The Report of the Consumer Credit Review

ANZ Submission

May 2006

Executive Summary

ANZ's response to the Report of the Consumer Credit Review recommendations is based on research. Since 2002, ANZ has devoted considerable resources to the issue of financial literacy and inclusion, including:

- conducting the first national survey into the levels of adult financial literacy in 2002;
- commissioning research into the levels and nature of financial exclusion in 2004; and
- repeating the quantitative study into levels of financial literacy in 2005 and conducting research into the causes of financial difficulty.

ANZ has used this research to design and effectively target strategies to improve levels of financial literacy and inclusion. The recent research into financial difficulty provided valuable information on the core factors leading to financial difficulty, the role of credit providers in credit overcommitment and the relevance of disclosure for those most at risk of difficulty.

As well as forming the basis for ANZ's response to a number of recommendations in the Report, this research has also informed ANZ's business practices, including the development last year of public and auditable responsible lending promises – a first for a bank in Australia.

This submission makes some key points in response to the Report's recommendations:

Responsible Lending and Advertising Practices

ANZ's responsible lending code excludes customers from credit card limit increase offers where they have a poor recent credit performance or are struggling to meet repayments on their credit card or if we know they are on a fixed income.

These promises were driven by the research into financial difficulty which told us:

- credit providers have a role in causing financial difficulty;
- financial difficulty is closely related to the behaviour, traits and circumstances of the individual rather than a lack of information;
- people are particularly vulnerable to difficulty where they do not have the capacity to deal with financial pressure when it arises; and
- 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 being that we should extend credit only to those we believe can repay.

We also concluded from the research that those most at risk of financial difficulty are unlikely to consider, and therefore benefit from, detailed disclosure.

For this reason, and the fact that only 2.5 per cent of ANZ customers habitually pay the minimum payment on their credit card, ANZ recommends the review reconsider the recommendation that credit providers disclose in detail how long it would take a customer to pay off their fully drawn credit limit with minimum payments. Credit card holders could instead obtain this information (and other information) through a free telephone number printed on the statement or credit limit increase offer, as occurs in the US. This information could be combined with a short generic warning about minimum payments.

ANZ supports the Report's recommendation that there be a positive obligation on credit providers to adequately assess a customer's capacity to repay credit, however the method used to assess that capacity should not be mandated in legislation. The Report essentially recommends a requirement that a customer's capacity for credit limit increase be assessed by a manual assessment of customer-provided financial information (the method most commonly used to assess new applicants). ANZ does not support this approach because:

- manual assessment is most useful where the credit provider knows nothing about the customer, but is otherwise less reliable than other methods;
- behavioural scoring is consistently shown to be a more reliable assessment method where the credit provider has built up information about the customer's credit behaviour over time; and
- previous legislation in the ACT prescribing manual assessment for credit limit increase offers has not reduced rates of default among ANZ customers in the ACT.

Rather than prescribing assessment methods, ANZ believes the better approach to reduce the incidence of financial difficulty through credit limit increase offers is to exclude the most vulnerable from those offers. ANZ would support the adoption of its own responsible lending promises as industry best practice guidelines. Similar guidelines are now contained in the UK Banking Code.

ANZ supports the Report's recommendation to conduct further research into credit advertising and standards. It is in ANZ's interests that its advertising of credit is consistent with its significant investment in financial literacy and public commitments to responsible lending. Research should avoid the presumption that credit advertising is, per se, irresponsible or dangerous.

Any measures to address the problem of overcommitment must be proportionate to the causes of financial difficulty, and in ANZ's view, both responsible consumer behaviour and responsible lending practices are required. The failure of either can result in financial difficulty.

Small Amount Lending

ANZ supports the recommendation that bank and non-bank lenders provide vulnerable and disadvantaged consumers with more access to low cost small amount credit, but it is important to note that credit providers cannot provide such programs alone. Partnership with community organisations is essential to attract the right participants; attract enough participants; build expertise in assessing the capacity of disadvantaged consumers; and build trust in the community about the program.

ANZ commenced a small loans program in April 2006, in partnership with the Brotherhood of St Laurence. The aim of the program is to provide affordable and safe small amount loans to people on low incomes and for personal/household purposes.

ANZ is willing to participate in a summit to explore ways to encourage the development of small loans programs.

Fees and charges

ANZ does not support the recommendation that all fees and charges be reviewable on the ground of 'unreasonableness' because:

- it involves legislative intervention in the mainstream market, when the clear market failure is in the non-mainstream sector;
- it will not address the lack of safe and affordable small amount credit options for low income or disadvantaged customers; and
- the enforcement of core terms of credit contracts would become uncertain.

A more appropriate legislative response to the immediate issue of predatory pricing of short term credit may be an effective interest rate cap, similar to the legislative cap introduced in New South Wales.

Regulation of Equity Release Products

ANZ supports the recommendation to conduct further analysis into consumer protection in relation into reverse mortgages. The current disclosure regime does not provide for the disclosure of some matters particularly important to consumers of reverse mortgages, such as the disclosure of risks, taxation and benefit implications and the cost of equity forgone. ANZ also sees a need for credit providers to treat the selling process for reverse mortgages differently to that of 'standard' mortgages.

Regulation of Finance Brokers

ANZ supports nationally consistent regulation of finance and mortgage brokers.

Unfair Contracts Terms in Credit Contracts

The issue of unfair contract terms in consumer contracts is more appropriately addressed by the Standing Committee of Officials of Consumer Affairs (SCOCA) which is currently developing policy positions in respect of a national unfair contract terms regime.

Business Purpose Test

The removal of the business purpose test presumption may create significant uncertainty for all credit providers. If removed, the presumption must be replaced with some other objective test on which a credit provider could rely to reverse the presumption in section 11(1) of the Consumer Credit Code.

Credit Reporting

ANZ supports the repeal of the *Credit Reporting Act 1978* and further research into the benefits and costs of a positive credit reporting scheme.

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

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Introduction

ANZ appreciates the opportunity to provide a response to the Report of the Consumer Credit Review (the Report). We applaud the efforts of the State Government of Victoria in promoting debate and discussion between industry, consumer advocates and Government of the important issues surrounding consumer credit, in particular responsible lending; the cost of credit; and small amount lending and access to credit.

ANZ's response to the Report's recommendations is based on research. Since 2002, ANZ has devoted considerable resources to the issue of financial literacy and inclusion, including:

- conducting the first national survey into the levels of adult financial literacy in 2002;
- commissioning research into the levels and nature of financial exclusion in 2004; and
- repeating the quantitative study into levels of financial literacy in 2005 and conducting research into the causes of financial difficulty.

ANZ has used this research to design and effectively target strategies to improve levels of financial literacy and inclusion. This includes development and implementation of a range of innovative community programs in partnership with government, regulators and community organisations.

The recent research into financial difficulty provided valuable information on the core factors leading to financial difficulty, the role of credit providers in credit overcommitment and the relevance of disclosure for those most at risk of difficulty.

As well as forming the basis for ANZ's response to a number of recommendations in the Report, this research has also informed ANZ's business practices, including the development last year of responsible lending promises included in the revised ANZ Customer Charter.

This submission will outline ANZ's approach to responsible lending and in so doing will address the majority of recommendations set out in Chapter 6 of the Report. The submission will then respond to the balance of Chapter 6 recommendations and the Report's recommendations on:

- small amount lending – including reference to ANZ's small loans program and the Report's recommendations in relation to reviewing 'unreasonable' fees and charges;

- regulation of 'equity release products';

- regulation of finance brokers;

- unfair contract terms in credit contracts;

- business purpose test declarations; and

- positive credit reporting.

1. Responsible Lending and Advertising Practices

1.1. ANZ's approach to responsible lending

ANZ 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 first bank in Australia to formally adopt an independently audited and publicly reported responsible lending code. The Charter is Attachment 1 to this submission.

The promises are that ANZ will:

- not offer a credit limit increase offer to customers with a recent poor credit performance or who are struggling to meet repayments on their ANZ credit card;

- not offer a credit card limit increase if we know the customer is on a fixed income (e.g. receiving a government pension);

- with any credit limit increase offer:
  - outline how much the minimum monthly payment would increase if the offer was accepted;
  - recommend the customer reject the offer if their personal circumstances have changed; and
  - include information about how to request a lower limit

In addition, ANZ's Customer Charter includes promises to:

- ensure the minimum monthly credit card payment does not fall below 2% 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);

- 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; and

- 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.

ANZ's performance on these promises is independently audited every 6 months, along with the other promises contained in the Customer Charter.

1.2. How the promises work

In practical terms, these promises mean ANZ customers must pass through a series of filters before they 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 within the previous 6 months period, fallen two months past the due date form making the minimum payment on their account;

- they have made only the minimum payment (lesser of 2% of closing balance or $10) or slightly more than the minimum payment on their credit card for the last 6 consecutive months;

- they have an ANZ deposit account which receives payment of Centrelink or Department of Veterans Affairs benefits;

- they have a deeming account or other ANZ account (e.g. ANZ Basic) specifically designed for benefits recipients, whether or not the account is currently receiving benefits payments.

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.

As a result of the responsible lending promises, the pool of customers to whom ANZ would have normally issued credit card limit increase offers reduced by around 12%. Broken down into the specific grounds for exclusion under ANZ's promises:

- a 5.5% reduction is due to the exclusion of customers who have repeatedly missed payments or made only the minimum payment for the previous 6 months; and
- a further 6.3% reduction was due to the exclusion of customers on fixed incomes.

ANZ is currently working on improving as much as possible the reliability of the 'filters' to improve the effectiveness of the promises.

Where ANZ is not immediately aware that a customer receives a Government benefit, we check their ANZ deposit account transaction record. We identify benefit payments by tracking the Australian Payment Clearing Association Direct Entry Numbers associated with regular payments from Centrelink and the Department of Veterans Affairs. A credit card customer is excluded from a credit limit increase offer where payments with these transaction codes are being processed to an ANZ deposit account in their name. This is currently a manual procedure. To automate this step and ensure we capture as many eligible customers as possible, ANZ is in the process of verifying the direct entry numbers relating to Government benefits and entering those details on ANZ's customer database. This ensures appropriate customer records can be flagged as Government benefit recipients and automatically excluded from credit limit increase offer mailings in line with the responsible lending promises.

The process of excluding benefit recipients involves matching the customer's credit card account with a deposit account receiving benefits. In some cases, the customer's name on their credit card account may differ slightly from the name of their deposit account (for example, only one account name includes the customer's middle name). In these circumstances we are not entirely sure, without making further investigations, whether the accounts are owned by the same person. To address this issue, we manually audited our customer database last year to verify instances where a customer owns both a credit card and deposit account and in those cases, merged the customer's two records into one. As a result of this exercise, around 150,000 records were merged. A recent follow-up audit required the merging of only 5500 records.

1.3. Why ANZ committed to these promises

In 2005, ANZ commissioned into the causes of financial difficulty. The research told us:

- credit providers have a role in causing financial difficulty;
- for the most part, financial difficulty is not caused by a lack of knowledge or information; and
- 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 extend credit only to those we believe can repay. 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. The overwhelmingly positive response to ANZ's responsible lending code from the community, government, regulators and ANZ staff suggests this acceptance of responsibility is in accordance with the expectations of ANZ's stakeholders.

This research also forms the basis for ANZ's response to many of the recommendations in the Report. The following sections will outline the findings of the research, and draw on these findings and ANZ customer data analysis to address the Report's recommendations to require 'health warnings' on credit card statements, credit contracts and credit limit increase offers.

1.4. Research into causes of financial difficulty

ANZ's research into the causes of financial difficulty was conducted last year as part of ANZ's national survey of adult financial literacy. The financial literacy research repeated the first ever national financial literacy survey, released by ANZ in 2003.

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; and
- have missed repayments and defaulted and feel severely out of control of their financial affairs.

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

- 80% feel 'in control' of their financial situation;
- 17% fluctuate between feeling 'in control' and 'out of control';
- 3% feel '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 has borrowings and feel out of control of their finances. The financial difficulty research delved further into this group to identify causes.

Three core factors emerged from the study as causes of people falling into financial difficulty:

A. Unhealthy ways of thinking about personal finances

A sizable portion of participants in the study displayed ways of thinking about finances which guided their financial decisions and behaviours and which had a negative impact on their finances. 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'; and
- 'emotional enhancement' – spending to feel better.

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.

B. Circumstances outside people's control

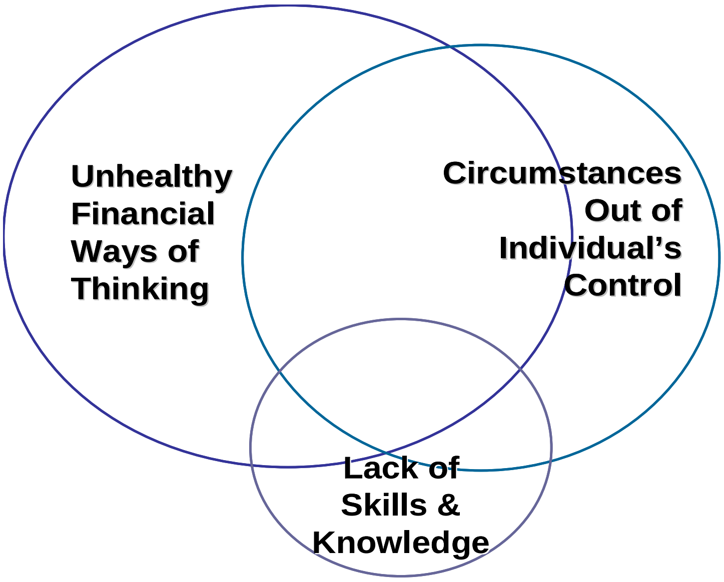
A similarly sized proportion of the sample were in financial difficulty due to events outside their control. These events had the effect of either decreasing income, increasing expenses, or both, and included job loss, poor health, divorce and relationship breakdown and small business failure.

C. 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 recognising when they should seek advice.

As can be seen by Figure 1, financial difficulty is most often caused by a combination of these factors. For example, unhealthy ways of thinking dominate decisions about finances and overwhelm basic awareness of financial concepts and ideas about the most appropriate way to behave. While a large number of these people have good basic financial knowledge, their disengagement from their finances often results in a failure to budget and control spending and establish a financial buffer or safety net. While under normal circumstances this itself may not cause difficulty, it can make these people particularly vulnerable in times of financial stress. People with unhealthy financial ways of thinking are often unprepared for an unexpected and uncontrollable event which limits income or increases expenses, leading them to financial difficulty.

Figure 1 – Factors Leading to Financial Difficulty



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

1.5. What the research tells us about financial difficulty

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 these skills were typically 'dormant' until a crisis point had been reached, often over-ridden by unhealthy ways of thinking about money.

People are particularly vulnerable to difficulty where they do not have the capacity to deal with financial pressure when it arises.

Importantly for ANZ, the research also confirms 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. These offers were found to have an indirect link to financial difficulty in two ways:

- for people with a predisposition to unhealthy financial ways of thinking or facing a financial emergency, by providing the opportunity to access credit; and

- by creating a perception that because it comes from a bank, it must be affordable – ie '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 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.

The research findings also shed light on the role of disclosure, and its relevance to those who are most at risk of financial difficulty. The following section will discuss this perspective with reference to the Report's recommendations for credit 'health warnings' on account statements, pre-contractual disclosure and credit limit increase offers.

1.6. Appropriateness of 'Health Warnings'

The Report recommends the Consumer Credit Code be amended to require credit providers to provide disclosures about the consequences of making minimum only repayments on credit cards. For ANZ credit card products, the minimum payment is the lesser of 2% of the closing balance or $10.

Option 6.3 recommends a requirement that credit providers include on all provisional credit card limit increase offers details of:

- the minimum repayment on the current limit if it is fully drawn and the minimum repayment on the limit contained in the offer;
- the time it would take to repay the current limit based on minimum repayments; and
- the time it would take to repay the limit contained in the offer based on minimum repayments.

Options 6.4 and 6.5 recommend health warnings on pre-contractual disclosure and credit card account statements detailing how long it will take the debtor to repay the credit limit if fully drawn and only the minimum payments are made.

The objective of these disclosures or 'health warnings' is to encourage a customer to consider whether it is prudent to accept a credit card offer – be that an offer for a new card or an increase to the limit of an existing card. The policy focus should be on 'at risk' customers: those who are struggling financially and making minimum payments or whose attitudes to credit could result in overcommitment. The recommendations presume the risk of overcommitment is at least partially caused by a lack of information provided to the customer and that the customers most at risk of overcommtiment would consider and respond to the information.

ANZ does not support these proposals because:

- it is better to provide customers with access to information that is relevant to them, when they need it;
- the information is relevant to only one payment scenario and will not apply to the vast majority of customers;
- our research shows that those most at risk of financial difficulty are unlikely to consider these detailed disclosures; and
- as minimum repayments diminish over time, the figures become meaningless as they do not relate to what the customer can afford to pay.

1.6.1. Alternative approaches – US and UK experiences

Alternative approaches to disclosing the effect of minimum payments can be found in the US and UK.

The *Bankruptcy Act* currently requires credit providers in the US to include on billing statements a short generic warning about the consequences of making only minimum payments on revolving credit facilities. In addition to the generic disclosure, the law requires credit providers to include a toll-free number that cardholders can use to obtain the actual number of months it would take to repay their outstanding balance based on minimum only payments.

In the UK, the Banking Code requires credit providers to include the following warning on credit card statements:

> *'If you make only the minimum payment each month, it will take you longer and cost you more to clear your balance'.*

ANZ believes there is merit in adopting a model which requires a general warning to remind customers of the issue of making minimum only payments, but which also includes a mechanism to allow customers to seek further information which is relevant to them.

While our view is that increased disclosure is unlikely to be considered by those most at risk, we would see as acceptable a general warning because it:

- is in plain English and therefore more likely to be understood by the majority of consumers who decide to read it;
- is relatively easy and inexpensive for industry to implement;
- is short and can therefore be located next to or near that part of the document that discloses the minimum payment, increasing the likelihood of consumers reading the warning;
- will not add significantly to the length and complexity of disclosure documents, statements and credit limit increase offers; and
- reinforces for the majority of consumers that making minimum payments should be a last resort and is not an appropriate way to manage their credit card account.

Options 6.3, 6.4 and 6.5 recommend detailed warnings about only one payment scenario which is unlikely to be relevant to a vast majority of consumers. Such warnings are obviously targeted at customers who make minimum only repayments or are forced to consider making minimum only repayments, however, the number of customers who habitually make minimum only repayments is very small.

ANZ estimates that, excluding those customers on special offers and payment moratoriums, less than 2.5% of customers are currently in the habit of making the minimum payment (or payments just below the minimum payment) on their credit card account.

Further, the detailed disclosure recommended in the Report would need to be tailored to each customer's credit card limit, and in the case of credit card limit offers, the credit limit offered to the customer. This would require significant investment in systems development and testing of the systems supporting statements, contracts and credit limit increase offers to enable automatic 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, we believe the interests of consumers may be better served by providing on credit card statements a free number which cardholders can call to request information about repayments that is specific to their needs and circumstances. For instance, under this model customer could request further information about:

- how long it would take to pay off their current balance with minimum payments;
- how long it would take to pay off their current balance, or fully drawn credit limit, with monthly payments of a set amount; or

- the monthly payments required to pay off the current balance, or fully drawn limit, within a specified time frame.

This model ensures customers are provided a generic reminder about the risks of making minimum payments on credit cards, plus access to further up-to-date and relevant information in the form and at the time they need it.

1.6.2. Effectiveness of detailed warnings for those at risk

ANZ's view, based on its research into the causes of financial difficulty, is that those most at risk of financial difficulty may be unlikely to consider, and therefore benefit from, detailed disclosure about minimum repayments. The main causes of financial difficulty relate to behavioural traits and unforeseen circumstances rather than a lack of information.

As mentioned in section 1.4, the vast majority of participants in the study experience difficulty through a combination of 'unhealthy ways of thinking about finances' and unforeseen circumstances or events.

'Unhealthy ways of thinking' tend to dominate decisions about finances, leaving little room for other considerations. For example, those who are 'disengaged' from their finances tend not to consider disclosure now, and are just as unlikely to read further detailed disclosure about minimum payments. Those who 'spend to feel better' or as a reward are being guided in their financial decision-making by emotional considerations and therefore seem unlikely to be distracted by detailed disclosures.

Turning to the other main causal factor of financial difficulty, 'circumstances beyond a person's control' create urgent financial pressure which would tend to overwhelm the effect of increased disclosure about minimum repayments.

The United States Government Accountability Office (GAO) recently completed research into customised disclosures about minimum payments on credit card statements[1]. The US Senate Committee on Banking, Housing and Urban Affairs requested the GAO to investigate the viability and utility of extending the requirement in the *Bankruptcy Act* to provide a general warning to also include a detailed disclosure about how long it would take for the customer to pay off their balance based on minimum payments – this disclosure would be tailored to the customer's actual balance at the time the statement is issued.

GAO found that while the consumers interviewed generally thought the disclosure would be useful, the impact of the warnings on customer behaviour is still not known.

The proposed warning about minimum repayments, to the extent it is considered by some customers, may be counter-productive. It may create the impression that making minimum payments is an appropriate way to manage credit card, thereby distorting the affordability of credit limits. In ANZ's view, this should be avoided. ANZ does not regard making the minimum payment on a credit card as 'normal' conduct of an account. As mentioned above, our estimate is that less than 2.5% of customers consistently make minimum payments. Under ANZ's responsible lending promises, customers who display a habit of making minimum only payments are excluded from offers of limit increases.

[1] United States Government Accountability Office, *Credit Cards – Customized Minimum Payment Disclosures Would Provide More Information to Consumers, but Impact Could Vary – Report to Congressional Requesters* (April 2006)

For these reasons, ANZ believes detailed disclosure of the time taken to pay down a credit limit by making minimum payments is unlikely to be considered by those most at risk and if anything, may increase the risk of some customers relying on minimum payments.

1.7. Credit assessment and credit limit increase offers

The Report makes two recommendations in relation to credit assessments and credit limit increase offers:

- **Option 6.1**: when offering customers an increase in credit limit, credit providers must allow customers to elect the credit limit increase they require; and
- **Option 6.2**: credit providers must adequately assess consumers' capacity to repay credit and assess capacity to pay any increase in credit or credit limit by the method used for new applicants. Credit contracts to be unenforceable to the extent they impose a liability beyond that which is appropriate.

ANZ supports Option 6.1 and the recommendation in Option 6.2 that there be a positive obligation on credit providers to adequately assess a customer's capacity to repay credit. However, ANZ does not support the recommendation which in practical terms mandates that credit providers must assess capacity to repay increases in credit or credit limits by manual checking of the customer's financial information.

1.7.1. Allowing customers to elect limits

ANZ supports the recommendation that all unsolicited offers of credit or credit limit increases must require the customer to elect the limit or limit increase they require. However, it is important that the customer's choice of credit amount be limited by their maximum eligibility for credit and the credit limits available on the particular product.

When ANZ sends a customer an unsolicited credit card offer or offer to increase a pre-existing credit limit, that customer has undergone a preliminary assessment of their ability to repay the credit offered. Therefore, the credit offered is usually the maximum amount ANZ will lend them based on this assessment. Should customers be required to elect a credit amount that is suitable for them when responding to an offer to apply, the credit provider must be permitted to include in the offer a suggested or maximum amount of credit, above which the customer may not apply for.

ANZ is limited in the credit limits it can offer customers. Our credit approval systems and financial reporting models are based on credit card limits in multiples of $500 only. For the majority of ANZ credit card products, the minimum allowable credit limit is $1000. This is a policy decision based on the fact that providing credit cards with lower limits becomes economically unviable. For some cards (e.g. 'gold' credit cards), the minimum allowable limit is greater and is imposed by the relevant credit card scheme rules.

Should Option 6.1 be introduced, ANZ would envisage disclosing on correspondence to customers a maximum credit amount for which the customer is eligible to apply for and three or four lower options for the customer to choose from. If the customer wishes to apply for an amount outside the maximum or pre-determined alternatives, that customer would be required to contact the credit provider directly.

1.7.2. Credit assessment

While ANZ fully supports the recommendation for a positive obligation on credit providers to adequately assess the capacity to repay credit, the method used to assess that capacity should not be mandated in legislation.

The Report states on pages 148 and 149 that prescription of credit assessment procedures is not appropriate because:

- it is difficult for a regulator to mandate a process that achieves good credit outcomes;
- it could limit innovation in credit assessment; and
- prescriptive regulation may impose high costs on providers.

The Report also acknowledges that it is preferable to ‘allow [credit providers] to select a system that best suits their business and thus to minimise the costs of its implementation’. ANZ strongly supports this view.

However, notwithstanding these statements, the Report recommends a positive obligation on credit providers to assess a consumer’s capacity to pay any increase in credit or in credit limit by the same method used to assess new applicants. For ANZ and arguably all mainstream credit providers, this will involve a manual assessment of the customer’s eligibility – in other words, asking the customer to complete a full credit application form with a statement of the customer’s financial situation, including income, other credit facilities and other repayment commitments. The Report also recommends a statutory statement that behavioural scoring alone is an insufficient assessment method.

For most credit providers, the recommendation is, in effect, a recommendation to introduce on a national basis the requirements of section 28A of the *Fair Trading Act 1992* (ACT). It prescribes at least part of the credit assessment process.

ANZ does not support this recommendation because it prescribes an assessment method which, in respect of credit limit increase applications, is inferior to behavioural scoring. Manual assessment is most effective to assess new applications, where the credit provider has little to no information about the applicant. However, where the credit provider knows more about the customer, behavioural scoring is consistently proven to be a more accurate method to assess capacity to repay.

ANZ would endorse, in preference to the prescription of credit assessment techniques, the approach in a recent amendment to the UK Banking Code Guidance for subscribers, which establishes best practice for assessing capacity for credit.

1.7.3. The experience with manual assessment

ANZ’s analysis of its customer base has consistently shown that behavioural scoring is a significantly more reliable assessment method than manual assessment of a customer’s financial information. The major weakness of manual assessment is that it relies on the accuracy and currency of information provided by customers.

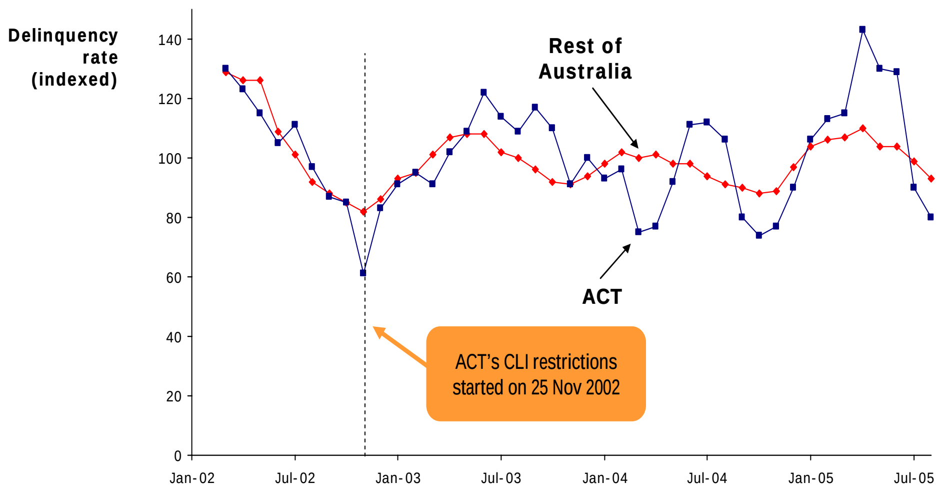
To illustrate this view, ANZ recently compared the credit behaviour of a group of recently acquired credit card customers who were approved through assessment of their self-reported financial details with a group of existing customers who had accepted a credit limit increase offer and were assessed using ANZ's behavioural scoring methods.

Over a 6 month period between May 2005 and October 2005, 1.7% of the first group showed signs of financial stress. For this study, financial stress was defined as being 30 or more days late on a payment on one or more occasions. During the same period, only 0.6% of those assessed by behaviour scoring displayed signs of financial stress.

ANZ has also conducted some analysis of the ANZ customer base in the ACT to illustrate the effect of section 28A of the *Fair Trading Act*, which requires all credit limit increase application to be assessed through manual assessment methods.

ANZ's analysis suggests the legislation has not reduced the rate of defaults in the ACT. As shown in Figure 2, since the legislation was introduced in November 2002, the rate of defaults among ANZ credit card customers in the ACT to June 2005 has remained steady and has not decreased.

Figure 2 – Delinquency rates of ANZ credit card customers in ACT and rest of Australia



Note: Delinquency rates show the percentage of customers 90 or more days past due in the last 12 months. Data for ACT and Rest of Australia has been indexed to give an average of 100 for 6 months prior to November 2002

Source: ANZ Credit Cards Australia

In April 2005, ANZ conducted a trial of completed financial information forms provided by ACT resident customers applying for a credit limit increase. The research provided some insight into the reliability of credit assessment based on financial information provided by customers.

As mentioned above, manual assessment techniques rely heavily on the accuracy of information provided by the customer. The study found that 24% of forms could not be processed due to errors and omissions in financial details. Around 12% contained obvious data errors while a further 12% of forms appeared to contain incorrect income details when viewed in conjunction with the living expenses stated – a common error was including a fortnightly income where a monthly figure was required. Although obviously not known, this suggests a substantial number of applications would contain other, less obvious mistakes or deliberate misrepresentations inflating income or understating credit commitments to improve the chances of approval. ANZ's research into financial difficulty suggests the financial decision making of those most at risk of financial difficulty is often dictated by unhealthy financial ways of thinking which can cloud judgment. Although undoubtedly in the minority of cases, these considerations may prompt some to misrepresent their financial position in an application form in the interests of accessing credit.

Although the ACT legislation prescribes only one form of assessment, ANZ has chosen, at significant cost, to continue to apply behavioural scoring assessment methods to these customers in addition to the required manual assessment. This decision is based on credit risk considerations and a reliance on behavioural scoring as the most reliable and robust technique for assessing existing customers.

1.7.4. Conclusions and alternative measures

ANZ does not support the (in effect) prescription of manual assessment as an assessment method which must be applied to applications to increase credit or credit limits. ANZ believes that by comparison, behavioural scoring is a more robust, reliable assessment method to assess credit limit increase applications and this has been demonstrated by the analysis performed on ANZ customer data, some of which has been described in this submission.

However, behavioural scoring is not the appropriate method in all circumstances. Different assessment methods are more appropriate, and therefore reliable, at different stages of the customer's relationship with the credit provider. For instance, manual assessment of financial information is clearly the most appropriate method to properly assess new applicants for credit where there is a lack of any other information. We generally do not rely on the behavioural score of a customer to assess capacity for a credit card limit increase offer until that score can be based on 9 to 12 months of the customer's transactional and repayment data.

Where the credit provider has built up information about the customer's credit behaviour over time and is assessing an application to increase the amount of credit, behavioural scoring is shown to be a more reliable technique to assess capacity. ANZ's behavioural scoring methods are also subject to a continual improvement process and will become more sophisticated as we understand more about the transaction and repayment patterns (including those on other products) that signal future financial difficulty. In ANZ's view, the prescription of manual assessment in these circumstances will not improve the rate of defaults and over-commitment and therefore represents an inefficient investment in a sub-optimal assessment method.

This need for flexibility has been recognised in a recent amendment to Clause 13 of the UK Banking Code Guidance. That clause establishes as best practice the consideration of at least two of the following matters when assessing capacity to repay credit:

- the customer's income and financial commitments;
- how the customer has handled finances in the past;
- information from credit reference agencies; and

- credit assessment techniques, such as credit scoring.

This recognises that one assessment method is not appropriate in all circumstances and allows the credit provider to choose those methods best suited to their business and the information available.

Rather than prescription of assessment methods, ANZ believes the better approach to reduce the incidence of financial difficulty through credit limit increase offers is to exclude the most vulnerable from those offers. This is why ANZ has excluded these customers from its own offers through its responsible lending promises, described in sections 1.1 and 1.2. ANZ's assessment of credit limit increase applications now involves more than behavioural scoring – the assessment process also involves consideration of how the customer has handled their credit card payments in the past and whether that customer is on a fixed income.

Similarly, the UK Banking Code Guidance has incorporated best practice guidelines specifically for credit limit increase offers, suggesting credit card issuers should:

- undertake appropriate checks;
- ensure any limit is proportionate to the customer's risk profile;
- not offer increases to customers in arrears or below credit scoring thresholds; and
- enable the customer to opt out of future credit limit increase offers or to reduce their credit limit.

ANZ is largely complying with these requirements already and would support their application to the credit industry in preference to the recommendation currently contained in Option 6.2.

1.7.5. Power to declare credit contracts unenforceable

The Report recommends a court or tribunal be given the power to declare a credit contract unenforceable to the extent it imposes a liability on the consumer beyond which is 'appropriate'.

This is similar to the jurisdiction of the Banking and Financial Services Ombudsman to assess disputes that raise issues of maladministration in the decision of a credit provider to lend.

ANZ believes the proposal in the Report will be unworkable unless there is sufficient certainty about what is 'inappropriate'. ANZ believes the terms of any such provision must be limited to situations where the credit provider's credit assessment practices are clearly deficient or non-existent, or where the credit provider has been reckless to the applicant's capacity to repay.

Credit providers must be able to defend any action by demonstrating they have satisfied minimum standards of responsible lending. Those standards could be derived from what has been introduced into the UK Banking Code or the responsible lending promises introduced by ANZ last year. What is 'inappropriate' must be judged according to what is, or ought to have been, known to the credit provider at the time the credit is provided, based on those minimum standards.

Any response to this recommendation must also consider the effect this provision may have on the financial decision-making of consumers. A provision essentially releasing a consumer from liability where the credit is ‘inappropriate’ may cause consumers to be less concerned about their capacity to repay credit at the outset.

The Victorian Government should only introduce such a provision as part of a national approach. Adoption by Victoria ahead of a national provision clearly undermines the intent of the uniformity agreement binding all States and Territories in relation to credit laws.

1.8. Advertising Practices

Option 6.6 of the Report recommends further research into credit advertising practices and standards. ANZ understands the review’s concern is primarily with advertising that is inconsistent with the responsible use of credit rather than misleading or deceptive advertising, which is sufficiently regulated under the ASIC Act and the Consumer Credit Code.

ANZ supports in principle the recommendation to conduct further research and agrees with the general proposition that advertising of credit must be consistent with the messages being conveyed by banks and other financial institutions about financial literacy and responsible management of credit. For ANZ, this view is partly driven by self interest - advertising which encourages ‘irresponsible’ credit behaviour undermines the significant investment the bank has made in financial literacy programs and public commitments to responsible lending, such as the responsible lending code. ANZ’s research into financial difficulty shows that some people are particularly vulnerable to credit marketing, particularly those predisposed to unhealthy financial ways of thinking. Credit advertising can provide the access to personal debt which, in conjunction with the other core factors of difficulty, can lead to financial difficulty. ANZ responded to this research by excluding from credit card limit increase offers the most financially vulnerable members of the community.

However, advertising affects different people in different ways. Any research into possible regulation or industry guidelines must avoid the presumption that advertising of credit is, per se, irresponsible or dangerous. We should not lose sight of the fact that for the vast majority of people who manage credit responsibly, a credit card is a convenient means to manage cash flow, transact overseas and manage larger transactions through low or no interest offers which have been driven by increased competition in the market in recent years. Credit providers should be able to promote this convenience in advertising without the presumption that such advertising is inconsistent with the responsible use of credit. Further, ANZ’s research has shown that financial difficulty occurs at all points of the age spectrum. Unhealthy ways of thinking about money were found in participants of all ages and did not relate specifically to any particular age group. Any research must therefore test the presumption that advertising is inappropriate merely for the reason it is targeted at a particular age demographic.

In any event, issues of credit advertising are secondary to responsible lending practices. Regardless of how an applicant is encouraged to apply for credit, the credit provider must properly assesses that applicant’s capacity to repay using the most reliable credit assessment tools available and not lend beyond that capacity.

1.9.Conclusions on Responsible Lending and Advertising

The Report recommends a mixture of increased disclosure and regulation of credit assessment methods to address the problem of overcommitment. However, ANZ's research and analysis suggests such measures are unlikely to have a significant impact on the rate of credit overcommitment:

- financial difficulty is most often associated with behaviours, traits and unforeseen circumstances of the individual rather than a lack of information. A large proportion of those in difficulty are disengaged from their finances and are therefore unlikely to consider current disclosure let alone extra detailed information about minimum repayments; and

- effective prescription of manual assessment techniques for credit limit increase applications is a backward step given behavioural scoring is statistically the more reliable assessment method.

Any measures to address the problem of overcommitment must be proportionate to the causes of financial difficulty. In responding to the Report, the Government should first consider the extent to which financial difficulty is related to the lending practices of credit providers and the extent it relates to other factors. Attitudes and ways of thinking of the consumer are linked to financial difficulty. In ANZ's view, both responsible consumer behaviour and responsible lending practices are required. The failure of either can result in financial difficulty.

ANZ has responded to the research findings by excluding the most vulnerable consumers from offers of credit and credit limit increases. ANZ would, in principle, support the introduction of a responsible lending code for the entire credit industry as the most effective way in which credit providers can discharge their duty to minimise credit overcommitment.

2. Small Amount Lending and Fees and Charges

This section will address two recommendations in the Chapter 5 of the Report:

- **Option 5.2:** bank and non-bank credit providers should provide vulnerable and disadvantaged customers more access to low cost, small amount short term credit. A summit should be convened to explore how this may be encouraged; and

- **Option 5.3:** All fees and charges should be reviewable on the grounds of 'unreasonableness. Default fees or charges to be prima facie 'unreasonable' where they exceed cost recovery.

2.1. ANZ Small Loans Program

ANZ commenced its small loans program in April 2006. The program is in response to research commissioned by ANZ and conducted by Chant Link and Associates in 2004 into the levels of financial exclusion in Australia. By financial exclusion, we mean 'a lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers, where that lack of access can cause a level of harm to the consumer'.

As discussed in ANZ's first submission to the Consumer Credit Review in September 2005, the research found around six per cent of adults have minimal financial access, owning only a transaction account, while around 120,000 people, or 0.8% of the population, could be considered totally excluded with no ownership of financial products.

In response to these findings, ANZ announced several initiatives, including to develop a new loans program tailored to the needs of people on low income. The research suggested that the concern for those on low income was not so much access to credit (in fact many respondents to the research were of the view that credit was too readily available), but that the credit they can access is generally at very high cost, which is more likely to lead to unmanageable debt. In ANZ's view, the discretionary and strategic targeting of 'profitable' customers by mainstream lenders has over the last few decades effectively excluded some lower income (and therefore less profitable) customers from the mainstream.

This exclusion has exposed this segment of the market to unethical, predatory and 'unsafe' lending practices in the form of high cost 'payday' loans and pawnbroking. Loans for this segment are often priced in excess of the risk posed by this group of consumers, who are, contrary to popular belief, largely good money managers. Other lower cost alternatives for this group such as low or no-interest loans schemes tend to have a welfare focus more suited to consumers 'in crisis' and/or are expensive to administer, and as a result have insufficient scale to satisfy demand. One observation of the interest free loan model is that while it responds to immediate need, it is limited in long-term poverty alleviation and inclusion of individuals into the mainstream financial system[2]. Attachment 2 outlines the existing small loan products available to low income consumers and some of the issues associated with those products.

ANZ's first submission to the review highlighted difficulties associated with making a microfinance program a commercially viable part of a large financial institution's business. These difficulties stem from high start-up costs, low take-up rates, comparatively high rates of default and high reputational risks associated with recovery of debts. Current small loans programs are labouring under these constraints, unable to build scale because the returns, while covering the cost of capital, invariably do not cover administration costs.

To address these difficulties, and the demonstrated need for appropriate credit for those on low incomes, ANZ has designed its small loans program in line with the following objectives:

- **affordable and transparent:** cost comparable to standard personal loan and credit card products and mainstream consumer protections including disclosure and dispute resolution procedures;
- **sustainable:** financially viable in the long term;
- **to build scale:** effectively targeted to reach as many eligible consumers as possible – this also contributes to financial sustainability;
- **'inclusive':** loans on normal commercial terms so participants can build a good repayment history, a sense of social inclusion and confidence to apply for future mainstream credit.

[2] Burkett, Ingrid: *Microfinance in Australia: Current Realities and Future Possibilities* (2003), p 34; Robert, Margaret: *Interest-Free Loans: A Review Commissioned by the Ian Potter Foundation* (2000), p 34

The following sections will outline the features of the small loans program, how ANZ's approach is addressing some of the difficulties identified in our previous submission and ANZ's response to Option5.2.

2.1.1. Program Features

Under the program, ANZ will offer loans of between $500 and $3000 with a loan term ranging from 6 months to 3 years. Revolving lines of credit will not be available. The pricing is relatively standard – during the initial pilot of the program, customers will be charged an interest rate of 12.70%p.a. which is comparable to the rate applying to many personal loan facilities. A one-off approval fee of $40 applies. Attachment 3 provides a product comparison between the ANZ small loan, comparable standard ANZ products, a low interest product (provided by National Australia Bank and Good Shepherd) and a No Interest Loan Scheme (NILS) product.

The program is being delivered in partnership with the Brotherhood of St Laurence. As the program develops, ANZ will expand its range of partnerships to other community organisations, including those with which ANZ is delivering its other community programs like Saver Plus. The Brotherhood of St Laurence (BSL) (or other community partner) will:

- be responsible for promoting the loan program through various channels and forums, with support from ANZ as needed;
- identify potential participants from existing client base as well as attracting other participants not currently engaged with the organisation; and
- once applicants are identified, perform an initial assessment of the applicant's ability to make repayments, check the applicant's identification, income, and explain the product to the applicant.

ANZ will review the credit history and record of the applicant and make the formal credit decision for applications based on modified credit approval criteria after receiving the initial assessment from BSL. ANZ will also provide the funding and training for dedicated loan assessors at BSL. Loans advanced under the program are fully funded by ANZ.

The program is targeted at individuals on low incomes with a Health Care or Pension Card. To be eligible, applicants must have proven money management skills, demonstrated through a savings history, timely payment of utility and other personal bills and no record of unpaid credit default above $300 within the last three years. The loan must be for a purpose associated with a household or education. Loans may also be advanced on certain conditions for the purchase of a motor vehicle. While preferred, current employment is not an essential loan criterion.

ANZ has designed the program in a way that addresses the difficulties identified in our previous submission. These difficulties are addressed through managing risks and building scale.

2.1.2. Managing risks

There is a perception that lending to people on low incomes will lead to higher credit and operational losses. However ANZ believes the partnership approach with community groups will minimise this risk in several ways.

First, the approach will minimise the risk of losses by attracting the right applicants. Community groups have an intimate knowledge of the circumstances commonly facing people on low incomes and are more likely to identify those individuals who have a real need and who will be sufficiently motivated to repay a loan. In the program pilot, this knowledge will be supplemented by ANZ's significant investment in quality induction, training and coaching of BSL loan assessors and clear credit guidelines supported by training.

A key indicator of success for microfinance programs worldwide is establishing a motivation for the participant to repay the loan. This motivation is often drawn from an emotional connection between the participant and the community organisation and an identification with the objectives of the organisation and the loan program, which is to help the applicant and people in similar circumstances to the applicant. A significant proportion of participants in the program may have an existing relationship with the community organisation and a well developed understanding of its objectives. A program administered solely by a bank or non-bank lender would not generate this emotional connection.

Second, the ANZ small loan program will involve an element of risk sharing between ANZ and the community organisation. For the program pilot, depending on the amount of defaults under the program, BSL may be liable for a small proportion of those loans which have been declared by ANZ as not recoverable and therefore 'written off'[3]. This arrangement not only provides a direct form of risk sharing, but also a real incentive for the community organisation to maintain high quality pre-screening and pre-assessment of applicants and seek the assistance and expertise of ANZ where appropriate.

Partnership with large and high profile community organisations will maximize the number of eligible applicants and therefore allow ANZ to diversify its exposure to applicants based on geography and loan purpose. A concentrated exposure to one type of low income customers may itself pose a risk of loss to the program.

Aside from the partnership structure of the program, the pricing of the product has been set to recover costs and also provide a margin to absorb a proportion of credit losses.

2.1.3. Building Scale

A lack of scale in microfinance has a two-fold effect. First, it diminishes the benefit of the program as a whole and second, it means the program does not generate a revenue which can fund the program's continued development. Low take-up rates is a common problem of microfinance programs in developed economies and ANZ has implemented a number of measures to encourage high levels of involvement in the small loans program:

- The **partnership approach** is central to building numbers of participants. Community organisations are involved on a day-to-day basis with the program's target 'market' and are best placed to promote and maximise awareness of the program among eligible consumers. ANZ will be aiming to build on this approach with partnerships with several community organisations, thereby establishing multiple marketing and distribution channels. While strategy and implementation of marketing will be determined

[3] Under the current model, the community organisation will absorb losses from loan defaults where the amount represents between 5% and 10% of the total loans written. ANZ absorbs all other loan defaults.

by community partners, ANZ, as the credit provider is financially responsible for the product and accountable for its promotion, and will be closely involved in formulating awareness raising strategies and preparing and approving any marketing material.

- ANZ is also tailoring its **credit assessment methods** and modeling to be more relevant to applicants on lower incomes and applications for lower amounts of credit. For instance, ANZ's standard assessment processes will assume a certain levels of living expenses for applicants in certain age and occupation demographics. However, those attributed living expenses are not necessarily relevant to those on lower incomes, who tend to be good money managers who through necessity will make their money stretch further. ANZ's normal assessment methods may therefore unfairly exclude too many applicants by virtue of income and living expenses to the detriment of both the applicant, and the growth of the program as a whole.

- For ANZ, **financial viability** of the program is vital to building scale. Independent financial viability will support within ANZ the continued investment in the program over time, including expansion with multiple community organisation partners and with that, expansion in distribution capability. Small loan programs can be particularly costly due to the low net interest income – by virtue of the product, average balances are lower so the interest revenue relative to the number of loans on the book is low compared to other loan products.

  Maximising the number of participants with innovative distribution strategies through community partners is one way to encourage viability – the other is through appropriate pricing. The pricing of ANZ small loans product pursues the dual objective of an affordable product and a sustainable program.

  While the loan will not be a low interest loan, the ongoing interest rate is comparable to the rates available on most personal loans and standard credit cards. As can be seen in Attachment 3, expressed as a single cost, incorporating upfront charges and total repayments of principal and interest, the new ANZ small loan is at a significantly lower cost than the most comparable mainstream ANZ product, the ANZ Personal Loan.

  However, while affordable for consumers, the interest rate and approval fee for the small loan product have been priced so that, subject to loan performance and volume of loans granted, ANZ may partially recover its administrative costs over the next 2 to 3 years, in particular, its investment in partnerships with more community organisations and high quality awareness programs and assessment procedures. Cost recovery is essential for the independent survival of this program. ANZ has been encouraged to pursue this objective by leading large community organisations currently involved in microfinance.

2.1.4. Small Amount Lending - Report Recommendation

ANZ supports the recommendation in the Report that bank and non-bank lenders provide vulnerable and disadvantaged consumers with more access to low cost small amount credit. ANZ would also support a summit to explore ways to encourage the development of small loan programs.

However, ANZ's strong view is that credit providers cannot provide these programs alone. The research conducted as part of the design of ANZ's small loans program suggests partnership with community organisations is essential in:

- attracting participants most at need and motivated to repay the loan;
- attracting sufficient volume and range of applicants;
- building expertise in assessing the credit capability of vulnerable and disadvantaged consumers;
- building trust in the community about the objectives of the program and therefore widespread community support; and
- sharing the risk.

ANZ would be pleased to share details of this partnership philosophy as well as its experience in implementing the small loans program at any summit convened by the Government in response to the Report.

2.2. Unreasonable Fees

The Report recommends in Option 5.3 that all fees and charges be reviewable on the ground of 'unreasonableness', which would include reference to the underlying costs of service provision as a key criterion.

ANZ does not support this recommendation because:

- it involves legislative intervention in the mainstream market, when the clear market failure is in the non-mainstream sector;
- it will not address the lack of safe and affordable small amount credit options for low income or disadvantaged customers; and
- the enforcement of core terms of credit contracts would become uncertain.

2.2.1. No Mainstream Market Failure

The focus of Part B of the Report is the concern about how the small amount lending market operates, including affordability. The Report rightly points out that a large proportion of dubious lending practices and excessive costs arise in relation to small amount, short term credit. However Option 5.3 contains a recommendation to impose regulation over the pricing of all credit. ANZ supports in principle measures to address prohibitively high or predatory consumer credit fees or charges, so legislative intervention should be concentrated on the 'fringe' market, where there is demonstrated market failure.

ANZ's research into the levels of financial exclusion identified a clear gap in the supply of appropriately priced, fair and safe short term credit options for people on low incomes, a gap which is partially filled by high cost 'pay-day' lending. Detailed financial analysis conducted in preparation for ANZ's small loans program suggests the pricing of many current small loan products is generally excessive relative to the risk and cost of lending. This is partly because the 'fringe' lending market suffers from a lack of competition – excessive and exploitative pricing is the result.

In contrast, there is no evidence of a similar market failure in the mainstream market. Increased competition in the consumer finance market over the last few years, especially from new non-bank entrants, has applied significant pressure on mainstream credit providers to compete on price. This has translated into a significant compression of interest rate margins in the home loan market. Margins are currently around 1.2 to 1.5 per cent, compared to an average margin of around 2-3 per cent in the mid 1990s. The RBA's May 2006 report into banking fees noted that banks are competing more aggressively for new home lending by discounting or waiving loan establishment fees.

In the credit card market, pricing pressure has come both from competition and regulatory development. The RBA's credit card interchange reforms in October 2003 and the resulting reduction in interchange revenue has prompted a growth in 'vanilla' credit card products. Issuers are now attracting customers with lower interest credit cards rather than higher cost loyalty schemes. Consumers can now choose from a range of credit cards with ongoing annual interest rates as low as 8.99 per cent, many with nil-annual-fee offers, saving some customers hundreds of dollars a year. This is a significant drop from the average annual percentage rate on most credit cards a few years ago, which was between 16 and 18 per cent.

While some may argue that a legislative safety net should be applied to fees and charges levied by all credit providers, good regulatory practice dictates that intervention be limited to instances of clear market failure.

2.2.2. Encouraging affordable and safe credit

Excessive and predatory pricing in the small amount loan market is caused at least partly by a lack of competition from more appropriately priced options. In ANZ's view, the proposed legislative test of 'unreasonableness' addresses the effect rather than the cause of this lack of access to safe and affordable small amount credit. Regulation is not the appropriate means to improve access to credit. High cost short term credit is best addressed by looking for ways to encourage bank and non-bank lenders to provide more affordable options for people on low incomes. The Government could do this a number of ways, including by facilitating partnerships between credit providers and the community sector. The small loan partnerships between ANZ and BSL and National Australia Bank and Good Shepherd are both evidence that the small amount credit market is already developing.

The better approach to improve access to small amount credit is to promote competition in the market by encouraging more entrants. A legislative power to review all fees and charges for 'unreasonableness' will not be a catalyst for better access to affordable small amount credit and is unlikely to influence the behaviour of the wider 'fringe' lending market.

A more appropriate legislative response to the immediate issue of predatory pricing of short term credit may be an effective interest rate cap, similar to the legislative 48% p.a. cap introduced in New South Wales, which factors in both interest charges and fees and which would therefore close the loopholes in the Victorian interest rate cap currently being exploited by some 'fringe' lenders. Such a cap would regulate clearly egregious lending practices, providing a legislative 'safety net' while the short term small amount credit market is developing. This is the more appropriate role for regulation.

In addition, an interest rate cap is a clearer minimum standard for both the regulator and the industry than a legislative standard of 'unreasonableness'. Provided the legislation is clear about the calculation of the cap, proof of a breach is largely a matter of fact for the regulator. However, the meaning of 'unreasonableness' will be open to interpretation and will more likely become subject to dispute in a court or tribunal, delaying enforcement efforts. The 'fringe' lending industry is largely disassociated, and is therefore less responsive than the mainstream to the reputational risks posed by regulatory action against other 'fringe' lenders. A minimum standard based on an interest rate cap is therefore a more efficient standard for a regulator to apply in this context, especially if multiple prosecutions are required to change the behaviour of the 'fringe' market as a whole.

2.2.3. Uncertainty of contract

ANZ believes credit providers should be able to rely with some certainty on the core terms and conditions which are disclosed to customers in compliance with the Consumer Credit Code and to which the customer has agreed. The proposed legislative test as set out in the Report would seem to threaten this certainty by opening up all fees and charges to review.

This issue is recognised in the UK law relating to unfair contract terms. Fees or charges which go to the main subject matter of the contract (eg. application fees, initially quoted ongoing monthly fees or initial interest rate) and which would have formed one of the main conditions upon which the consumer voluntarily entered the contract with the credit provider are specifically excluded from the test of unfairness under the UK's Unfair Terms in Consumer Contracts Regulations (UTCCR) 1999. Under the UTCCR, core or 'expected' terms are still subject to the requirement to be expressed in plain and intelligible language, however once accepted by the consumer, they cannot be subsequently reopened on the basis of fairness. However, any unilateral price or interest rate variation clause is unlikely to fall within the exemption and would remain subject to an unfairness test. Such clauses relate to varying price rather than setting the initial price.

In addition to the above, the proposed test of 'unreasonableness' may lead to a form of price control, which from a market efficiency viewpoint, should be a last-resort regulatory approach. Pricing freedom provides incentives for service providers to invest in efficient processes and administrative systems and therefore maximise, within the constraints of the law, the margin between cost of service and price. Efficient systems and processes can improve convenience and innovation in service delivery to consumers.

3. Regulation of Equity Release Products

ANZ supports Option 7.4 of the Report, which recommends the Ministerial Council on Consumer Affairs conduct further analysis of the need for, and nature of, additional consumer protection in relation to reverse mortgages. ANZ is planning to pilot a reverse mortgage product later in 2006.

We agree the current disclosure regime for consumer credit products was not designed for reverse mortgage products and does not specifically require the disclosure of some matters which are particularly important to consumers of these products, for instance:

- **the disclosure of risks:** these may include the risk posed by a drop in the housing market and value of the home subject to the mortgage;

- **effect on tax and benefits:** taxation implications and the impact on pensions or other government benefit entitlements;

- **negative equity guarantee:** what it means, how it works, and in what circumstances, if any, it will cease to apply;

- **the status of renovations:** any conditions about making alterations to the property, including whether the consumer or the credit provider receives the financial benefit of those alterations;

- **cost:** the cost of reverse mortgages can have several elements which cannot all be expressed as an interest rate or credit fee or charge. Such costs include equity forgone and capital gain.

We would expect these issues to be addressed as part of the design of any specific disclosure rules for reverse mortgages. ANZ believes further consultation is required on the question of whether the Consumer Credit Code is amended to require a completely new disclosure document for reverse mortgage products (perhaps drawing on the Product Disclosure Statement regime in the Corporations Act 2001) or whether the existing disclosure requirements are simply supplemented by a specific information statement about those features particular to reverse mortgages.

ANZ sees a need for credit providers to treat the selling process for reverse mortgages differently to that of 'standard' mortgages. In ANZ's view, the decision to acquire a reverse mortgage is more akin to an investment rather than credit decision. Therefore, ANZ will:

- recommend customers receive independent financial advice before making a decision to acquire a reverse mortgage; and

- ensure that only a small number of appropriately trained staff are authorised to provide advice on, or sell, reverse mortgages.

4. Regulation of Finance Brokers

ANZ fully supports a nationally consistent regulation of finance and mortgage brokers and in February 2005 confirmed this support in a submission to a Discussion Paper released by the NSW Office of Fair Trading. In addition, ANZ agrees with the view expressed in the Report that a broker should be required to disclose upfront to a customer whether the broker is:

- 'tied' to two or more credit providers; or
- is permitted to provide the customer with advice on credit products from a full range of credit providers.

5. Unfair Contract Terms in Credit Contracts

The issue of unfair contract terms in consumer contracts should be addressed by the Standing Committee of Officials of Consumer Affairs (SCOCA), which ANZ understands is currently developing policy positions in respect of a national unfair contract terms regime. ANZ believes the question of whether consumer contracts be included in any such national regime is more appropriately considered by that forum than the current review. We understand SCOCA has not yet made any final decision about the inclusion or otherwise of consumer credit contracts in the proposed regime.

ANZ is strongly opposed to Option 9.1 which recommends Victoria proceed to apply Part 2B of the *Fair Trading Act 1999* in the event of delay to a national solution. Such an approach is inconsistent with:

- the uniformity objective of the Consumer Credit Consumer Code;
- the work currently underway to establish a nationally consistent regime of unfair contract terms legislation; and

- the current focus on improving business regulation, which includes encouraging harmonisation of laws across States and Territories.

6. Business Purpose Test Declarations

ANZ agrees that the current presumption accorded to business purpose declarations is abused by some segments of the market and therefore has the potential to cause consumer detriment, especially in relation to enforcement proceedings.

However, the removal of the presumption could create significant uncertainty for all credit providers in some circumstances, especially if the consumer is disputing the credit provider's recovery of an outstanding business purpose loan, on the basis that the loan was in reality used for a personal purpose. ANZ questions the wisdom of introducing a legislative amendment, which causes uncertainty for all credit providers, to address abuse by a small minority of the market.

Should the recommendation in the Report be adopted, and if the Code is to retain the presumption in section 11(1) that all credit is subject to the Code unless otherwise established, there must be some other objective test on which a credit provider can rely on to reverse this presumption. One option would be to replace the current business purpose test declaration in section 11(2) with a provision that, in the event of a dispute about the purpose of the loan, a contract will be outside the Code where the credit provider demonstrates that at the time the contract was entered into, a reasonable person standing in the credit provider's position would have understood the loan to be wholly or predominantly for business and/or investment purposes.

7. Credit Reporting

ANZ supports the recommendations in the Report to repeal the *Credit Reporting Act 1978* and for the Review to commission further research into the benefits and costs of implementing a positive credit reporting scheme.

Attachment 1 – ANZ Customer Charter

‘ANZ’s commitment to you’

ANZ is committed to providing you with Australia’s most convenient banking services, based on products that are simple to understand and delivered in a responsible manner by our people, in accordance with the highest standards of integrity.

This Customer Charter sets out the specific service standards you should expect us to meet. It reflects both the products and services that we currently offer and the higher standards towards which we aspire.

Our external auditors will review our performance against these standards every year and we will report the results to you. In this way, we hope to earn your faith in us as Australia’s most respected retail bank.

Welcome to ANZ.

Signed

Brian Hartzer
Group Managing Director – Personal Division

Convenient

1. Convenient access – we will:

- Maintain our branch presence in the rural communities we serve;
- Continue to expand our branch network by opening new branches;
- Open selected branches on Saturdays and for extended hours on weekdays;
- Keep our call centre open 24 hours a day, 7 days a week;
- Install more than 200 ATMs over the next year;
- Have our web site www.anz.com, Internet Banking, Phone Banking and EFTPOS available at least 99% of the time.

2. Quick, friendly and reliable service – we will:

- Aim to serve you within 5 minutes in our branches;
- Aim to answer your call to our call centre within 60 seconds;
- Provide you friendly and reliable service by staff who are qualified to serve you.

3. Swift resolution of complaints – we will:

- Aim to resolve your complaint within 48 hours and within a maximum of 5 business days;
- Let you know who is responsible for resolving your complaint if we expect this to take longer than 48 hours;
- Offer to have your complaint reviewed by our Customer Advocate, if we can’t resolve it to your satisfaction;

– Provide you with information on external financial services dispute resolution if you are not satisfied with the steps taken by ANZ to resolve your complaint.

Simple

4. Simple products – we will provide you with clear choices in everyday personal banking accounts:

– An account with either unlimited ANZ transactions for a $5 monthly fee, or an account which allows you to manage your monthly fees by limiting the type and number of withdrawals you do each month;
– Fee-free Internet Banking for all everyday personal banking accounts;
– An everyday personal banking account with unlimited ANZ transactions and no monthly fee for seniors, health care cardholders, people under-18 and Centrelink payment recipients.

5. Fast account opening – we will refund one month's standard fee or its equivalent if we do not meet our account opening standards:

– Have your personal banking account available within 24 hours of satisfying identity requirements;
– Answer standard loan applications quickly:
  o Personal loan and car loan applications within 1 business day;
  o Home loan applications within 2 business days;
– Answer your standard credit card application within 4 business days.

6. Simple and clear communication – we will write our letters, brochures, ATM and web site messages, and other notices in plain language.

Responsible

7. Privacy – we will keep your personal information private and secure.

8. Financial literacy – we will:

– Continue to invest in community programs aimed at improving the financial literacy of Australians, particularly the most vulnerable and disadvantaged groups;
– Work through our community partners to:
– deliver our Saver Plus matched savings program to 1,000 low income families who are committed to improving their financial literacy, building a long term savings habit and saving for their children's education;
– fund the training of financial counsellors and community educators to deliver our MoneyMinded program, aimed at building the skills, confidence and knowledge of low-income earners, to 15,000 Australians.

9. Responsible lending – we will:

– Not offer you a credit card limit increase if you have a recent poor credit performance or are struggling to meet repayments on your ANZ credit card - one indicator of this may be that you are only making minimum monthly repayments on that card;
– Not offer you a credit limit increase if we know that you are on a fixed income, for example, receiving a government pension (e.g. old age pension, veteran's pension)

- Provide you with information about easy and efficient ways to reduce your credit card limit;
- Ensure your minimum monthly credit card repayment does not fall below 2% of the outstanding balance, unless:
  - you are in financial difficulty and we are assisting with reduced repayments;
  - you have 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:
  - outline how much the minimum monthly repayment would increase if the offer was accepted;
  - recommend you reject the offer if your personal circumstances have changed;
  - include information about how to request a lower offer.
- Explain in clear and simple terms how interest on your credit card or loan is calculated and charged, what fees may apply and when, and the consequences of paying late on your credit;
- Respond to you within 48 hours if you have contacted us by telephone, and within 5 days if you have contacted us by letter, to advise us of your financial hardship. We may also refer you to an accredited financial counsellor.

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Feedback

We value your feedback about ANZ's Customer Charter. Please contact us by:

Phone:	FREECALL 1800 805 154 (8am to 7pm AEST) TTY 1300 366 255
Mail:	ANZ Customer Response Centre Locked Bag 4050 SOUTH MELBOURNE VIC 3205
Fax:	1800 269 030
Email:	YourFeedback@anz.com

Attachment 2 – Small Loans Market

Provider	Description	Average Loan			Issues
		Amount	Period	Interest % pa	
Pay Day Lenders	Short term loans for small amounts with the money to be paid back in a short period, usually the next payday, eg Money Tree, Money Plus	$200-300	2-4 weeks	Up to 700%	Need for fast cash Fees excessive and not transparent Take excessive collateral for relatively small loans (eg car)
Loan Sharks	Unlicensed money lenders who target consumers who need cash quickly	$500-2,000	A few weeks	Up to 200%	Need for fast cash Fees excessive and not transparent Aggressive enforcement
Pawnbrokers	Lender of last resort who provides cash for up to 30-50% of the value of goods left, eg Cash Converters	Small amounts	n/a	n/a	30% of goods are never collected
Store finance	Attractively packaged financing options provided at the point of sale, often on a 'buy now, pay later' basis, eg GE, City Finance	Varies $1,000+	12 mths	30%	Conditions are not transparent Interest is back dated to purchase date if cannot make payment at 12 months
Centerlink Advance	Advance on future benefit payments that is allowed once per year per person	$500	6 mths	None	Fast pay back rate ($38 per fortnight)
Interest-Free Loan Schemes	Interest free loans provided by community organisations from a revolving capital pool, usually for household goods/services, eg NILS®	<$1,000	<2 years	None	Welfare focus and can be stigmatising Diminishing capital pool
Affordable Interest Loan Schemes	Loans with an interest rate of 7-15%, usually provided via credit unions or community organisation/bank partnership, eg Advance Personal Loans, Step Up Loans	<$3,000	<3 years	7-15%	Tend to be small and not financially self-sufficient despite charging interest

Source: Boston Consulting Group: based on literature review and interviews

Attachment 3 – Small Loans Product Comparison

Criteria	Small Loan	Personal Loan (ANZ)	Low rate card (ANZ)	Step Up (NAB/GS)	NILS – no interest
Loan amount	**$500 - $3,000**	> $5,000	> $1,000	$800 - $3,000	< $800
Interest Rate (p.a.)	**12.70%**	12.67%	11.99%	6.99%	-
Approval fee	**$40**	$125	-	-	-
Maximum repayment period	**3 years**	7 years	-	Negotiated	1.5 years
Administration fee p.a.	**-**	$100	$58	-	-
Redraw	**No**	Up to $500	Full	No	No
Purpose	**Household +**	Very broad	Personal	Whitegoods	Whitegoods
Builds credit history	**Yes**	Yes	Yes	Yes	No
Interest and fees (even repayment)					
$500 over 6 months	**$59**	$194[1]	$76[1]	$10	-
$1,000 over 1 Year	**$110**	$295[1]	$124	$38	-
$2,000 over 2 years	**$315**	$600[1]	$375	$149	-
$3,000 over 3 years	**$663**	$1,047[1]	$761	$334	-

Note 1: Illustration assuming minimum loan size restriction is ignored