year transition period, as was provided for FSR and the UCCC, should be provided in this legislation.

As discussed above, we believe that the most appropriate credit assessment method differs depending on the stage of the customer's relationship with a credit provider. It should also be a judgement based on the risk of the customer and the product. To clarify that this is permitted within responsible lending obligations we would like it to be clear in the Bill that:

- a risk-based approach is acceptable with the level of assessment undertaken based on both the risk of the customer and the risk of the product; and
- for established customers, existing customer information, including behavioural scoring, is a reliable way to determine capacity to pay.

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

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