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Review of the Code of Banking Practice
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RE: Issues Paper - Comments

The Finance Sector Union of Australia (FSU) welcomes the opportunity to comment on the Issues Paper for the review of the Code of Banking Practice. The FSU represents approximately 50,000 members employed in the finance sector across Australia.

Our submission is divided into two parts:

1. Continuing concerns about the Review process; and
2. Comments on specific Code provisions.

Part 1

The FSU continues to have concerns about some aspects of the review process, primarily in relation to transparency. The ABA submission has not been made public; however it appears to have been given considerable weight when the issues paper was drafted. Parts of the ABA submission are referenced in the paper but the complete submission is not available to others wishing to engage in the review process. This lack of disclosure makes it hard to assess the ABA's arguments.

The paper has a number of interim recommendations that appear to favour the arguments put forward by industry despite submissions from a diverse range of stakeholders advocating different positions. Readers are simply unable to explore the detail of arguments from the ABA (presumably) due to their request that the submission be kept confidential. Consequently our criticism is primarily directed at the ABA for not conducting itself in a manner consistent with a "transparent review" as envisaged by the terms of reference. We submit that the review process can only be weakened by important documents being kept confidential.

In various places it has been recommended that 'policies and processes' be developed by the ABA in consultation with consumers, regulators and banks. This appears to give the ABA more control over issues that could've been dealt with in this independent review process and potentially leads to a long and drawn out processes with no specific end dates.

Part 2

The FSU continues to advocate for responsible lending provisions to be included in relevant legislation and standards such as the Code. Banks should not "sell credit products to a customer unless they have carried out a genuine assessment of the

customer's needs and capacity to repay the credit product"¹ without encountering difficulty or hardship.

We see no reason why the Code shouldn't be a vehicle for banks to lift standards for responsible lending, especially when other sectors appear to have acknowledged their obligation to lend responsibly. Examples of this include the draft Abacus Mutuals Code, the draft Finance Broking Bill 2007 and the MFAA Code of Practice. The greater detail contained in these various instruments gives consumers much better protection than those likely to emerge from the processes proposed by the interim recommendation.

The FSU recommends that the principle of responsible lending be included (as a separate provision) to ensure that lenders genuinely engage with the financial situation of the consumer before an application for credit, or increase in credit is approved. The FSU continues to advocate that unsolicited offers of credit, including credit cards and increasing credit card limits should not be made. These recommendations are consistent with the FSU Draft *Charter of Responsible Lending* (attached).

If you have any questions in relation to this submission please contact James Bennett, Senior Policy & Research Officer on (02) 6247 7172.

Yours sincerely



Leon Carter
National Secretary

1 August 2008

¹ FSU Draft *Charter of Responsible Lending*.

Finance Sector Union – Charter of Responsible Lending DRAFT - June 2008

The Finance Sector Union of Australia calls on all members of the finance industry and the Australian Government to adopt, implement and adhere to a national Charter of Responsible Lending. The key principles and regulatory initiatives underpinning the Charter are as follows:

- A consistent Commonwealth regulatory regime covering the provision of financial products should apply to all credit products and providers; incorporating on the highest standards of disclosure and procedural fairness, access, and affordability of redress for consumers,
- All loans and credit products must be based on a genuine assessment of the consumer's needs, the suitability of the product to meet those needs, and demonstrated capacity to meet the repayments;
- No unsolicited pre-approved credit offers should be made to consumers;
- Sales targets for finance industry staff should only be linked to remuneration if a living wage and across the board, guaranteed minimum salary increases are already in place;
- Consumers must be informed of any commissions, bonuses, incentives or remuneration implications that those making the sale may receive as a result of selling a financial product;
- Consumers must be allowed to 'opt-out' of receiving unsolicited product offers in their dealings with their financial institution;
- Information about assistance mechanisms for people facing financial hardship must be made easily available;
- All institutions must be members of an alternative dispute resolution scheme with the powers to resolve disputes without redress to the courts;
- Financial literacy and education programs must be encouraged and supported by the industry and governments and provided to the community, particularly to vulnerable or disadvantaged groups.
- Financial institutions will improve their credit risk management by developing comprehensive programs, and contributing capital, to enable consumers to reschedule credit repayments during periods of short-medium term cash flow asymmetries.

Background

The finance industry plays an essential role in Australian society as a provider of capital, insurance, investment, personal credit, financial advice, assessment and deposit taking. In Australia, the finance industry makes up approximately 40% percent of the value of our stock market and employs around 400,000 people.

The people and practices in the finance industry determine public goodwill and confidence in its reputation and sustainability – without these it could unravel causing enormous damage to the Australian economy.

The Finance Sector Union (FSU) accepts and understands that the finance industry must be a very competitive industry; however finance products can have serious or long term implications if sold inappropriately.

Purchasing any financial product is a serious matter, especially a home loan which will usually be the biggest financial commitment a person makes in their lifetime. Financial institutions should always try to ensure that products are appropriate to a persons circumstances and do not result in people becoming overly financially committed.

Australia's level of personal debt is at record highs and continues to rise. In 1981 personal debt as a proportion of GDP was 50% by early 1999 it had risen to 100% and in 2007 it was 156%. If the current trend continues, it will reach 200% of GDP by 2015.² Given this trend the FSU advocates that all financial institutions adopt and that Government's enact the necessary regulation to give affect to this Charter of Responsible Lending to preserve the good reputation of our industry, the financial welfare of our citizens and the economy of our community.

Regulatory arrangements

Under the current national regulatory regime, most financial service providers are required to hold an Australian Financial Services (AFS) licence. This includes banks, credit unions, insurance companies and financial advisors. Licensing conditions include training requirements and membership of an industry alternative dispute resolution scheme.

However, the provision of credit is regulated under the Uniform Consumer Credit Code which is enacted through State based legislation. Under this regime credit providers are not automatically required to hold an AFS licence and consequently may not be members of a dispute resolution scheme.

The FSU also calls for the regulation of credit to be brought into a Commonwealth regulatory regime, consistent with other financial products to ensure that consumers have the same level of protection and avenues for redress. In addition there should be national legislation to regulate the conduct of finance brokers in the marketplace.

² *Deeper in Debt - Australia's Addiction to Borrowed Money*, Dr Steve Keen September 2007.

As part of such a regulatory regime, all providers of credit must be members of an alternative dispute resolution scheme.

Credit assessment and increases

Institutions must not sell credit products to a customer unless they have carried out a genuine assessment of the customer's needs and capacity to repay the credit product.

This process must sufficiently consider the debtor's financial situation to satisfy a diligent and prudent credit provider that the debtor has a reasonable ability to repay the amount of credit provided or to be provided.

Institutions should obtain information about the customer's financial position with specific regard to:

- level and type of income; and
- all credit accounts and applicable limits and balances;
- other repayment commitments; and
- credit history.

If this process suggests that a consumer will have difficulty meeting the repayments then approval should not be given unless changes are made that would ensure the consumer has sufficient capacity to make repayments.

Institutions should not increase the amount of credit available unless the consumer has requested the increase in writing, and the credit provider has carried out a satisfactory assessment as previously outlined.

Where credit limit increases are offered they should include details about what the new minimum repayments would be if the consumer accepted the increased limit.

Unsolicited offers of credit, including credit cards and increasing credit card limits must not be made.

Sales targets and finance sector employees' remuneration

The FSU is concerned that the industry is increasingly moving towards a culture of sales targets and incentive based remuneration for employees. Achievement of targets is now explicitly linked to remuneration outcomes – unfortunately, achieving targets is now becoming the only way employees can access pay increases.

The culture of sales targets is, by definition, designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring. The FSU policy on performance pay³ clearly states that sales targets or performance hurdles should only be linked to remuneration outcomes where across the board, minimum pay adjustments already exist to provide employees with sustainable cost of living and real wage growth increases. Base salary levels should reflect the professional nature

³ FSU Policy - Regulation of Performance Based Pay, 2007 – www.fsunion.org.au

of the service being provided and reflect the need to attract and retain a skilled and responsible workforce.

In addition, consumers must be informed of any commissions, bonuses, incentives or remuneration implications that finance sector employees may receive as a result of selling a financial product.

'Opt out'

Financial institutions that wish to offer superior customer service should offer consumers an 'opt-out' mechanism. Under such mechanisms, customers can indicate they do not wish to receive unsolicited offers of products either when dealing directly or indirectly with their financial institution. This would ensure that consumers who are not interested in additional products do not feel pressured by constant unwanted offers and ensure that finance sector employees do not have to persistently make such offers.

Assistance for people facing financial hardship

A proportion of consumers will experience financial difficulty at some stage of their lives. In many cases this will be temporary and institutions can help consumers to manage these periods if they have policies and procedures in place to provide assistance, advice and information.

These procedures should include:

- clear contact points for people experiencing financial difficulty;
- discretion to grant relief mechanisms such as deferred repayments or penalty waivers;
- contacting customers who appear to be having difficulty managing their repayments;
- referral to free and independent financial counselling where appropriate; and
- information regarding dispute resolution procedures.

Financial Literacy and Education

Given the increasing complexity and essential nature of financial services it is critical that people have access to education and information to increase their level of financial literacy. This is particularly important for young people and other potentially vulnerable groups. Industry should take a leading role along with Government in providing these education programs and include them as part of the mainstream curriculum in secondary schools.