National Credit Reform Green Paper

11 | 08 | 2010

ANZ Submission to the Treasury

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INTRODUCTION

INTRODUCTION

ANZ is pleased to provide a submission on the Green Paper on National Credit Reform. In our submission, we have addressed the sections of the Green Paper discussing:

- Credit for small business;
- Regulation of credit cards;
- Regulation of investment lending; and
- Enhancements to the National Consumer Credit Protection regime.

ANZ does not offer reverse mortgages or consumer leases (except for novated leases using the Esanda brand) and has not commented on these areas of the Green Paper. We consider that the chapters on short-term small-amount lending and the coverage of credit under the National Consumer Credit Protection Act 2009 and avoidance practices are not directly relevant to ANZ. On these issues, ANZ has contributed to an industry submission prepared by the ABA.

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

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CREDIT FOR SMALL BUSINESS

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Lending to small businesses is different from lending to consumers. Lending to small business carries a greater risk than consumer lending, particularly in comparison to residential mortgages. In some cases, such as lending to start-ups, it involves lending to businesses with limited or no financial history. This requires credit providers to take a different approach to the credit decision than in consumer lending.

Notwithstanding our assessment for the lending decision, a proportion of small businesses will fail. This is often caused by external factors including variations in revenue or economic conditions. Losses can compound quickly and sometimes we need to act to minimise the loss for the customer and the bank. This requires more active management of small business customers and a different approach to assisting businesses that are in financial difficulty. Options are provided, where possible, to assist customers repay the debt, including long-term repayment arrangements, loan extensions, deferrals, restructured loans or refinancing.

Issues of most concern to small business generally relate to the cost of finance or a decision not to lend to that customer. For example a recent survey by the Australian Chamber of Commerce and Industry found that cost and access to finance was one of the top three issues for small businesses in 2010. Small business groups have been particularly vocal about these concerns throughout the global financial crisis. Concerns expressed by small business groups prompted the Senate Economics Committee's Inquiry into Access of Small Business to Finance, which provided its final report in June 2010.

In contrast, we hear almost no complaints about the need for additional protection for small business customers or the need to prevent some small businesses from accessing credit. As far as we are aware, no small business group raised this issue in its submission to or appearances before the Senate inquiry (although we note this was not the focus of the Committee's inquiry). The very small number of complaints to the Financial Ombudsman Service (FOS) in the data presented in the Green Paper also seems to suggest no systemic consumer protection issues with small business lending.

Small business lending is already subject to regulation. When lending to small business, subscribing banks must comply with the requirements of the Code of Banking Practice. A breach of the Code of Banking Practice is a breach of contract. A small business which believes its bank has breached its obligations under the Code can take a complaint to FOS or raise the matter with the Code Compliance Monitoring Committee. As noted in the Green Paper the number of complaints made by small businesses is small. However, there may also be some small businesses which choose not to take their complaint to FOS.

There is also existing regulation in the National Consumer Credit Protection (NCCP) Act which allows borrowers to sign a Business Purpose Declaration provided they meet certain requirements. Lending to those borrowers will then be unregulated. Some lenders may not apply this appropriately and allow what should properly be consumer lending to be treated as commercial lending. This may lead to problems associated with mixed finance or assets which are used for both business and personal use.

In addition to these protections, small business owners often benefit from advice from a range of professionals. When establishing or running a business, a small business owner typically seeks advice from professional advisers, including solicitors and accountants, other small business owners and consultants. Banks also act as advisers on the various financing options. ANZ also provides a range of services to small business owners to assist them to build capacity and connect with other small business owners.

DEFINITION OF SMALL BUSINESS

The definition of a small business is an important consideration in determining the scope of any regulation. We note that the Treasury, for the purposes of the Green Paper, has adopted the definition in the Corporations Act: a business with 20 employees or a manufacturing business with 100 employees. Many businesses of this size would be sophisticated with large and appropriately complex borrowing relationships with credit providers.

ANZ treats businesses with business lending of $500,000 or less as small businesses. Other lenders use different thresholds. Where a lender borrows from more than one lender this is not a 'fail-safe' definition. For example, a lender may have significant lending from another bank but we treat them as a small business. This poses a real risk that the same borrower could be treated differently by different lenders, dependent on the "threshold" they set and the total exposure to the lender.

In practice, it would be difficult to set a clear definition for a small business which would ensure that the same business was treated the same way by all credit providers. There is also no 'one size fits all' approach to small business lending. Definitions based on simple attributes such as number of employees or lending relationship fail to take this into account and may have unintended consequences for some industries or businesses which do not fit the standard.

ANZ'S OFFERING TO SMALL BUSINESS

ANZ provides products and services to small business through its Commercial Banking business. Commercial Banking delivers products and services to customers in the Commercial market through dedicated managers focussing on Business Banking, Small Business and Regional Commercial and Agribusiness segments. ANZ provides a range of credit products to business customers including overdrafts, lines of credit, car and equipment loans and credit cards. ANZ also offers small business customers a range of other banking products including transaction accounts and merchant services (i.e. EFTPOS terminals).

Small Business Banking services customers with total business lending of up to $500,000. ANZ considers these businesses to be 'small business' and they typically have 20 or fewer employees.

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In this segment we have 320,000 customers, with only around 113,000 of those customers holding lending products. These customers have access to small business specialists through branches, online and over the phone and dedicated relationship managers located in ANZ Business Centres.

Larger businesses are managed through Business Banking. These businesses have lending of more than $500,000 and up to $10 million. These customers typically have a dedicated relationship manager who is responsible for tailoring their banking arrangements to their needs and managing those arrangements as needed.

Regional Commercial Banking is dedicated to supporting commercial and agricultural businesses across regional and rural Australia, including regional Small Business customers. This segment offers many of the same products as the above segments, but also offers specific products for farming business, such as revolving lines of credit which are specifically structured to account for typical (i.e. infrequent) agribusiness cash flows as interest can be charged in accordance with the customer’s income (i.e. monthly, quarterly, half yearly or yearly).

Esanda is a division of ANZ which, amongst other lending, supports the Asset Finance requirements of Small Business customers. A significant proportion of lending from Esanda is for cars and other vehicles. However, it also covers equipment lending such as commercial equipment and other machinery.

Car finance is an area where the line between business use and personal use can be blurred. A small business owner may acquire a car in the name of the business but use the car for personal use. This raises concerns when lenders repossess the vehicle. In these cases the business owner will typically sign a Business Purpose Declaration (BPD) when applying for the loan.

Esanda operates a policy on BPDs that makes every effort to ensure unregulated products are not offered to applicants who should be afforded the protection of the NCCP Act. Our default position is that if the applicant is not a body corporate and the proof of income supplied to us is payslips, then we will not offer a commercial lending product. Where the applicant is a small business (unincorporated such as a sole trader, partnership or unincorporated entity such as an association) and the proof of income supplied is business financials, we still require the BPD to be signed by the applicant confirming the asset will be used 50% or more for business purposes. We think this is a robust approach which ensures that customers who are really consumers enjoy the protections under consumer credit laws and are not offered small business products.

The Government may wish to consider codifying what constitutes a business purpose. In particular, it could be beneficial to move away from an applicant declaration basis to a clear standard which all lenders could apply consistently. This would ensure that genuine consumer lending is afforded the protections offered by the National Consumer Credit regime.

ANZ also offers a range of tools to assist small business customers. These are intended to help support small businesses at all stages of their life cycle. For example, we provide our small business customers with an online small business hub (www.sbhub.com.au) which allows

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customers access to business tools and, data about industry and other market trends. We also provide free workshops Australia-wide to help small business operators learn about new cash flow and marketing techniques to help build their businesses through the global economic downturn, and how to write business plans. We have been offering these workshops since 2005. They are actively promoted and we find that ANZ customers who complete the courses submit higher quality credit applications. The sessions are available to both ANZ and non-ANZ small business owners and feature a range of industry experts.

In addition, ANZ has a partnership with Xero, an online accounting system. Xero is an award winning, easy to use, online accounting system that provides small business owners with real-time data, online at any time. The software aggregates banking transaction data so that users can accurately, and in real time, understand their trading performance and cash flow position. This is another tool to assist small business customers better manage their businesses

While ANZ provides credit to small and medium sized enterprises, a large focus of the Commercial Banking business is on transaction accounts. Lending is subsequent to the establishment of a transaction account along with the personal service and tools provided. In fact, deposits from small businesses are almost four times more than the lending funds provided to small business customers.

HOW DO SMALL BUSINESSES USE CREDIT

The way businesses use credit varies widely across industries, the size of the company and stages in a business' life cycle. It is therefore difficult to provide a simple picture of how a small business uses credit.

We are, however, able to provide data on the types of credit products small businesses use. In ANZ's Small Business Banking segment:

- 61% of small business lending customers have a business credit card;
- 39% have a property mortgage; and
- 3.5% have a personal loan.

A large number of customers have more than one product. A large number of customers have no lending relationship at all and access only transaction products or merchant services.

DIFFERENCES BETWEEN SMALL BUSINESSES AND INDIVIDUALS

As noted above, there are some fundamental differences between lending to small business and lending to individuals. The additional risks involved require credit providers to take a different approach to credit assessment and closer ongoing monitoring of small business customers.

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Credit assessment

Credit assessment for small businesses is more complex than the assessment applied to individuals. It is less automated, requires a higher degree of judgment and involves higher levels of risk. We lend to a combination of existing businesses, new businesses, expansions and new to bank customers across a wide range of industries. Their lending needs vary and the considerations we need to make vary depending on these factors. There is no ‘one size fits all’ approach to lending to small business and it would be difficult to apply a ‘one size fits all’ regulatory regime.

Unlike consumer lending, each small business and each lending decision is very different. A heavy reliance is placed on judgmental credit assessment by experienced staff. The process is not as automated as consumer lending for this very reason. The assessor needs to determine the business viability, along with the customer’s track record and potential for success. This is particularly the case for start-up businesses where there is no proven financial history and the credit decision is based on our assessment of the business’ plan, any existing vendor information if available and future projections.

Experienced credit assessment staff are used for judgmental decision making. Both application and behaviour scorecards (transaction history) based on a range of customer attributes are used as part of the assessment of the customer’s likelihood of repaying the contract. These scorecards are regularly updated based on portfolio performance to ensure they are a reliable tool. In SME assessment, the scoring, credit policy and assessment is applied to both the individual and the business. The credit bureau check is used in conjunction with our scoring and assessment on both the individual and business or company.

The risk profile of the application and customer will determine the level of financial information and documentation required for new or additional credit. For example, a new to bank customer with no security or having a start-up business will need to provide full financials including up to two years of proven financials or projected financials including, if available vendor financials or BAS statements validating turnover.

Existing customers that have already been through a detailed assessment and have some level of security with the bank are offered a more streamlined assessment process. The limits are determined from an internal behaviour score (updated monthly) that has calculated the customer’s limit from proven repayment history and account conduct.

We must lend prudently (as required by the Code of Banking Practice) and price small business loans to cover the risk associated with different customers. Small businesses have a higher probability of default compared with retail home loan customers. They also tend to have a higher loss once default has occurred. The loss rate for the small business segment is 1.5-2 times higher when compared with mortgage loans. As a result banks are typically required by APRA to hold three times as much capital for small business lending than for less risky residential mortgage lending. This is the case even where the small business loan is secured against a residential property.

ANZ lends to small business on both a secured and unsecured basis. Where security is provided by the business or business owner, it is predominantly cash cover or property, either residential or commercial. We will also take security over the financed asset where we are lending for vehicles and other equipment. Residential property is the major asset held by most Australians. Allowing entrepreneurial business owners to access the equity in their home enables to them to obtain finance to develop or grow their business. New regulation should not restrict access to credit for these small business owners.

Ongoing monitoring

Circumstances can change very quickly for a small business due to weather or seasonal variations (particularly relevant for textile, clothing and footwear retailers), key customer or supplier insolvency or economic conditions. If a business gets into difficulty, losses can also compound very quickly. As a result we actively monitor small business customers' financial performance.

This monitoring uses internal behaviour scores. Any deterioration in a customer's account conduct is flagged and sent to a centralised team for review and potential remedial action. Customers with lending above $100,000 also have a relationship manager as a contact point who is responsible for regular contact with the customer and to meet the customer's credit needs.

TREATMENT OF BUSINESSES IN FINANCIAL DIFFICULTY

For a range of reasons some small businesses will get into financial difficulty. We appreciate that in many cases small business owners have put up their own home as security for their business loan or may have a business loan to purchase a car which is used for both business and personal purposes. The potential effect on the individual means we treat these cases sensitively. We need to minimise the losses for ANZ and the customer and sometimes this requires us to act more quickly than we would in relation to consumer credit.

The percentage of homes repossessed is extremely low relative to the number of customers in default. Less than 0.5% of customers who become 90 days or more delinquent and have the loan secured by residential property will have the property repossessed. A range of options is provided, where possible, to assist customers repay the debt, including permanent repayment arrangements, loan extensions, deferrals, restructured loans or refinancing. Realisation of the security is the last resort for the bank.

We also give customers every opportunity to repay car loans. Our general policy is that vehicle security is sold after the customer has been in default for an extended period unless they are

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under hardship arrangements. If the customer has not been able to refinance, make a permanent arrangement or repay the debt, the car must be sold as it is a depreciating asset. This protects both the customer and the bank. However, even where we have provided the customer with notice of repossession, we will not enforce our right if the customer enters into an arrangement, where they are able to afford to, or corrects the default. Where a customer falls into arrears we provide a notice indicating that they have 7 days to repay or we may take action to repossess the car. The car is not immediately repossessed at the end of the 7 day period and the actual process may take months. If the customer corrects the default in this time or enters into an arrangement we may not continue repossession. It should be noted that, in our Esanda division, on average over the last 9 months, only 0.25% of non-consumer accounts have been overdue by more than 90 days.

We provide finance to small businesses for a range of vehicles and in some cases the vehicle is clearly not used for personal purposes. For example, a sole trader who runs a small courier business may have a light truck which is used for the business. This vehicle is not likely to be used for personal purposes in the way that a standard sedan may be. The individual would likely be less affected by the repossession of a light truck than they would if it were a standard passenger vehicle. A faster process is appropriate to minimise any further loss. This is a further example where a 'one size fits all' regulatory approach would not be appropriate for small business lending.

The hardship process for small business loans is similar to the mortgage hardship process offering customers a maximum 12 months loan term extension or repayment deferral period on existing loans that qualify. Depending on the length of extension/deferral and existing security position, credit criteria and a financial assessment is applied to determine whether hardship assistance is suitable for the customer. Unlike retail mortgage customers, small business customers have a range of secured, partially secured and unsecured loans, therefore the range of options and determination of the businesses viability needs to be judgementally assessed.

For customers requesting hardship assistance for less than 3 months, we will assess the customer's situation, including their equity position, loan type and prospects for recovery, to determine if hardship assistance is suitable. If we do provide assistance, the loan term will be extended by the period we have provided. We also provide extensions or deferrals for 6 and 12 months. Customers must meet a number of criteria to be eligible for this longer term assistance.

The criteria to be eligible for 6 months hardship assistance are:

- Business must be solvent
- Sole Trader / Partnership hardship event must have caused current arrears or difficulty in payments
- There should be a strong focus on current equity position and strong opportunity for a resolution
- Documentation will be requested to support request

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- Customer is required to be contacted every 3 months

Criteria to be eligible for 12 months hardship assistance are:

- Business must be solvent
- Customer has had a strong relationship with the Bank and their loan history reflects this
- A full valuation of security will be required for all requests
- Documentation will be requested to support request
- Customer is required to be contacted every 3 months which will include:
    - Update on customers circumstances (i.e. cash flow, trading position, etc)
    - Ensure payment arrangement has been adhered too, if arranged
    - Confirm customers intentions post assistance (i.e. recommence payments, sale of property, refinance, etc.)

OPTIONS FOR REFORM

The Green Paper proposes three options for reform:

- Limited application of consumer credit protection regulations
- Full application of consumer credit protection regulations; and
- Development of tailored regulations for small business lending

Small businesses are concerned about access to and cost of finance. We are not aware of significant consumer protection concerns from small business. This is also reflected in the small number of complaints made to FOS by small businesses. We do not believe there are significant market failures in the small business lending market which need to be addressed through regulation.

If new regulation were to be applied to credit for small business, a clear case would need to be established based on a cost-benefit analysis. In particular, any consideration to implement new regulation must ensure that it does not restrict access to credit to small business owners who would otherwise be left with diminished options if they wish to establish or grow their business.

The full application of consumer credit protection regulations to small business would be inappropriate. It is also likely to be detrimental for small businesses. The responsible lending obligations which are imposed under consumer credit protection laws would be inappropriate for small business. Small businesses often have variable income or, in the case of start-ups, no established record of income. A business would not always be able to meet the strict 'capacity to repay' requirement under NCCP but may nevertheless be solvent and a low risk.

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It is not in the interests of credit providers to lend to businesses which will not be able to afford to repay the loan. We apply rigorous assessment processes to ensure that we lend responsibly to small businesses. Additional regulation of our credit assessment processes are likely to result in increased costs, particularly where we need to increase resources to collect and assess prescribed information. There could also be significant transitional costs if new regulation requires technology changes to our systems to ensure compliance.

Notwithstanding our credit assessment, a proportion of small businesses will fail due to unforeseeable factors such as seasonal or economic conditions. When those customers find themselves in financial difficulty, we apply policies which are fair and recognise that there may be an impact on the business owner if they have used their home as security or use a vehicle for mixed purposes. Our right to security of a business owner's home or car is exercised only as a last resort. For example, of those customers who have credit secured against their home and fall into financial difficulty, less than 0.5% have their homes repossessed. In our Esanda division, on average over the last 9 months, only 0.25% of non-UCCC accounts have been overdue by more than 90 days. Additional regulation to restrict lenders' rights to access the security may reduce small business access to credit or increase the cost of credit to small businesses.

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The Green Paper puts forward a number of options which are aimed at reducing the incidence and impact of unmanageable credit card debt on consumers while maintaining appropriate access to such credit. Unmanageable debt has been defined as a situation where a consumer does not have the capacity to repay the debt in a reasonable amount of time without substantial hardship.

The responsible lending provisions of the NCCP Act came into effect on 1 July 2010 (with ADIs having to comply from 1 January 2011). The obligations of lenders under the NCCP are intended to ensure consumers are not advanced more credit than they can afford to repay without substantial hardship and that they are not sold a product which is unsuitable for their needs. A customer has a range of remedies where a credit provider is found to have breached its responsible lending obligations. We believe this has addressed some of the key concerns raised in this paper and provides consumers with additional protections.

As is noted in the Green Paper, ANZ conducted research into financial difficulty in 2005 and 2008. The results of these surveys are discussed in more detail below, including how ANZ responded to the issues that they raised. This research suggests that the causes of financial difficulty are complex and may not be immediately solved by additional regulation.

ANZ RESEARCH INTO THE CAUSES OF FINANCIAL DIFFICULTY

In 2005 ANZ conducted research into the causes of financial difficulty as a part of our national survey of financial literacy. The first step was to quantify for the first time the incidence of financial difficulty in the general population. 'Financial difficulty' was defined as referring to those who:

- Feel out of control of their finances even though they have not missed repayments or defaulted on their commitments
- Have missed repayments and defaulted and feel severely out of control with their financial affairs.

Out of the 3500 adult participants in the national financial literacy survey, it was found that:

- 80 per cent feel 'in control' of their financial situation
- 17 per cent fluctuate between feeling 'in control' and 'out of control'
- 3 per cent felt 'out of control most or all of the time' and of these, two thirds had borrowed money.

In other words, our research showed that 2 per cent of the population with borrowings felt out of control with their finances.

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The findings of our 2008 financial literacy survey show similar results, with 3 per cent of survey respondents with borrowings feeling ‘out of control most or all of the time’. The slight increase in the percentage of people saying they felt out of control likely reflects the economic conditions at the time of the survey, which was an environment of rising interest rates combined with higher food, fuel and utilities prices.

2008 survey respondents who felt ‘out of control’ were less likely to have a credit card than those who felt ‘in control’ (51 versus 67 per cent) but more likely to have a loan from a pay day lender (5 versus 1 per cent), a personal loan (30 versus 14 per cent) or a line of credit or overdraft (20 versus 13 per cent). This means that only 2 per cent of respondents felt out of control with their finances and held a credit card.

The 2005 financial difficulty qualitative research delved further into the group that felt out of control and had borrowings to identify causes. Three core factors emerged as causes of people falling into financial difficulty:

1. *‘Unhealthy’ ways of thinking about personal finances*

There were a number of ‘unhealthy’ ways of thinking about personal circumstances that dominated people’s beliefs and influenced the unhealthy financial behaviour of over-spending or over-commitment. ‘Unhealthy’ ways of thinking refers to where these thought patterns had a negative outcome on people’s personal debt levels and experience financial difficulty. These included:

- ‘Living for today’—focusing on the present not the future and the consequences of today’s spending
- ‘Financial disengagement’—no interest in managing finances and therefore no monitoring of, or responsibility for, spending
- ‘Aspirational’—spending to ‘keep up with the Joneses’
- ‘Emotional enhancement’—spending to feel better
- Ownership of credit—over time developing an attitude of ‘it’s my money’ as opposed to credit that needs to be repaid
- Credit as supplementary income—‘I need more to live’: to supplement a low income, to replace a loss in income or for those with higher incomes to support a ‘lifestyle’.

These ways of thinking tended to dominate financial decision making in this group, overwhelming application of financial knowledge and planning and due consideration of the consequences of spending.

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2. Circumstances outside of people's control

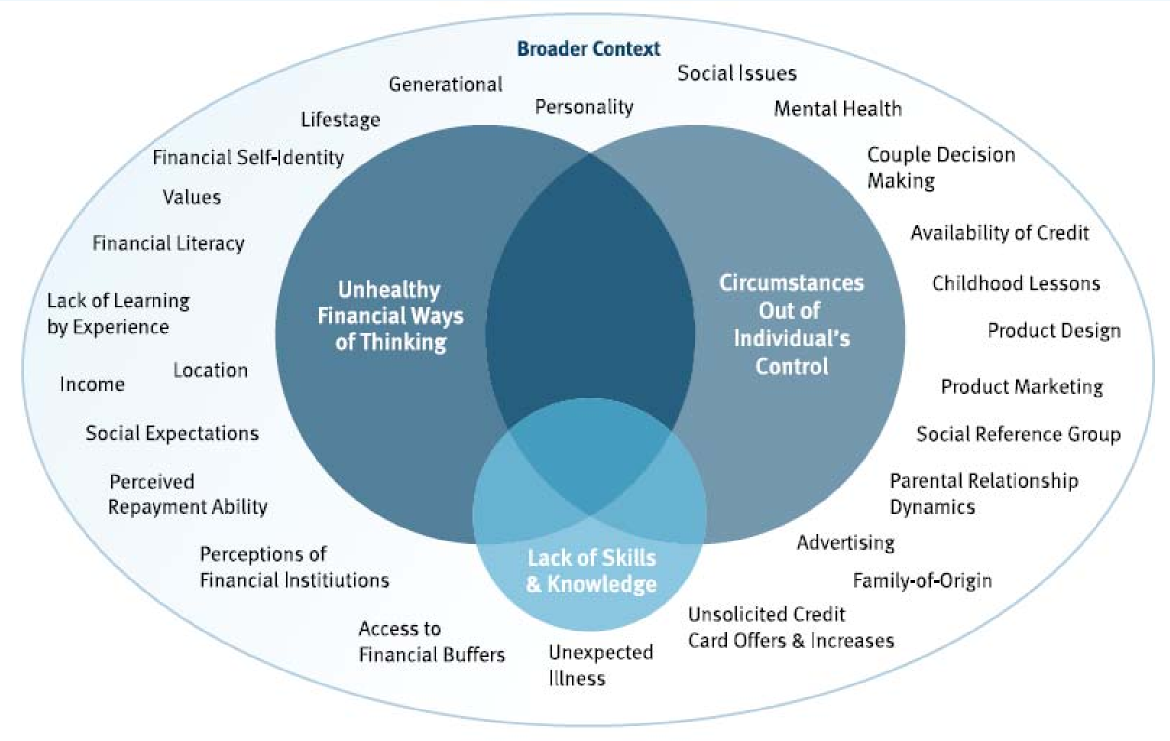
A similarly sized proportion of the sample was in financial difficulty due to events outside of their control. These events had the effect of decreasing income, increasing expenses, or both, and included job loss, poor health, divorce and relationship breakdown and small business failure.

3. Lack of financial skills and knowledge

A lack of financial skills and knowledge was a factor for only a minority of people in the sample. It applied to people having too low a skills base to conduct their affairs effectively, such as not knowing how products work or not recognizing when they should seek advice.

As illustrated in Figure 1, financial difficulty is most often caused by a combination of these factors.

Figure 1—Factors Leading to Financial Difficulty



Source: Understanding Personal Debt and Financial Difficulty in Australia—November 2005

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The research told us that financial difficulty is closely related to the behaviour, traits and circumstances of the individual rather than a lack of information available to the consumer. Many in difficulty have reasonable financial literacy skills yet those skills were typically 'dormant' until a crisis point had been reached, often over-ridden by 'unhealthy' ways of thinking about personal finances.

People are particularly vulnerable to financial difficulty where they do not have the capacity, for example, assets to sell or a savings buffer, to deal with financial pressure when it arises.

Importantly for ANZ, the research also confirmed that credit providers have an indirect role in causing financial difficulty. For instance, half of the people in the study with credit cards had received unsolicited credit limit increase offers and around half of those had accepted them. For some people, these offers were found to have an indirect link to financial difficulty in two ways:

- For people with a predisposition to 'unhealthy' ways of thinking about personal finances or facing a financial emergency, by providing the opportunity to access credit
- By creating a perception that because it comes from a bank, it must be affordable – i.e. 'If the bank thinks I should have a $5000 limit then I should be able to afford it'

In conjunction with 'unhealthy' ways of thinking about personal finances and/or financial stress caused by an unexpected life event, offers can be accepted by customers with little consideration of their own financial situation.

ANZ'S RESPONSIBLE LENDING PROMISES

In response to our findings in relation to financial difficulty we concluded that:

- Credit providers do have a role in causing financial difficulty
- For the most part, financial difficulty is not caused by a lack of knowledge or information
- Excluding the most vulnerable is more likely to be effective than increasing disclosure or asking the customer for more details about their financial status.

We concluded, in consultation with our external stakeholders, that there is a group of customers who should be excluded from credit limit increase offers on their credit cards. The underlying philosophy is that we should not extend credit to those who may be vulnerable. It is in ANZ's interests to ensure both a low level of debt losses and that community expectations about responsible lending behaviour are met.

ANZ then revised its Customer Charter in November 2005 to include a set of promises relating to responsible lending, primarily aimed at credit card limit increase offers. ANZ is the only bank in Australia to formally adopt an independently audited and publicly reported responsible lending code. The promises mean that ANZ customers must pass through a series of filters before they

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receive a credit card limit increase offer. Customers are excluded from offers if they fall into one or more of the following categories:

- They have a recent poor credit performance or are struggling to meet repayments on their ANZ credit card, for example they are only making minimum monthly repayment on a regular basis
- They have an ANZ deposit account which receives payment of Centrelink or Department of Veterans Affairs benefits.

Customers who are not removed through these filters are then subjected to a second set of discriminating criteria based on behavioural scoring. This method of credit assessment eliminates customers whose accounts show signs of unreliable credit behaviour over the preceding 12 months or are associated with characteristics of ‘strugglers’. Behavioural scoring uses historical data about credit performance to identify, and appropriately score, behaviour indicating a high risk of financial difficulty.

There are two main scores used. The first is an ‘account’ score, which looks at how the customer is managing repayments and the credit limit on their credit card. The second score looks across the whole of a customer’s relationship with the bank and is designed to pick up signs of immediate financial stress and early warning signs of difficulty across all products the customer holds with the bank. Customers are automatically excluded from all offers if they are in default on any other ANZ credit product. Customers are also excluded from credit limit increase offers where they have opted out of receiving marketing material from ANZ.

ANZ uses the receipt of Government benefits and consumer behaviour, 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 measure available to us. Additional information sourced from the customer is unlikely to identify vulnerable customers any further—such as those who may face future employment instability or other changes to their circumstances.

ANZ also introduced other responsible lending promises in 2005 including that:

- With any credit limit increase offer we would:
  - Outline how much the minimum monthly payment would increase to if the offer was accepted
  - Recommend the customer reject the offer if their personal circumstances have changed
  - Include information about how to request a lower limit.
- Ensure the minimum monthly credit card payment does not fall below 2 per cent of the outstanding balance (unless the customer has accepted a special offer or is in financial difficulty and we are assisting the customer with a tailored repayment plan)

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- Explain in clear and simple terms how credit card interest is calculated and charged, what fees may apply and when, and the consequences of paying late
- Respond within 48 hours if a customer contacts us by telephone, and within 5 days if the customer contacts us by letter, to advise us of financial hardship
- Provide customers with information about easy and efficient ways to reduce their credit card limit.

ANZ's performance on these promises is independently audited every year, along with the other promises contained in the Customer Charter.

From 1 January 2011, this will be supplemented by the responsible lending obligations set out in the NCCP Act.

OPTIONS CONSIDERED BY MCCA

The Green Paper includes six options which were the subject of consultation by the Ministerial Council on Consumer Affairs in 2008. We believe some of these options have been addressed as part of the first phase of credit reform. Where this is not the case, we have provided our position on the options.

MCCA Option 1: Change the timing of essential information

Option 1 of the Consultation Paper suggests that disclosure of interest rates, fees and interest free periods should be provided to consumers in promotional material and within the application for credit.

ANZ ensures that our interest rates, fees and charges, and interest free periods are clearly disclosed to all of our credit card customers. As noted above in 2005 ANZ introduced a responsible lending commitment into our Customer Charter which, amongst other things, specifies that we will "explain in clear and simple terms how interest on your credit card or loan is calculated, what fees may apply and when, and the consequences of paying late on your credit".

The significant majority of our upfront promotional material includes information on core pricing terms, including interest rates, interest free periods and upfront fees. Links to interest rates and terms and conditions are available on each page referring to credit cards on www.anz.com. If requested these can be sent to a customer. The ANZ Credit Cards Conditions of Use contains a section "Important things to know about using your ANZ credit card" which states in plain and simple language how interest is calculated.

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In addition, all pricing is clearly and simply disclosed to customers in ANZ's Letter of Offer. The credit card account is not available for the customer to use until they have received our offer and telephoned us to accept it based on the pricing outlined in the Letter of Offer.

ANZ believes that our customers already have the pricing information they need to make a decision on acquiring a credit card and our research shows that the main causes of financial difficulty relate to behavioural traits and unforeseen circumstances rather than a lack of information. As such, additional disclosure in promotional material or within an application is unlikely to assist customers avoid future financial difficulty.

However, we are not opposed to changing the presentation or timing of essential information if it can be demonstrated that this will improve the customer's ability to make an informed choice between credit card contracts. To implement this option systems changes would be required because ANZ uses a standard form application and terms and conditions documents for all types of credit cards. This practice was adopted to streamline the process and ensure that branch staff did not have to source multiple application forms for our many different credit card products, as well as any promotional offers associated with particular products.

MCCA Option 2: require credit providers to allow consumers to nominate the credit limit sought

ASIC Regulatory Guide 209 sets out what a credit provider must do to meet its responsible lending obligations under the NCCP Act. RG 209 says 'we expect that you would … make inquiries about the maximum limit the consumer requires on the card, as this is a key feature of the product that relates to the consumer's requirements and objectives.' As a result, we believe this option has been implemented and no further regulation is required.

MCCA Option 3: Prohibit the card issuer from providing more credit than the consumer can repay from income without substantial hardship

A key requirement of the responsible lending obligations in the NCCP is that a credit provider may only provide credit where the customer has the capacity to meet the repayments without substantial hardship. This option has also been implemented and we consider that no further regulation is required.

This option also includes discussion on whether a minimum repayment period should reflect the ability of the customer to repay the loan within a defined period. This makes a broad assumption that a credit card is similar to a personal loan. A credit card is a very different product to a personal loan in that it is a cash management tool which customers can use to make large purchases and balance their income and expenses over a period of time. By their nature, credit 'revolves' on credit cards, rather than being paid off in a set period as occurs with personal loans.

REGULATION OF CREDIT CARDS

MCCA Option 4: provide relief for consumers by making the debt unenforceable to the extent that it exceeds an amount granted in accordance with option 3

The NCCP Act provides a number of remedies and sanctions where a lender has breached their responsible lending obligations. These include remedies to compensate any loss by the consumer, as well as criminal and civil penalties for the credit provider.

Customers who they have been advanced too much credit may also complain to FOS. If the complaint is upheld and there is a finding of 'maladministration' against the bank, the debt becomes unenforceable. We believe this adequately addresses this option and no further regulation is required.

MCCA Option 5: Require card issuers to warn consumers about the effect of paying only the minimum repayments

Option 5 would require a 'health warning' on monthly statements in relation to the time that a consumer could expect to be indebted if paying only the minimum payment (and not making further purchases or cash advances). This warning would also include the total interest that would be payable.

The warnings recommended by the Green Paper are clearly targeted at customers who only make minimum repayments. ANZ estimates that, excluding those customers on special offers and payment moratoriums, less than 1.5 per cent of our customers are currently in the habit of making the minimum payment (or payments just below the minimum payment) on their credit card account.

A personalised disclosure as recommended by the Consultation Paper would need to be tailored to each customer's credit card limit. This would require significant investment in systems development and testing of the system's supporting statements to enable automated calculation of repayment time based on the customer's limit – investment in disclosure which will be relevant to only a small minority of customers.

Rather than providing detailed information about one payment pattern, based on assumptions which are unlikely to eventuate for the customer, we believe the interests of consumers may be better served by providing a general warning message.

REGULATION OF CREDIT CARDS

MCCA Option 6: Require card issuers to increase the minimum repayment percentage for new credit card contracts and for offers of increased credit limits on current cards

Option 6 would require credit card providers to increase the minimum repayment percentage on new credit card contracts and for offers of increased credit limits on existing cards.

As with Option 3, this option makes a broad assumption that a credit card is similar to a personal loan and that the minimum repayment needs to reflect the ability of the customer to repay the loan within a defined period.

Increasing the minimum monthly repayment amount has the potential to diminish the effectiveness of credit cards for the majority of customers who use them as a cash management tool. Customers generally do not spend up to their limit and then repay the amount by making only the minimum monthly repayment over a long period of time. The average monthly repayment made by ANZ customers on their credit card is 52 per cent of their outstanding balance (the average credit card balance is 38% of the maximum limit).

An extremely small minority of customers make minimum repayments on a regular basis (less than 1.5 per cent as highlighted above) and these customers are excluded from credit limit increase offers. Around 4 per cent of customers make minimum credit card repayments on an ad hoc basis. Regulation of the minimum monthly payment would remove the flexibility for those customers who want to make the minimum monthly payment on an ad hoc basis. Furthermore, it may have a detrimental impact on customers who find they are only able to make the minimum monthly repayment for a period. Increasing the amount they are required to repay may put them at risk of additional hardship or default during that period.

UNSOLICITED CREDIT LIMIT OFFERS

As discussed above, ANZ takes a responsible approach to exclude customers who may be vulnerable to offers of additional credit. In addition, the first phase of credit reform applies to all forms of consumer credit, including unsolicited credit limit offers. This protects consumers by preventing credit providers from offering more than the customer can repay without financial hardship.

The take-up rate on offers to customers who are eligible suggests that there is a demand and customers welcome the convenience offered by credit limit offers. The default rate for customers who accept CLIs is 1 per cent compared with 3.5 per cent for the rest of the credit card portfolio, suggesting that customers are also able to make the repayments on increased credit limits.

ANZ’s analysis of our credit card customer base has shown consistently that behavioural scoring is a significantly more reliable assessment method than manual assessment of a customer’s financial information. It provides a reliable indication of a customer’s actual behaviour in relation to a credit card over time rather than a point in time assessment of their financial position.

REGULATION OF CREDIT CARDS

We believe the existing protections are adequate and that further regulation is not required in this area. At this stage, it is too early to fully consider the effect of the responsible lending obligations on credit limit offers. These regulations should be allowed to take effect and their impact and effectiveness reviewed before any consideration is given to further regulation of credit limit offers.

OTHER ISSUES

The Green Paper also canvasses a number of other potential issues with credit cards. We do not believe these issues lead to consumers taking on unmanageable debt. They are, however, generally areas where there needs to be effective disclosure to consumers to enable them to make an informed choice between credit card contracts.

We note questions are raised about the allocation of repayments. The way in which ANZ allocates repayments to different credit card balances is fully disclosed in ANZ's credit card terms and conditions. However, we understand that practices vary and this is important information to enable consumers to make an informed choice between credit card providers. We have already taken steps to include improved disclosure upfront in credit card terms and conditions by providing a section called "Important things to know about using your ANZ credit card", which states in plain and simple language how interest is calculated.

We believe that standardising the way credit card providers apply interest is a form of price regulation. Rather than imposing this form of regulation, the focus should be on ensuring disclosure is made across the industry in a way which will enable consumers to compare products.

The Paper seeks comment on whether there should be a longer notification period for interest rate increases.

Recent regulation has been introduced in the United States to require credit providers to send customers a notice 45 days before an increase in their credit card interest rate. There are some exceptions including where the card has a variable interest rate tied to an index and the index moves. The regulation was intended to address the practice in the US where a credit provider would increase substantially a customer's credit card interest rate following any change in their credit bureau score. This would typically be because they have defaulted on another credit contract but also may be affected by inquiries on their file. This does not happen in Australia and we do not plan to adopt such an approach. We believe our approach is fair and does not lead to consumer detriment. Customers are easily able to close or switch their credit card account if they are unhappy with an increase in their credit card interest rate. Balance transfers allow this to happen even where the customer has an outstanding credit balance.

REGULATION OF CREDIT CARDS

Similarly, exceeding credit limits does not in itself lead to consumer detriment. It is a service that ANZ provides to customers who want and value the flexibility. As a fee is charged for this, we offer customers ways to avoid these fees and have committed to applying them fairly.

ANZ provides customers with information and options to help them avoid overlimit fees on credit cards. In particular, we give customers the option of electing not to exceed their credit card limit on electronically authorised purchases and cash transactions. If they do not elect this option and incur an overlimit fee we provide advice on ways they can avoid them.

In addition, we want to ensure these fees are applied fairly. Customers will not be required to pay the first overlimit fee they incur if they contact us to discuss it and the options to avoid these fees in the future. In addition, customers will not be charged more than one overlimit Fee in any one monthly statement cycle. To ensure these fees do not impact on vulnerable consumers, ANZ credit card customers who are recipients of Government benefits and also hold an ANZ Access Basic account will not incur any overlimit fees.

ANZ Access Basic is an everyday transaction account which is free of monthly account keeping fees and exception fees to customers who receive Government benefits and/or hold a health care card. It offers unlimited access to ANZ ATMs, Phone & Internet Banking, plus branch and EFTPOS with no account keeping fees or exception fees. Customers are eligible for ANZ Access Basic if they:

- are an Australian resident, with an Australian address;
- hold the account in a personal name;
- have their income, pension or allowance paid into their ANZ account; and
- and hold a Seniors Concession card, Pensioner Concession card, Centrelink Health Care card or Repatriation Health card.

We believe we have adopted a fair approach by allowing customers to opt out and applying fees fairly where customers do exceed their credit card. Additional regulation may be detrimental for customers who want the flexibility and convenience of being able to exceed their credit limit for a short time.

REGULATION OF INVESTMENT LENDING

REGULATION OF INVESTMENT LENDING

ANZ currently offers personal lending products which would allow people to invest (other than in residential property or margin loans). These include:

- Mortgages: we allow people to borrow against their home to invest. The loan is secured against the home;
- Personal loans: unsecured loans which can be used for investment purposes;
- Commercial Banking: for small business owners to invest on a secured and unsecured basis; and
- ANZ Private Bank: Specialises in assisting high net worth individuals and families to manage, preserve and grow their assets. In this area, we typically offer margin loans, which are provided by our Investment Lending business. However, for some high net worth customers we offer tailored lending to enable them to invest in other assets.

The Green Paper suggests that borrowers may use credit cards to invest in shares. We are not aware that this is a widespread practice. If a customer was seeking a loan to invest in shares, we would not offer a credit card. However, once a customer has obtained a credit card, if they choose to use it for investment purposes, there is little we can do to prevent that from occurring. Credit cards are treated as regulated products regardless of purpose, so consumers will have the protection of the NCCP regime if they choose to use it to invest in shares.

Under existing law we can treat loans for the purpose of investment (other than residential property and margin loans) as unregulated loans. While these loans are unregulated, they are assessed in accordance with our credit policies to ensure that the customer can afford to repay the contract and customers would have access to our standard hardship process if they find themselves in financial difficulty.

In 2009, the Parliamentary Joint Committee on Corporations and Financial Services considered issues relating to financial products and services in light of the collapse of Storm Financial, Opes Prime and other similar financial services providers. We note that the Committee did not recommend the regulation of lending for investment purposes. The key concern was access to and quality of financial advice.

We are not aware of significant concerns associated with investment lending outside the areas of residential property and margin loans. Regulation will impose additional costs on lenders in assessing and managing these loans. For example, systems will need to be changed to ensure that regulated Letters of Offer and other notices are provided to the customer.

If it is considered necessary to regulate all loans for investment purposes, the regulatory approach should seek to minimise the impact on lenders and not impose different processes for similar lending. Loans to invest in shares are more like investments in residential property than margin loans. Residential investment loans are regulated under the NCCP Act. Given the

REGULATION OF INVESTMENT LENDING

similarities to a residential investment loan, a consistent regulatory approach should be adopted if necessary.

It would be inconsistent to bring the types of lending for investment purposes discussed in the Green Paper under Chapter 7 of the Corporations Act. This will impose a higher standard on loans for other investment purposes than residential investment loans. Completely new processes and procedures would need to be developed for these loans which would increase the cost of implementation. It would also impose significant additional cost to ensure that all staff who are involved in the sale and processing of loans for investment purposes are trained to the necessary level.

ENHANCEMENTS TO THE NCCP REGIME

ENHANCEMENTS TO THE NATIONAL CONSUMER CREDIT PROTECTION REGIME

ENHANCEMENTS TO THE HARDSHIP VARIATION PROVISIONS

The Green Paper raises two issues in relation to hardship variations: the types of variations that can be requested; and the monetary threshold above which a consumer cannot request a hardship variation.

Issue 1: Types of hardship variations

Under the National Credit Code, customers are able to request:

- An extension to the period of the contract, and reducing repayments accordingly
- A repayment holiday, without extending the period of the contract; or
- A repayment holiday and extending the period of the contract

Both the ABA Code of Banking Practice and the Mutual Banking Code of Practice go further than the NCC and require banks and mutuals to try to assist debtors to overcome their financial difficulty. Where a customer feels we have not given appropriate consideration to their request, they are able to complain to FOS.

In practice, we also offer a wider range of assistance measures than required under the NCC. For example, we waive fees and interest in many situations and have signed up to the Principles developed with Treasury for assisting customers who are in financial difficulty. Each hardship request is different and the prospects for customers to overcome their financial difficulty will vary. For some customers there will be little we can do and the best option is for the customer to exit the contract. This suggests that a principles-based approach, such as that adopted in the CoBP may be preferable to a prescriptive regulatory approach which provides less flexibility for credit providers to tailor their processes to accommodate these differences. Access to external dispute resolution services currently allows customer complaints in this area to be resolved cheaply and relatively informally. We would support this remaining the domain of industry codes and external dispute resolution bodies rather than government regulation and the courts.

Issue 2: Monetary threshold

The principles agreed by the Government and all retail banks, building societies and credit unions require credit providers to offer all customers access to hardship variations, regardless of the value of their loan. As a result, we do not currently enforce the monetary threshold for hardship applications. For now, we do not consider it necessary to codify this standard. This

ENHANCEMENTS TO THE NCCP REGIME

should be considered further in the future if the Government determines the principles are no longer necessary.

In the change from the Uniform Consumer Credit Code to the National Credit Code the threshold has been increased to $500,000. Future increases to the threshold are already permitted by regulations under the NCC. This mechanism could also be used to adjust the threshold in the future if it is considered necessary.

ENHANCEMENTS TO THE STAY OF ENFORCEMENT PROVISIONS

The NCCP Act imposes obligations on lenders where a customer is in default. Before a credit provider can initiate proceedings, the customer must be provided with a credit default notice. Court proceedings may not commence until 30 days after the notice has been sent. The notice is a prescribed form and sets out:

- the customer's right to request a variation to their contract on hardship grounds and the number they need to call to request a hardship variation; and
- their right to access EDR if they are not satisfied with the final outcome or the lender fails to respond within the required timeframe.

This provides consumers with a reasonable opportunity to seek a hardship variation or make a complaint to FOS.

FOS's terms of reference have recently been revised and now allow FOS to take on cases where legal proceedings have already commenced. This gives customers an opportunity to access EDR where court proceedings have commenced. Additional enhancements to the stay of enforcement provisions should be considered only after this new process has been observed in operation.

ANZ