

23 November 2020

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Dear Manager

Banking Code Compliance Committee submission: Consumer Credit Reforms

Thank you for providing the Banking Code Compliance Committee (BCCC) with an opportunity to comment on the proposed credit law reforms which will be implemented through changes to the National Consumer Credit Protection Act 2009 (Cth) (the Credit Act).

The BCCC is an independent body that monitors subscribing banks' (banks) compliance with the Banking Code of Practice (the Code). Further information about the BCCC, the Code, and banks' lending obligations under the Code is provided in an Appendix to this submission.

Responsible Lending under the Code

Clause 49 of the Code requires banks to *exercise the care and skill of a diligent and prudent banker* when they are considering providing customers with a new loan or an increase in a loan limit. This obligation applies differently for individual and small business customers.

Clause 50 states that a bank will meet this requirement by *complying with the law* for individual customers.

Clause 51 states that when assessing whether a small business customer can repay a loan, a bank will consider the appropriate circumstances reasonably known about the customer's financial position or account conduct.

The BCCC's views on the credit law reforms

This submission is made on the basis that, if a legislative change alters the scope or operation of the Code, it is important for the Committee to express its views on the potential impact of that change on both the Code and the BCCC's monitoring of the Code.

The BCCC notes that the Fact Sheet published by the Australian Government when the credit law reforms were first announced in September 2020 stated that, “the duty under the Banking Code of Practice for signatory banks to exercise the care and skill of a diligent and prudent banker will still apply”.¹

The BCCC considers it has an obligation to highlight that because the operation of clause 49 of the Code is directly linked to the relevant law for responsible lending, namely the Credit Act, the proposed legislation will effectively remove the framework under which banks currently comply with the *care and skill of a diligent and prudent banker* requirement.

At this stage it is not clear to the BCCC whether or how clause 49 of the Code will apply to lending to individual customers in a credit-risk based lending regime rather than one of responsible lending.

While the Committee understands that lending by banks will continue to be regulated by the Australian Prudential Regulation Authority (APRA), the BCCC would need to consider whether the legislation that provides APRA with its powers to determine prudential standards, including the Banking Act 1959, could or should be considered when assessing a bank’s compliance with clause 49 under the Code.

The BCCC is concerned that these proposed changes will considerably diminish the operation and effect of the Code as a protection for each individual bank customer. They may also result in the position where, with regard to lending, small business customers have protections under the Code, but banks’ individual customers do not.

Contact details

Should you wish to speak with the BCCC to obtain any further information about the Code or the BCCC’s role monitoring the Code, please contact us c/o the BCCC’s CEO, Sally Davis, on 03 9613 7341 or by email at sdavis@codecompliance.org.au.

Yours sincerely,



Ian Govey AM

Independent Chairperson
Banking Code Compliance Committee (BCCC)

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¹ <https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2020-09/Consumer-credit-reforms-fact-sheet.pdf>, September 2020

Appendix

The Banking Code of Practice

The Banking Code of Practice (the Code) sets out standards of practice and service in the Australian banking industry for individual and small business customers, and their guarantors. It was developed by the Australian Banking Association (ABA) and has been approved by the Australian Securities and Investments Commission (ASIC).

It is a condition of ABA membership that member banks with a retail presence in Australia are required to sign up to the Code. Nineteen banking groups currently subscribe to the Code. These banking groups account for approximately 95% of the household lending market for authorised deposit-taking institutions.²

The standards of behaviour and service set out in the Code are enforceable rights for banks' customers.

The current version of the Code applied from 1 March 2020. In June 2020, ASIC approved a variation to the Code to incorporate the "COVID-19 Special Note".

The BCCC

The BCCC is an independent compliance monitoring body established under clause 207 of the Code. The Committee is comprised of an independent chairperson, a banking representative and a consumer representative.

The BCCC's purpose is to monitor and drive best practice Code compliance.

To do this the BCCC:

- examines banks' practices
- identifies current and emerging industry wide problems
- recommends improvements to bank practices, and
- consults with and keeps stakeholders and the public informed.

The BCCC's role and functions are set out in its Charter. The BCCC has the power to:

- monitor Code-subscribing banks' compliance with the Code
- investigate allegations that a bank has breached the Code
- make Code breach findings and recommendations, and
- apply sanctions.

This Appendix to the BCCC's submission also refers to reports published by the BCCC's predecessor, the Code Compliance Monitoring Committee (CCMC). The BCCC replaced the CCMC on 1 July 2019.

² Australian Prudential Regulation Authority - Monthly Banking Statistics for August 2020.

Copies of the Code and the BCCC Charter are available on the BCCC's website.³

The BCCC's interpretation of relevant Code obligations

2013 Code of Banking Practice – Provision of Credit

Under clause 27 of the 2013 Code, a bank was required to exercise the care and skill of a diligent and prudent banker when it:

- selected the credit assessment method it applied to a credit facility or credit increase
- applied the selected credit assessment method to the customer, and
- formed its opinion on the customer's ability to repay the credit facility.

This 2013 Code obligation applied to both individual and small business customers.

In 2017, the CCMC published a report of its inquiry into banks' compliance with clause 27 of the 2013 Code when providing unsecured credit (the Inquiry Report).⁴

In the Inquiry Report, the CCMC noted that:

- banks must comply with the responsible lending obligations contained in Chapter 3 of the Credit Act when lending to individual customers, and
- the principles of the Credit Act were a relevant consideration when assessing compliance with clause 27 of the Code and when deciding whether a Code subscribing bank had exercised the care and skill of a diligent and prudent banker when lending to an individual customer.

Consistent with the requirements of the Credit Act, a bank needed to have regard to the individual circumstances of a customer or potential customer and make reasonable inquiries about a customer's circumstances, objectives and financial situation, including making reasonable inquiries to verify a customer's financial situation.

In the Inquiry Report, the CCMC also reported that banks had not demonstrated, to its satisfaction, that the use of an automated system or statistical credit scoring model alone was sufficient to comply with the Code obligations, unless up-to-date information regarding a customer's financial position was incorporated into the credit assessment.

The Committee considered that having a full and current picture of a customer's financial circumstances was fundamental to complying with the Code obligations.

The CCMC considered that while the Code obligations under clause 27 did not extend to a banks' commercial judgment, they were designed to ensure that a bank made informed decisions about the provision of credit and took a 'responsible approach to lending'.

³ <https://bankingcode.org.au/>

⁴ Own Motion Inquiry - Provision of Credit, CCMC, <https://bankingcode.org.au/app/uploads/2019/06/CCMC-Inquiry-Report-Provision-of-credit-January-2017.pdf>, January 2017

Banking Code of Practice - A responsible approach to lending

The 2013 Code was reviewed in 2016, and the Code Reviewer considered whether clause 27 should be redrafted either to convey the bank's commitment more clearly, or to enhance the legislative process requirements.⁵

The Reviewer recommended that the obligation should be renamed from *Provision of Credit* to *A responsible approach to lending* and that the revised Code should contain a new clause that obliged banks to:

- review the applicant's financial information, situation and requirements carefully and prudently and consider the application on its merits, and
- only lend amounts that the bank believed the applicant could reasonably afford to repay.

When the Banking Code of Practice came into effect in July 2019, it contained an amended requirement for lending to individual customers under Chapter 17. Banks are required to take a responsible approach to lending. This commitment is reinforced by one of the Code's Guiding Principles.

Clause 49 of the Code requires banks to *exercise the care and skill of a diligent and prudent banker* when they are considering providing customers with a new loan or an increase in a loan limit.

This obligation applies differently for individual and small business customers. Clause 50 states that a bank will meet this requirement by *complying with the law* for individual customers.

Clause 51 states that when assessing whether a small business customer can repay a loan, a bank will consider the appropriate circumstances reasonably known about the customer's financial position or account conduct.

The Code contains further obligations regarding responsible lending including requirements to:

- lend to co-borrowers only if they receive a substantial benefit unless certain criteria apply (clauses 53 to 57)
- tell customers about the bank's suitability assessment for a loan if it is regulated under the Credit Act (clause 58)
- assess a customer's ability to repay a credit card within a three-year period (clause 60), and
- not provide a customer with a credit card limit that is greater than the amount requested (clause 61).

There are also additional Code obligations which cover lending to small businesses set out in Part 6 of the Code.

⁵ Independent Review - Code of Banking Practice, Mr Phil Khoury, <http://cobpreview.crkhoury.com.au/wp-content/uploads/sites/2/2017/02/Report-of-the-Independent-Review-of-the-Code-of-Banking-Practice-2017.pdf>, January 2017

The BCCC also notes that Code obligations should not operate in isolation from one another. As such, banks may need to consider and comply with additional obligations when lending to customers, including Code requirements to:

- engage with customers in a fair, reasonable and ethical manner (clause 10)
- train staff to work competently and comply with the Code (clause 9)
- communicate with customers in a timely manner and give customers information that is useful and clear (clause 17)
- train staff to treat diverse customers and customers experiencing vulnerable circumstances with sensitivity, respect and compassion (clause 33)
- take reasonable measures to enhance access to banking services for Indigenous customers, people with a disability and older customers and people with limited English (clauses 34 and 35), and
- take extra care with customers who are experiencing vulnerable situations (clause 38).

The Committee requires banks to complete a Compliance Statement on their compliance with the Code on a biannual basis. Banks reported 20,863 Code breaches for the period July to December 2019, including 2,446 breaches of Chapter 17.⁶

The breach data indicates that the majority of breaches of Chapter 17 of the Code occur where a bank fails to meet responsible lending requirements, including:

- a failure to collect all required information about a customer/borrower
- incorrectly calculating or recording the customer's financial situation, or
- where supporting documents did not match or support some elements of the credit application.

⁶ <https://bankingcode.org.au/app/uploads/2020/08/BCCC-Report-Banks-compliance-with-the-Banking-Code-of-Practice-July-to-December-2019-August-2020.pdf>, August 2020