

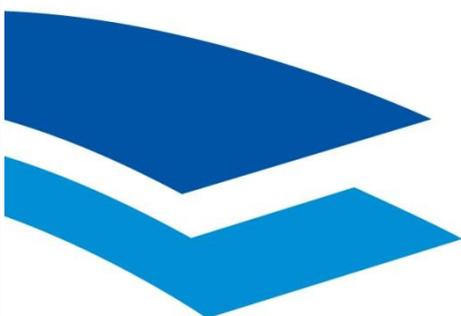


Code Compliance Monitoring Committee

# Own Motion Inquiry Provision of Credit

Examining banks' compliance with the provision of  
credit obligations under clause 27 of the Code of  
Banking Practice

January 2017



# ABOUT THE CODE AND THE CCMC

## The Code

The Code of Banking Practice (the Code) is a voluntary code of conduct which sets standards of good banking practice. These are standards that subscribing banks are expected to follow when dealing with persons who are, or who may become, an individual or small business customer (or their guarantor) of a Code-subscribing bank. There are 13 banking groups which subscribe to the Code, covering approximately 95% of the Australian retail banking market.

## The CCMC

The Code Compliance Monitoring Committee (the CCMC) is an independent compliance monitoring body established under clause 36 of the Code.

The CCMC's purpose is to promote compliance with the Code and thereby contribute to the improvement of standards of practice and service by banks. Its aim is to be a trusted and valued partner, helping the Code-subscribing banks to comply with their Code obligations, ultimately creating a better banking experience. To achieve this, the CCMC adopt a responsive, focused and collaborative approach to working with the Code-subscribing banks.

The CCMC's powers and functions are set out in its Mandate. The Mandate is published by the Australian Bankers' Association (ABA) along with the Code. By adopting the 2013 version of the Code, Code-subscribing banks endorsed this Mandate.

The CCMC conducts a compliance program that reflects the objectives of the Code and comprises three core activities, namely monitoring, investigating and engaging. Under clause 5.1 of its Mandate, the CCMC's monitoring role includes conducting own motion inquiries for the purpose of monitoring compliance with a particular requirement or requirements of the Code.

The CCMC is able to use a range of investigative and monitoring techniques when conducting these inquiries including:

- requests for information from Code-subscribing banks
- compliance visits to the premises of Code-subscribing banks
- consultation with consumer advocates
- market research activities such as mystery shopping, surveys and forums, and
- engaging external experts.

The findings of these inquiries are provided to all participating banks to influence and encourage positive change in code compliance monitoring frameworks and to share experience of good industry practice and areas requiring improvement.

The CCMC publishes reports of all completed inquiries on the CCMC website at [www.ccmc.org.au](http://www.ccmc.org.au).

## How to read this report

For ease of reference:

- 'bank' means a bank which subscribes to the Code
- 'Code' is a reference to the 2013 version of the Code, unless otherwise stated, and
- 'consumer' or 'customer' means an individual or small business that is either a customer or potential customer of a bank.

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# Executive Summary

This is a report of an Own Motion Inquiry (the Inquiry) by the Code Compliance Monitoring Committee (the CCMC) into Code-subscribing banks' compliance with their provision of credit obligations under clause 27 of the Code of Banking Practice (the Code).

Compliance with the provision of credit obligations is a common theme in the CCMC's investigations of alleged Code breaches and one of the highest areas of self-reported Code breaches by banks over the last 5 years.

To comply with clause 27 of the Code, a bank is required to exercise the care and skill of a diligent and prudent banker in:

- selecting the credit assessment method it will apply to a credit facility or credit increase
- applying the selected credit assessment method to the customer, and
- forming its opinion on the customer's ability to repay the credit facility.

To assess whether a bank has in place robust processes and procedures to act as a diligent and prudent banker, the Inquiry considered whether:

- the bank collects and uses appropriate information to form an opinion on a customer's ability to repay a credit facility, and
- its use of technology and automated systems associated with the provision of credit is appropriate to comply with the Code obligations.

The focus of this Inquiry is on the provision of unsecured loans, overdrafts, credit cards and credit card limit increases to individual and small business customers<sup>1</sup>.

Banks must comply with the responsible lending obligations contained in Chapter 3 of the National Consumer Credit Protection Act 2009 (Cth) (NCCP)<sup>2</sup> when lending to individual customers. This legislation does not apply to small business customers.

When assessing compliance with clause 27 of the Code, the CCMC considers that the principles of the NCCP are a relevant consideration when deciding whether a Code-subscribing bank has exercised the care and skill of a diligent and prudent banker in relation to an individual customer. As the Code covers both individual and small business customers, these principles may also provide guidance when considering whether a Code-subscribing bank has exercised the care and skill of a diligent and prudent banker in relation to a small business customer.

In conducting the Inquiry, the CCMC:

- engaged with all banks to better understand the credit assessment processes and procedures they have in place
- collected data about unsecured credit applications processed during the month of March 2016, and
- surveyed consumer advocates to gain insight into customer experience when dealing with banks in relation to the provision of credit.

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<sup>1</sup> Small business is defined under the Code.

<sup>2</sup> See [ASIC - Responsible lending 2015](#) and [National Consumer Credit Protection Act 2009 \(Cth\) \(NCCP\)](#). The NCCP includes the [National Credit Code \(NCC\)](#) as Schedule 1.

### Unsecured credit applications in a typical month in 2016:

- Credit cards account for 68% of applications for unsecured credit.
- Less than 3% of all applications for unsecured credit are from small business customers.
- Automated systems are used to process approximately 97% of applications for unsecured credit.
- Where an automated system is used at some stage of the credit assessment process, 65% of unsecured credit applications are approved.

The CCMC found that the primary credit assessment method applied by all banks involves collecting and verifying information, before making a decision regarding whether a customer can afford to repay a credit facility. Banks demonstrated to the CCMC that they generally have robust, and often complex, processes in place to assess the majority of applications for unsecured credit in compliance with the Code.

However, the CCMC identified a number of potential issues regarding:

- banks not making inquiries about a customer's purpose for credit card applications
- the collection and verification of current customer information when processing applications for credit card limit increases, and
- the assessment of a customer's ability to repay a credit card balance.

Information provided to the Inquiry suggests that the majority of applications for unsecured credit are processed using automated systems. Banks also indicated that the use of technology in the credit assessment process is likely to continue to grow over the next 12 months and beyond.

At this point in time banks have not demonstrated, to the CCMC's satisfaction, that the use of an automated system or statistical credit scoring model alone is sufficient to comply with the Code obligations, unless up-to-date information regarding a customer's financial position is incorporated into the credit assessment. The CCMC considers that having a full and current picture of a customer's financial circumstances is fundamental to complying with the Code obligations.

The CCMC thanks all stakeholders for their contributions to this Inquiry which was conducted in accordance with clause 5.1 of the CCMC's Mandate.

## Key findings

Area of assessment	Key findings
Credit assessment methods	<ul style="list-style-type: none"><li>• While individual banks use different processes, each bank generally applies the same overall method to each type of unsecured lending product it offers.</li><li>• Eight banks use automated systems, including 'behavioural scoring' techniques, 'application scorecards' and automated decision-making tools.</li><li>• Three banks use only manual credit assessment processes.</li><li>• Two of the 13 Code-subscribing banking groups do not provide unsecured credit facilities.</li></ul>

Area of assessment	Key findings
Inquiries about requirements and objectives	<ul style="list-style-type: none"> <li>• Overall, banks have processes in place to make inquiries about a customer's requirements and objectives for unsecured loans and overdrafts.</li> <li>• Banks do not generally make inquiries about a customer's purpose when they apply for a credit card.</li> </ul>
The collection and verification of information	<ul style="list-style-type: none"> <li>• Banks do not always request updated information for credit card limit increase applications.</li> <li>• Some banks verify information about a customer's income using benchmarks and internal models.</li> <li>• When verifying individual customers' expenses, all banks use comparison to an expenditure measure. The Household Expenditure Measure is used most widely.</li> <li>• Liabilities are verified by reviewing system data or account statements.</li> </ul>
Assessment of a customer's ability to repay a credit facility	<ul style="list-style-type: none"> <li>• When calculating a customer's capacity to repay based on income, expenses and the relevant repayment of the facility being applied for (serviceability), banks generally assess the customer as being able to repay the credit facility if their remaining surplus funds are greater than \$0.</li> </ul>
Training and compliance monitoring	<ul style="list-style-type: none"> <li>• Banks have training frameworks and processes to monitor credit assessment methods in place.</li> <li>• Four banks confirmed that they have processes in place to ensure that instances of inappropriate credit provision discovered as a result of a request for financial difficulty assistance are reported as part of the bank's compliance monitoring framework.</li> </ul>
Identification of small business	<ul style="list-style-type: none"> <li>• Generally, banks are unable to distinguish small business customers (as defined by the Code) from other business customers.</li> </ul>

## Recommendations

The CCMC encourages banks to consider the following recommendations, which:

- support Code compliance, and
- can assist banks to continuously work towards improving standards of practice and service in the banking industry as anticipated by clause 3.1(a) of the Code.

Most of these recommendations are consistent with the current or proposed practices of one or more Code-subscribing banks.

### Inquiries about requirements and objectives (see Page 21)

**R1** Consider the following options:

- Inform the customer on the application form or in other prominent guidance that credit cards provide credit that can be used for general living expenses, but in some circumstances another credit product may be more appropriate; and that a customer can contact the bank to discuss options if they are unsure.
- Take steps to promote better informed decisions by providing effective disclosure of information, such as the development of online comparison tools that compare the features of different types of credit products, for example, whether or not the facility has a fixed term and the interest rate that applies.

### The collection and verification of information (see Page 22)

**R2** Banks should consider developing and using automated tools that can better verify a customer's actual financial circumstances. This may include tools for the analysis of transactional account data (where the customer is already a customer of the bank), and/or documentation to demonstrate income and expenses.

**R3** Banks should ensure assessment processes for credit card limit increases are robust. They should request and verify the customer's current income, expense and liability information, unless up-to-date information has been recently provided and verified. This information should be used in addition to any available information a bank holds that can be assessed using behavioural scoring techniques.

**R4** When comprehensive credit reporting information is available, banks should consider how that data can assist them to better assess a customer's financial position.

### Assessment of a customer's ability to repay a credit facility (see Page 24)

**R5** Banks should consider introducing a serviceability buffer that ensures a customer being provided with a credit card:

- can pay more than the minimum monthly payment, and
- can save additional funds each month.

**R6** The CCMC encourages banks to provide additional information regarding minimum payments to assist customers to make better informed decisions about banking services. For example, provide prominent information and examples for customers, before they apply for a credit card that explains how long it will take to repay a balance equal to the credit limit if they only make minimum monthly payments.

## Training and compliance monitoring (see Page 27)

- R7** Banks' automated credit assessment systems and the outputs of these systems should be robustly monitored, particularly through the use of manual file reviews of a sample of applications. In addition, banks should:
- have a clear and well-understood process for identifying, recording, reporting and rectifying non-compliance with the Code
  - ensure that arrangements are in place to prevent a recurrence of breach activity, and
  - have appropriately trained personnel within each operational area to identify and report when and where breaches have occurred.
- R8** Banks should ensure that they have systems in place to:
- capture and report all information about the inappropriate provision of credit through their monitoring frameworks, and
  - ensure they rectify serious or systemic non-compliance with the Code to minimise the risk of reoccurrence in a timely manner.

## Identification of small business (see Page 29)

- R9** Banks should record the nature of the business and how many employees a business has at the time of application for a credit facility in order to identify small business customers as defined by the Code and apply the obligations of the Code accordingly.

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The CCMC will continue to monitor banks' compliance with the provision of credit obligations under the Code through its investigations into alleged Code breaches and its Annual Compliance Statement program.

# Own Motion Inquiry

## Code obligations

Clause 27 of the Code states:

*Before we<sup>3</sup> offer, give you<sup>4</sup> or increase an existing, credit facility, we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay the credit facility.*

The CCMC has previously set out its approach to compliance with clause 27 in Guidance Note 9<sup>5</sup>.

Banks must comply with the responsible lending obligations contained in Chapter 3 of the National Consumer Credit Protection Act 2009 (Cth) (NCCP)<sup>6</sup> when lending to individual customers. This legislation does not apply to small business customers.

When assessing compliance with clause 27 of the Code, the CCMC considers that the principles of the NCCP are a relevant consideration when deciding whether a Code-subscribing bank has exercised the care and skill of a diligent and prudent banker in relation to an individual customer. As the Code covers both individual and small business customers<sup>7</sup>, these principles may also provide guidance when considering whether a Code-subscribing bank has exercised the care and skill of a diligent and prudent banker in relation to a small business customer.

The Code obligations do not extend to a banks' commercial judgment, but are designed to ensure that a bank makes informed decisions about the provision of credit.

In addition, when assessing whether a bank has complied with its provision of credit obligations, the CCMC may also consider:

- whether banks have met their key commitments and acted fairly and reasonably towards customers in a consistent and ethical manner and complied with laws in accordance with clauses 3 and 4 of the Code<sup>8</sup>
- whether staff are trained to competently and efficiently discharge their functions in accordance with clause 9 of the Code
- the Australian Securities and Investments Commission's (ASIC) Regulatory Guide (RG) 209 *Credit licensing: Responsible lending conduct*<sup>9</sup>, and
- the series of documents on responsible lending published by the Financial Ombudsman Service (FOS) Australia<sup>10</sup>.

Additional Code obligations that relate to clause 27 are set out in full in Appendix 1.

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<sup>3</sup> 'We', 'us' and 'our' means the Code-subscribing bank.

<sup>4</sup> Under the Code, 'you' and 'your' means a person who is an individual or a small business that is a customer of a Code-subscribing bank.

<sup>5</sup> [Guidance Note 9 – Provision of credit](#)

<sup>6</sup> See [ASIC - Responsible lending 2015](#) and [National Consumer Credit Protection Act 2009 \(Cth\) \(NCCP\)](#). The NCCP includes the [National Credit Code \(NCC\)](#) as Schedule 1.

<sup>7</sup> Clause 1 of the Code states: 'This Code is a voluntary code of conduct which sets standards of good banking practice for us to follow when dealing with persons who are, or who may become, our individual and small business customers and their guarantors'.

<sup>8</sup> Code clause 36(b)iii states that the CCMC's compliance monitoring functions and powers do not extend to clauses 3 and 4 of the Code unless a breach of clause 3 or 4 is also a breach of another provision of the Code.

<sup>9</sup> [RG 209 Credit licensing: Responsible lending conduct](#)

<sup>10</sup> [FOS Approach – Responsible Lending series](#)

## Background

In its *2015–17 Annual Work Plan*<sup>11</sup>, the CCMC identified provision of credit as a focus area for additional monitoring in 2016.

The CCMC's monitoring and investigations work has highlighted the provision of credit as an area for further inquiry. In the 2014–15 Annual Compliance Statement (ACS) program,<sup>12</sup> banks self-reported a high number of breaches of the provision of credit obligations. This has been among the top five breach categories for the last five years of monitoring.

In addition, a significant proportion of customer Code breach allegations received by the CCMC relate to the provision of credit. These allegations suggest that non-compliance with provision of credit obligations can have a significant impact on customers. Similarly, stakeholder input to the CCMC's 2015 Financial Difficulty Inquiry suggested that banks' decisions about the provision of credit sometimes contribute to customers' financial difficulties.

Further information is in Appendix 2.

## Objective

The objective of this Inquiry is to assess whether banks have in place robust processes and procedures to act as a diligent and prudent banker in the provision of unsecured credit to their customers. To achieve this, the CCMC aimed to:

- identify areas of emerging risk and challenges that may impact on a banks' compliance with the provision of credit obligations under the Code
- confirm whether banks are making suitable inquiries when selecting the most appropriate credit assessment method
- assess whether the use of technology and automated systems associated with the provision of credit is appropriate to comply with the obligations under the Code
- verify whether information received as part of the ACS program regarding frameworks for the provision of secured credit also extends to the provision of unsecured loans and credit cards
- ensure banks effectively train staff on the obligations contained in the Code and comply with their key commitment to act fairly and reasonably towards customers in a consistent and ethical manner in meeting their obligations under clause 27
- benchmark current industry practice in this area and identify both good industry practice and areas where banks' practice can improve.

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<sup>11</sup> The full CCMC work plans for [2015–17](#) and [2016–17](#) are available on the CCMC website.

<sup>12</sup> For more information regarding the CCMC's Annual Compliance Statement program please see [CCMC Guidance Notes 1](#) and [12](#).

# Methodology

The Inquiry was carried out in three stages:

## Stage one: Data collection

A questionnaire was provided to 13 banking groups seeking information about bank practices relevant to the Inquiry (see Appendix 3). The CCMC also surveyed consumer advocates and received 20 responses. Those questions are listed in Appendix 4.

The CCMC drew on its previous compliance monitoring work, considered findings from investigations into alleged breaches of the provision of credit obligations and reviewed information provided by banks as part of the ACS program.

The CCMC also reviewed relevant literature, guidance and consultation papers.

## Stage two: Analysis and assessment

The CCMC then collated and analysed the data, using it to:

- form a view as to whether subscribing banks have adequate processes and procedures in place to comply with clause 27 of the Code
- assess whether these processes and procedures are being applied in practice
- identify examples of good industry practice and areas for improvement, and
- develop a broader understanding of trends and issues regarding compliance with the provision of credit obligations.

## Stage three: Consultation and reporting

The CCMC discussed the key findings with all participants and reported individual issues to each subscribing bank where appropriate. Before completing the report, the CCMC also consulted with key stakeholders.

# Data collection

The CCMC gathered basic data about the types of unsecured loan products offered by Code-subscribing banks and how applications are processed.

There are 13 banking groups that subscribe to the Code, representing 18 banks.

Eight banks confirmed that they use automated decision-making systems to varying degrees. Three banks confirmed that they use manual credit assessment processes exclusively. Two banks do not provide unsecured lending products so did not participate further in the Inquiry.

## Applications for unsecured credit

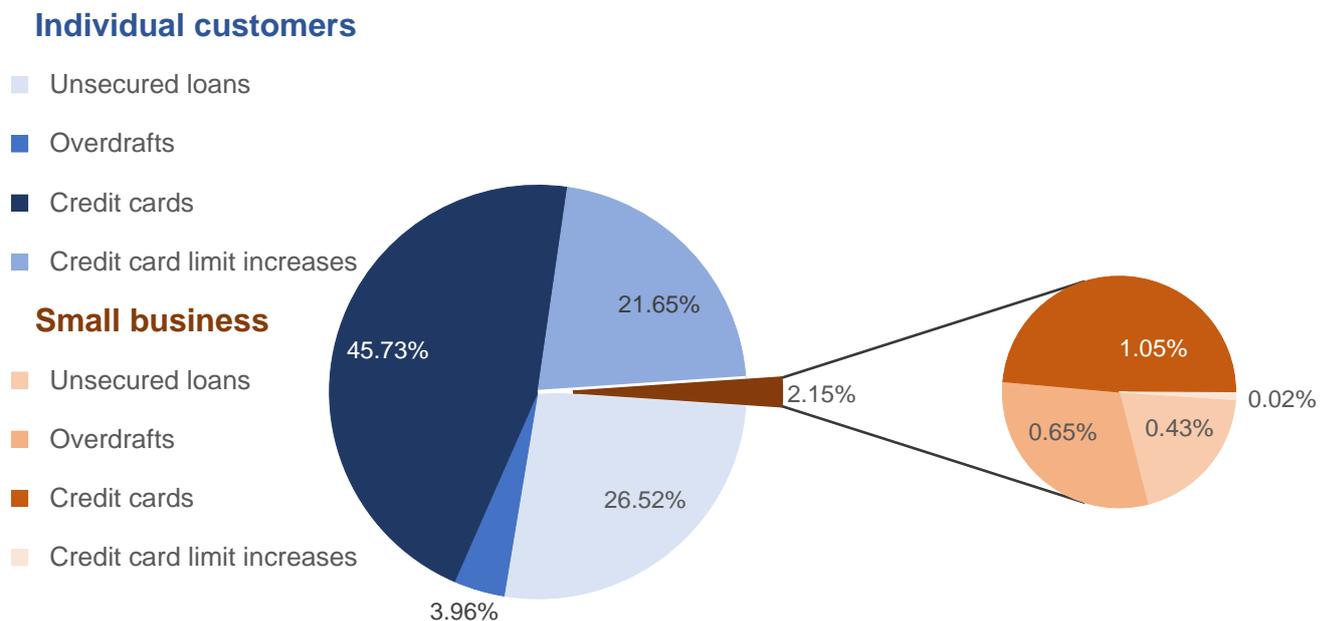
In total, banks processed 380,879 applications for unsecured credit during March 2016. This ranged from approximately 10 applications at one bank to 130,000 at another.

**Chart 1** sets out the types of credit applications involved.

Credit cards make up about 68% of applications for unsecured credit from individual customers (46% new applications and 22% credit limit increases).

Small business customers made less than 3% of all applications for unsecured credit.

**Chart 1: Breakdown of applications for unsecured credit by product type**



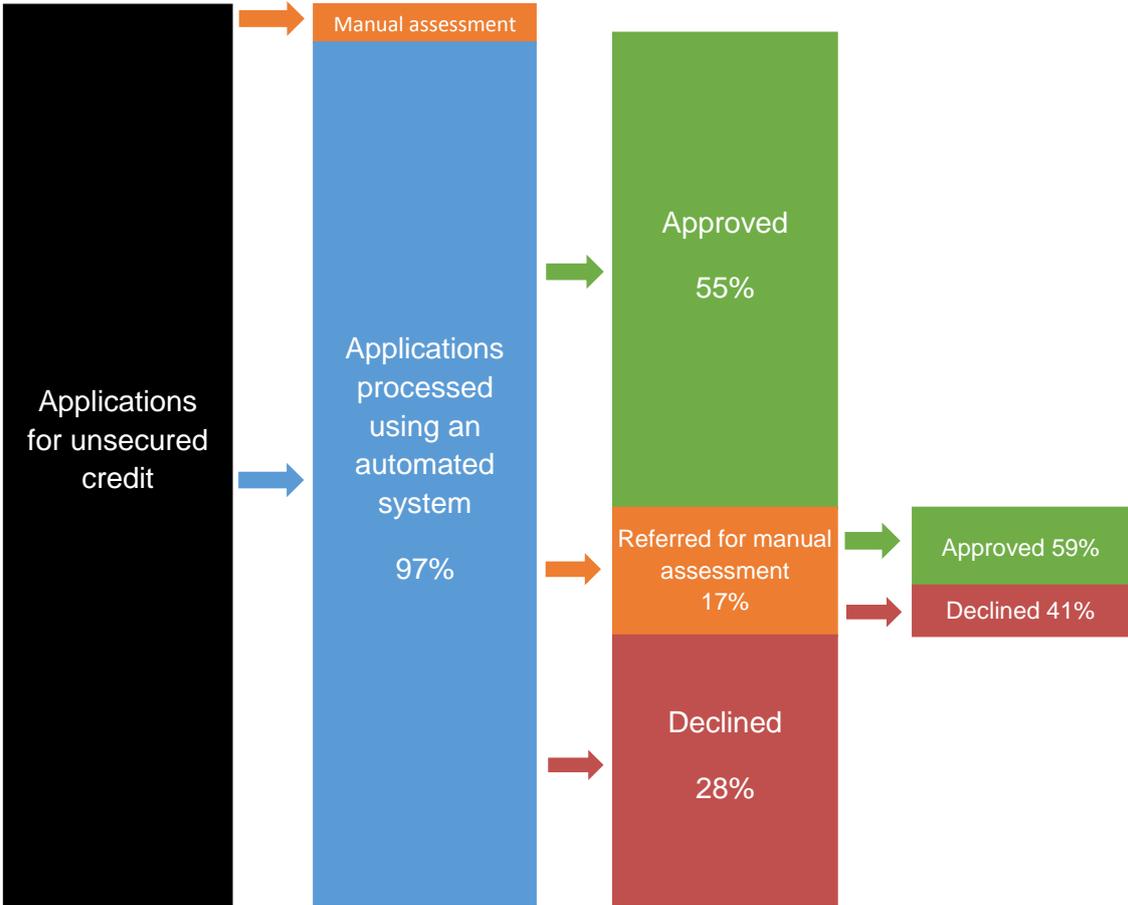
## Application processing

Automated systems were utilised to process approximately 97% (369,965) of total applications made.

Approximately 55% of applications that were processed using an automated system were approved, 28% were declined and 17% were referred for manual review. Of this 17%, 59% were approved and 41% declined (see **Figure 1** below).

Overall, therefore, 65% of all applications for unsecured credit were approved where an automated system was used at some stage during the process.

**Figure 1: Breakdown of how applications were processed and outcomes**



## Products offered

**Table 1** provides details of the number of banks which provide each type of product. While some banks provide a full range of unsecured credit products to both individual and small business customers, others provide only a selection. For this reason the figures in Table 1 do not total the number of Code-subscribing banks.

**Table 1: No. of banks which provide unsecured credit products to individual and small business customers**

Product Type \ Customer Type	Unsecured loans	Overdrafts	Credit cards	No products provided
Individual	8	7	9	3
Small business	7	9	8	3

Table 1 includes one bank which provides credit cards under its own name and for two other subscribing banks under a 'white label' agreement.

# Findings and recommendations

## Credit assessment methods

The CCMC asked banks to:

- explain how they determine what credit assessment method to use for different unsecured lending products
- provide a high level outline of these methods, and
- explain how they capture, verify and use customer information as part of their credit assessment methods, in particular through the use of automated systems and tools.

The CCMC also requested information about improvements to credit assessment methods that banks are planning to implement in the near future, as the CCMC is aware that this area is constantly evolving and planned improvements could represent good industry practice.

**Figure 2** outlines the broad credit assessment method that all banks apply, based on their responses to the Inquiry.

**Figure 2: The general credit assessment method**

<p><b>Collect information</b></p>	<p><b>Information from a customer</b></p> <ul style="list-style-type: none"> <li>• Personal information to:             <ul style="list-style-type: none"> <li>• identify the customer, and</li> <li>• confirm they meet minimum eligibility criteria (for example, age and residency status)</li> </ul> </li> <li>• Requirements and objectives, including the purpose and size of the credit facility.</li> <li>• Financial information (for example, net income, living expenses).</li> </ul> <p><b>Information held by the bank</b> Data the bank holds where the application is from an existing customer.</p> <p><b>Information from credit reporting bodies</b> Including credit scores and any adverse information held about the customer.</p>
<p><b>Verify information</b></p>	<p>Verify the information provided by the customer.</p>
<p><b>Make a decision whether to approve an application</b></p>	<p>Assess:</p> <ul style="list-style-type: none"> <li>• the suitability of the credit facility for the customer's requirements and objectives</li> <li>• the customer's risk score in relation to the banks' credit policy. Information that feeds into the scoring process includes the above and aspects such as:             <ul style="list-style-type: none"> <li>• stability of the customer's circumstances</li> <li>• strength of employment</li> <li>• length of relationship with the customer</li> </ul> </li> <li>• the customer's capacity to repay the facility (known as 'serviceability') using information provided by the customer and any internal information available where the applicant is an existing customer of the bank.</li> </ul>

Six banks confirmed that the method applied is the same for each unsecured product type. Five other banks' said that, while the overall method is the same for each product type, certain aspects do vary and are tailored for different products depending on the bank's credit risk appetite and product policies.

For example, with the customer's prior consent, a bank may invite the customer to apply for a credit limit increase. When initiating credit limit increases in this way, banks may carry out the steps in the credit assessment method in a different order, checking account conduct and credit reporting information *before* inviting the customer to apply for a limit increase. In these cases, a bank's systems may calculate a limit that the bank believes the customer can service.

Several banks noted that for small business customers, there are some differences in the assessment method in terms of data capture and risk assessment.

## **Automated systems**

Banks use a range of information and systems to make decisions on whether or not to offer a credit facility. These include:

- filtering by key criteria (for example, minimum customer age)
- tools for the verification of information
- manually applied scoring models, and
- automated decision-making systems.

Automated systems use a series of filters, algorithms and statistical scoring models to either decide, or provide input into decisions, about whether or not to approve an application for unsecured credit.

The degree of automation varies between banks. Some banks do not use automated systems at all. Within banks that do, there may be variation depending on factors such as product and customer type (for example, individual or small business). For some credit products the process is fully automated, for others a system may produce a score or risk rating which is then manually assessed by bank lending staff alongside other information provided by a customer.

Banks confirmed that scoring models (also referred to as 'scorecards') are statistical models for predicting whether a customer will exhibit a certain behaviour and, essentially, whether or not they will be able to repay the credit provided.

## **Behavioural scoring**

'Behavioural scoring' is a technique used to summarise a customer's past behaviour in relation to accounts held by that bank. Banks' responses suggest that the term is used to apply to both manual checks on past behaviour as well as systems that can do this automatically. Behavioural scoring is most often used when providing credit card limit increases and this is discussed in more detail below.

## **Collecting information**

Banks stated that they make reasonable inquiries about a customer's financial situation primarily through needs-based discussions with the customer and/or a statement of position using mandatory fields in an application form. Data is also collected from internal systems (where an application is from an existing customer) and credit reporting bodies.

**Figure 2: Examples of the information used by automated systems**

Types of information	Examples
<b>Personal and demographic information</b>	<ul style="list-style-type: none"> <li>▪ Age of customer</li> <li>▪ Occupation</li> <li>▪ Employment status</li> <li>▪ Employer details</li> <li>▪ Number of dependents</li> <li>▪ For small businesses - directors, number of employees</li> </ul>
<b>Financial information</b>	<ul style="list-style-type: none"> <li>▪ Income</li> <li>▪ Savings</li> <li>▪ Assets</li> <li>▪ Expenses (fixed and variable)</li> <li>▪ Other liabilities/ debts / existing credit facilities</li> </ul>
<b>Credit reporting body data</b>	<ul style="list-style-type: none"> <li>▪ Number of credit inquiries made</li> <li>▪ Any default listings</li> <li>▪ Bankruptcy listing</li> </ul>
<b>Information from existing facilities with the bank</b>	<ul style="list-style-type: none"> <li>▪ Credit limit</li> <li>▪ Repayment amount</li> <li>▪ Repayment history</li> </ul>
<b>Information about the product requested</b>	<ul style="list-style-type: none"> <li>▪ Type</li> <li>▪ Limit</li> <li>▪ Term</li> </ul>

Customers are typically required to provide income details for credit limit increases, whether initiated by the bank or the customer. In some cases, a customer will be asked to confirm that their income exceeds a certain level.

Banks do not always request updated expenses for limit increases. This depends on the application method (online, telephone or paper-based) and whether the increase is bank- or customer-initiated.

For bank-initiated increases, some banks use internal modelling (including behavioural scoring) to make a preliminary assessment and assign a pre-determined limit.

When conducting behavioural scoring, banks generally take into account between 3 and 12 months' worth of account information. The period considered and the information included depends on a number of variables, including for example how long the customer has had a product with the bank. Another consideration is whether customer-level information (where a customer has multiple products with the bank) or account-level information (looking at activity related to one credit facility) is appropriate.

Several banks confirmed that behavioural scoring is also used as part of the assessment process for small business customers.

The CCMC asked consumer advocates whether, in their experience, customers were asked to provide sufficient evidence of income, expenses and liabilities. While advocates had different views about the sufficiency of the evidence requested, most provided additional comments, such as:

- information is requested, but not critically or adequately assessed
- information is requested less often for online applications
- information requested for credit cards is less detailed than for home loans
- customers may not be candid in their stated income or liabilities and lenders are not scrupulous in checking whether the customer's stated position is correct
- there is no meaningful discussion at all about living expenses.

## ***Inquiries about requirements and objectives***

The CCMC asked banks to explain how they make inquiries about a customer's requirements and objectives for unsecured credit products, and credit cards in particular.

To demonstrate compliance with clause 27 and that it has exercised the care and skill of a diligent and prudent banker, the CCMC considers that a bank should make reasonable inquiries about a customer's requirements and objectives, including purpose<sup>13</sup>.

Similar requirements are contained in RG 209 which sets out ASIC's expectations for meeting the obligations under the NCCP. RG 209 states that banks must make reasonable inquiries about a customer's requirements and objectives and assess whether the credit contract is 'not unsuitable' for the customer on that basis.

A credit contract will be 'unsuitable' where, at the time of the assessment, it is likely that the contract does not meet the customer's requirements and objectives.

### **Unsecured loans and overdrafts**

Depending on which bank is involved, applications for unsecured credit can be made in branch, over the phone or online. All banks that provide personal and business loans and overdrafts reported that they ask the customer for information about their requirements and objectives, including the purpose of the loan. This is done either in an application form or through 'needs-based' conversations with the customer. This conversation is unlikely to occur if an application is being made online.

### **Credit cards**

Credit cards differ from other unsecured credit in that they may not have a specific purpose. The 'Explanatory Memorandum<sup>14</sup> to the *National Consumer Credit Protection Bill 2009* states that, 'a credit card has no particular purpose and therefore there would be a limited requirement to understand the consumer's requirements and objectives in this case'. Nevertheless, Example 3.5 of the Explanatory Memorandum also indicates that where a bank *does* know the initial intended use of the credit card (for example, a car purchase) it must take that into account in considering whether or not the credit contract is 'not unsuitable'.

Most banks that provide credit cards noted that credit cards may have 'no particular purpose' and are used for general expenses. As such, banks generally reported that they do not ask about the purpose for a credit card and our review of credit card application forms generally confirmed that this is the case.

There are some notable exceptions. One bank's form does ask customers to confirm the purpose of the application. Another bank, notes that 'Credit cards are a flexible credit product allowing general purchases' at the start of the application form. A third bank confirmed that customers applying for credit cards are asked to declare that their sole requirement and objective is to obtain a general purpose transaction facility to facilitate future personal, domestic or household purchases.

The CCMC also asked consumer advocates whether they are aware of any issues regarding whether credit products meet the needs and purpose for customers. The majority of respondents were concerned about this issue and provided examples including customers using credit cards:

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<sup>13</sup> [Guidance Note 9 – Provision of credit – paragraph 8](#)

<sup>14</sup> National Consumer Credit Protection Bill 2009 – [Explanatory Memorandum](#)

- to purchase a car
- to pay off other debts
- to gamble
- to obtain money to assist with getting a home loan.

The Treasury's May 2016 consultation paper, *Credit cards: improving consumer outcomes and enhancing competition*, notes that:

*In some cases, a consumer may be better off taking out a personal loan instead of a credit card. If the purpose of a credit card is to finance a specific, one-off purchase over a number of years, a personal loan would offer multiple advantages. Secured personal loans are available at interest rates that are lower than many low-rate cards, and unsecured personal loans offer rates lower than most high-rate cards. A personal loan also offers certainty and commitment when it comes to the amount borrowed, the schedule of repayments, total interest costs, and the life of the loan.<sup>15</sup>*

## Verifying customer information

The CCMC expects a diligent and prudent banker to make reasonable inquiries to verify a customer's financial situation. Under paragraph 9 of Guidance Note 9, the CCMC states that:

*[In] all cases, banks are required to make reasonable inquiries to verify the customer's (or potential customer's) financial situation.*

RG 209 sets out ASIC's expectations regarding verification requirements, stating that:

- *'what constitutes taking 'reasonable steps to verify' information is generally scalable, and what amounts to reasonable verification will depend on the information and resources that you have access to and the facts and circumstances of each case' (RG 209.46)*
- *'in certain circumstances, some credit providers will be able to verify a consumer's financial situation without receiving additional information from the consumer. For example, a bank could look at a consumer's regular deposited salary, the timing of credit card payments, and the payment of other expenses. However, credit providers should take care relying on such information, which may not reflect the consumer's entire financial position – for example, if the consumer holds credit cards with other financial institutions.'* (RG 209.48)
- *'after inquiries have been made and information about the consumer's financial situation has been gathered, a [bank] may use benchmarks or automated systems and tools for testing the reliability of the information obtained as part of the process for taking reasonable steps to verify the consumer's financial situation. For example, these kinds of systems and tools can be useful for confirming whether it is reasonable to rely on the information provided by a consumer for the purposes of the unsuitability assessment, or whether further inquiries may be warranted. However, automated systems and tools are not a substitute for making inquiries about the consumer's current financial situation.'* (RG 209.49)

## Verifying income

Banks advised that the steps made to verify a customer's income include:

- collecting documentary evidence (for example payslips, letter of employment or an Australian Tax Office assessment notice)
- contacting a customer's employer
- reviewing salary credits to accounts held by the bank, and/or
- income benchmarking<sup>16</sup> or using internal income verification tables.

<sup>15</sup> The Treasury's consultation paper, ['Credit cards: improving consumer outcomes and enhancing competition'](#), released in May 2016

<sup>16</sup> Where a customer's disclosed income is compared to a statistical model to establish the probability that the stated income is likely to be correct.

For most applications, income is verified by reviewing documentary evidence. Some banks said they use income benchmarking. Banks explained that these income benchmarks use statistical data to calculate whether a customer's disclosed income falls within the expected range given their circumstances, including occupation type and employment status. Where a declared income is not within an acceptable range compared to the benchmark, the bank will obtain documentary evidence to support the declared income.

### Verifying expenses

Living expenses are validated against transaction account statements and/or an expense benchmark. Banks use expenditure measures such as the Household Expenditure Measure (HEM) and Henderson Poverty Index (HPI) to verify expenditure and ensure serviceability. All banks providing unsecured credit confirmed they use a measure for individual retail customers, with HEM the most widely used. Banks noted that while these measures do not apply for small businesses, other appropriate checks are in place.

One bank noted that there is currently no other viable data source to validate customer-stated expenses, and that it and other industry participants are exploring opportunities to develop capability to better assess expenses in future.

### Verifying existing liabilities

For banks, validating a customer's other liabilities appears to be more challenging than verifying income or expenses. Nevertheless, banks assess liabilities using documentation (including account statements), internal systems data (also referred to as 'corporate knowledge') and statements for any accounts that are to be refinanced.

Information from credit reporting bodies is key to verifying a customer's financial situation. One bank noted that it uses data from a credit reporting body to assess liabilities, mitigating against those customers who may under-declare liabilities in their application. Credit reporting bodies also provide scores which feed into the overall credit assessment process.

## The outcomes of automated decision-making systems

The CCMC asked banks about the decision-making process and the factors that would lead to an automated system declining an application for credit or referring it for manual assessment.

There are a range of factors that can lead to an automated decision-making system determining that an application needs to be declined or referred for a manual decision. A bank's automated decision making system may decline an application where:

- a customer does not satisfy the basic eligibility criteria for the product
- the minimum credit limit for a product is more than the customer requires
- there are adverse findings in the customer's credit history or the customer appears to be seeking credit facilities across multiple lenders
- the customer does not meet 'serviceability' requirements or the customer's financial position indicates that they would not be able to service the credit facility without substantial hardship.

An automated decision-making system may decide that an application needs to be referred for a manual decision where:

- additional or missing information, documentation or financial details are required
- further verification of this information is required
- the information provided does not meet the banks' internal policy requirements
- there are issues or adverse findings on a report from a credit reporting body
- the 'serviceability' ratio has not been met, but because it was marginal it was not automatically declined
- adverse account conduct for existing customers
- the output of the 'scoring' methodology is at a certain level where the bank requires a manual review
- the credit limit sought is high or higher than a pre-determined limit calculated by the bank.

Banks referred to several other cases where manual assessment may be required – not necessarily related to decisions made by automated systems alone – such as where:

- 'sensitive'<sup>17</sup> customers are involved (for example, those who live in remote postcodes)
- an application is from an existing customer (particularly of high net worth)
- a customer has been in financial difficulty in the previous 12 months, but otherwise meets approval
- the application or credit facility is complex (which can often be the case for small businesses).

Several banks also referred to cases where staff feel, based on discussions with the customer, that the product is too complex for the customer's needs or that the customer does not understand the basic product features or requirements. For example, a relatively high interest credit card product may be compared to a lower interest rate product with a fixed term and repayments.

## Assessment of customer's ability to repay a credit facility

When calculating 'serviceability' – that is, a customer's capacity to repay based on income, expenses and the relevant repayment of the facility being applied for – banks generally assess the customer as being able to repay the credit facility if the funds remaining to them after they meet their expenses and credit repayments in a period (either weekly or monthly) will be greater than \$0.

Some stakeholders have suggested that banks should include 'serviceability' buffers when assessing customer capacity to repay. For example, in its July consultation paper, *Everyone Needs a Savings Buffer*, Financial Counselling Australia (FCA) states that the inclusion of a savings buffer in assessing a customer's capacity to repay a loan is a fundamental component of responsible lending.<sup>18</sup> Further, Treasury has expressed the concern that 'the current industry practice can result in a subset of consumers incurring credit card debts that cannot be paid down in a timely manner without substantial financial hardship and which are associated with very large cumulative interest charges.'<sup>19</sup>

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<sup>17</sup> This terminology was used by one bank in response to the Inquiry.

<sup>18</sup> FCA consultation '[Everyone needs a savings buffer](#)', chapter 4.2.

<sup>19</sup> Page 16 of the Treasury's [credit card reform consultation paper](#)

Most of the consumer advocates that provided a response to the Inquiry highlighted issues related to a customer's ability to repay unsecured credit. More specifically, these were issues about a lack of consideration of the potential long-term nature of credit card debt and customers being unable to pay off more than the minimum payment. They also noted that when banks consider expenses, they are unlikely to take into account unexpected or irregular expenses.

## Conclusions and recommendations

### Credit assessment methods

While individual banks use different processes and systems, all banks apply the same general credit assessment method to each type of unsecured lending product that they offer (as described in **Figure 2**). Credit assessment processes vary depending on product type, whether it is a credit limit increase and the degree to which an automated system is applied to each step in this process. Of the 11 banks which provide unsecured lending products:

- Eight banks use 'behavioural scoring' techniques, 'application scorecards' and automated decision-making systems to a greater or lesser extent.
- Three banks use only manual credit assessment processes.

### Inquiries about requirements and objectives

The CCMC is satisfied that banks have processes in place to make inquiries about a customer's requirements and objectives for unsecured loans and overdrafts. However, most banks do not have processes in place to make detailed inquiries about the customer's requirements and objectives in relation to a credit card application, particularly where it is made online.

A bank that establishes the purpose for a credit card application may be in a better position to assess the facility's suitability for the customer.

Comparison tools on banks' websites allow customers to compare the features of credit products of the same type, rather than different types of product. The guidance and tools on banks' websites generally appears to be predicated on the assumption that a customer has already decided that a particular product type is the correct one for them. For credit cards, the only decision to be made is based on terms and features such as 'rewards', low fees, low rates, 'frequent flyer' or 'premium' etc.

Recommendations	Rationale
<p><b>R1</b> To help ensure a customer is provided with an appropriate credit product, the CCMC encourages banks to consider the following options:</p> <ul style="list-style-type: none"> <li>• Inform the customer on the application form or in other prominent guidance that credit cards provide credit which can be used for general living expenses, that in some circumstances another credit product may be more appropriate and that a customer can contact the bank to discuss options if they are unsure.</li> </ul>	<p>Such information can help a bank to meet its obligations under clause 3.1(b)(i) of the Code and inform a customer (who may not have a full understanding of financial products or appropriate financial literacy) that credit cards may be inappropriate for their intended purpose in some circumstances.</p>

- Take steps to promote better informed decisions by providing effective disclosure of information, such as the development of online comparison tools that compare the features of different types of credit products, for example whether or not the facility has a fixed term and the interest rate that applies.
- 

## Collecting and verifying information

Banks use a range of:

- information to assess applications for unsecured credit, and
- methods to verify this information, with the level of verification varying depending on the bank, product, customer and type of information involved.

Banks do not always request updated information for credit card limit increase applications. Some banks verify information about a customer's income using benchmarks and internal models. All banks verify individual customers' expenses by way of comparison to an expenditure measure. Liabilities are verified by reviewing system data or account statements.

The CCMC is aware that several banks are actively considering significant changes in their practices in relation to the collection and verification of information. One bank is planning to implement benchmarks to verify income levels, two others advised that they plan to move away from benchmarks in favour of 'account interrogation' techniques. These techniques use transactional data (where accounts are held with the bank) or documentary evidence (where the customer has accounts elsewhere).

One bank is planning to change its credit card limit increase application process, aligning it to its process for new credit card applications. The new process will include additional inquiries into a customer's financial situation (income and expenses) and verification of those details.

Banks are also considering tools such as Optical Character Recognition, which can automatically capture information from payslips which have been provided by the customer online; and, with customer consent, 'screen scraping' to review and analyse transactions from accounts held at other banks.

Four banks referred to their plans to use comprehensive credit reporting information, and have advised the CCMC that it will provide more data on indebtedness and repayment history. One bank also stated it will enable it to better validate customer-stated liabilities with other financial institutions.

Consumer advocates suggested that banks should:

- develop a more sophisticated means of understanding and inquiring into living expenses, and projecting these into the term of a loan
- seek more evidence of income and expenses and more information to assess whether customers have other debts they have not divulged, and
- be more diligent in asking for accurate and up-to-date information and correctly assessing that information.

The CCMC acknowledges that given the volume of applications processed by banks (over 380,000 in March 2016), there are likely to be considerable efficiencies brought by using automated systems, behavioural scoring techniques and comparative benchmarking tools.

However, our investigations into Code breach allegations have indicated that exclusive reliance on such tools and systems can lead to non-compliance with the Code.

Behavioural scoring may be a good predictor of repayment behaviour and appropriate for many applications, however when used in isolation and without the verification of a customer’s current circumstances, banks are at risk of non-compliance with the Code obligations. In such cases, this can have a significant impact on customers and contribute to future financial difficulty.

Should the CCMC investigate an alleged breach of the provision of credit obligations under the Code and identify that the bank failed to use up-to-date and verified information, it is likely to find that the bank has breached clause 27 of the Code.

As such, the CCMC makes the following recommendations:

Recommendations	Rationale
<p><b>R2</b> Banks should consider developing and using automated tools that can better verify a customer’s actual financial circumstances. This may include tools for the analysis of transactional account data (where the customer is already a customer of the bank), and/or documentation to demonstrate income and expenses.</p>	<p>The use of current and accurate information regarding a customer’s financial circumstances is crucial to meeting the provision of credit obligations under the Code. The more accurate and up-to-date the information a bank can obtain, the more effective and Code compliant its credit assessment processes are likely to be.</p>
<p><b>R3</b> Banks should ensure assessment processes for credit card limit increases are robust. They should request and verify the customer’s current income, expense and liability information, unless up-to-date information has been recently provided and verified. This information should be used in addition to any available information a bank holds that can be assessed using behavioural scoring techniques.</p>	<p>Banks need to demonstrate that they have taken positive steps to ensure that information provided is accurate when making a credit assessment.</p> <p>The use of behavioural scoring to analyse corporate information held by the bank can help it form a more comprehensive and holistic view of a customer’s financial position when used alongside updated or current and verified information from a customer. Behavioural scoring techniques that identify any repayment issues, for example, should prompt a bank to seek further information from a customer before approving an application.</p>
<p><b>R4</b> When comprehensive credit reporting information is available, banks should consider how that data can assist them to better assess a customer’s financial position.</p>	<p>This data may ensure that banks are better-placed to validate customer-stated liabilities with other financial institutions.</p>

**Assessment of a customer’s ability to repay a credit facility**

As indicated previously, automated decision making systems include a range of criteria which would lead to an application being approved, declined or referred for manual assessment.

One of these criteria is based on whether a customer meets ‘serviceability’ requirements or the customer’s financial position indicates that they would not be able to service the credit facility without substantial hardship.

The CCMC shares the concerns of industry stakeholders regarding the assessment of a customer’s capacity to repay a credit facility. Two banks’ indicated that they are aware of and are seeking to address serviceability issues. One confirmed that it would be ‘reviewing serviceability and the use of buffers and income surpluses’ in the next 12 months. Potential enhancements include assessing a credit contract as being ‘not unsuitable’ if there is a surplus of 2% of income plus a fixed dollar amount per month. Another noted that it sets a surplus funds target of \$200 per month for credit contracts.

The CCMC makes the following recommendations:

Recommendations	Rationale
<p><b>R5</b> Banks should consider introducing a serviceability buffer that ensures a customer being provided with a credit card:</p> <ul style="list-style-type: none"> <li>• can pay more than the minimum monthly payment, and</li> <li>• can save additional funds each month.</li> </ul>	<p>Serviceability buffers are already being considered by some banks and the CCMC views this to be good practice. These buffers may help ensure that customers:</p> <ul style="list-style-type: none"> <li>• are able to pay off credit card debt in a reasonable timeframe, and</li> <li>• have sufficient funds to save or cover unexpected expenses not addressed in their stated expenses for the purpose of credit assessment.</li> </ul>
<p><b>R6</b> The CCMC encourages banks to provide additional information regarding minimum payments to assist customers to make better informed decisions about banking services. For example, provide prominent information and examples for customers, before they apply for a credit card that explains how long it will take to repay a balance equal to the credit limit if they only make minimum monthly payments.</p>	<p>While banks already provide information to customers on credit card repayment timeframes on statements and links to the MoneySmart website in their Key Facts sheets, this information could be made more prominent and timely (i.e. before a customer applies for credit).</p>

## Training and compliance monitoring

Banks' ongoing compliance with clause 27 is in part dependant on how well they train their staff in relation to the clause and how well they monitor their ongoing compliance.

The Code includes provisions on training under clause 9. A bank must ensure that its staff will be trained to:

- competently and efficiently discharge their functions in compliance with the Code, and
- have an adequate knowledge of the provisions of the Code and its application to banking services.

The CCMC has set out its expectations regarding a bank's compliance framework in Guidance Note 12.<sup>20</sup> The CCMC expects it to:

- have a clear and well-understood process for identifying, recording, reporting and rectifying non-compliance with the Code
- ensure that arrangements are in place to prevent a recurrence of breach activity, and
- have appropriately trained personnel within each operational area to identify and report when and where breaches have occurred.

The CCMC asked banks several questions about the training they conduct that is associated with the provision of unsecured credit facilities and how they monitor compliance with the Code obligations when using automated systems and when dealing with customers experiencing financial difficulty.

### Staff training

All banks indicated that they have a structured training and development framework in place, covering both initial training for staff commencing a lending role and ongoing training, including mandatory and informal training and coaching.

Banks confirmed that training is delivered through a variety of methods including a mixture of online training, face-to-face or classroom-based learning, staff bulletins and on-the-job training, observation and assessment.

Six banks confirmed that customer-facing staff involved in the provision of credit are required to undertake training accreditation. Others confirmed that staff have a continuous education or professional development plan. One bank noted that professional standards are established for specific job roles.

Subject areas covered by training include:

- needs-based discussions with customers
- NCCP and responsible lending obligations
- completing a statement of position with a customer
- income verification
- banks' credit risk principles or policies
- products and product features
- systems and processes, and
- the Code of Banking Practice.

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<sup>20</sup> [Guidance Note 12 - Classification, Reporting and Remediation of Non-Compliance with the Code of Banking Practice](#)

Overall, banks reported that the training requirements for unsecured credit facilities have essentially the same base level as those for secured credit applications. However, some extra aspects apply for secured credit facilities.

### Monitoring compliance with clause 27

Banks have monitoring processes in place for automated systems. The two main ways that banks monitor credit assessment processes that use automated systems are by analysing trends in data, such as approval rates, and manually reviewing a sample of between 5% and 100% of files.

### Monitoring the provision of credit in cases of financial difficulty

Banks were asked what they would do to rectify a situation where a customer's financial difficulty brought to light that a credit facility had previously been provided where it should not have been. All banks confirmed that such a situation would be assessed on a case-by-case basis and that generally, financial difficulty processes and assistance would apply.

Four banks also said that where there was evidence that poor credit provision was one of the causes of the customer being in financial difficulty, a wider investigation such as a review of processes and/or staff conduct would be triggered.

### Conclusions and recommendations

The CCMC found that banks have frameworks in place to train staff on the provision of credit and has therefore not identified any particular ways in which staff training needs to be improved to increase compliance with clause 27 of the Code.

However, noting the discussion of the potential weaknesses of automated credit assessment systems referred to earlier, the CCMC is concerned that banks do not have sufficiently robust processes in place to monitor compliance with clause 27.

The identification of non-compliant provision of credit from financial difficulty cases is one way banks can monitor compliance with the Code and the CCMC considers this to be good practice.

The CCMC reminds banks of its expectations with regard to monitoring compliance and makes the following recommendations:

Recommendation	Rationale
<p><b>R7</b> Banks' automated credit assessment systems and the outputs of these systems should be robustly monitored, particularly through the use of manual file reviews of a sample of applications. In addition, banks should:</p> <ul style="list-style-type: none"> <li>• have a clear and well-understood process for identifying, recording, reporting and rectifying non-compliance with the Code</li> <li>• ensure that arrangements are in place to prevent a recurrence of breach activity, and</li> <li>• have appropriately trained personnel within each operational area to identify and report when and where breaches have occurred.</li> </ul>	<p>Banks' internal Code compliance monitoring arrangements are essential to ensure they act fairly and reasonably, in a consistent and ethical manner when providing banking services to individual and small business customers.</p>

**R8** Banks should ensure that they have systems in place to:

- capture and report all information about the inappropriate provision of credit through their monitoring frameworks, and
- ensure they rectify serious or systemic non-compliance with the Code to minimise the risk of reoccurrence in a timely manner.

Robust compliance monitoring frameworks and feedback mechanisms should be in place to identify such issues and support the continual improvement of processes.

## Identification of small business

All Code obligations, including those related to the provision of credit, apply to both individual and small business customers.

Small business is defined within the Code as a business with either less than 100 full-time (or equivalent) people if the business is or includes the manufacture of goods or, in any other case, less than 20 full-time (or equivalent) people.

All of the questions the CCMC asked banks as part of this Inquiry related to both individual and small business customers. The CCMC asked banks to note where their responses differed for small business customers and some of the data requests asked for specific information about small business customers.

During the Inquiry's planning phase, several banks advised the CCMC that they are generally unable to distinguish small business customers, as defined by the Code, from other customers. Banks may not record the number of employees within a business, instead assessing the relative size of a business based on turnover or another financial measure. As a result, responses to the CCMC's Inquiry questionnaire may have included businesses that are not covered by the small business definition in the Code.

## Conclusions and recommendations

Generally, banks are unable to distinguish small business customers (as defined by the Code) from other business customers.

For the CCMC, this definitional issue raises a broader concern about how banks ensure that they are meeting all their Code obligations to small businesses. In its submission to the current Code review, the CCMC has asked the reviewer to consider the appropriateness of the definition of small business in respect of the provision of banking services, as well as the practical implications of the current definition for banks.

The CCMC makes the following recommendation to address this issue:

### Recommendation

**R9** Banks should record the nature of the business and how many employees a business has at the time of application for a credit facility in order to identify small business customers as defined by the Code and apply the obligations of the Code accordingly.

### Rationale

Subscribing banks are committed to apply the Code obligations to customers who are or may become small business customers. Subscribing banks should therefore ensure that all relevant customers, including those small business customers that meet the Code definition receive the protection intended by the Code's provisions.

## Next steps

Based on the findings and recommendations of this Inquiry, the CCMC will review its Guidance Note on the provision of credit. These guidance notes ensure stakeholders are aware of how the CCMC is likely to approach potential breaches of Code obligations. They set out the CCMC's views on good industry practice, illustrating how Code obligations can be effectively applied in practice and potentially, in some cases, extending beyond the strict requirements of the Code.

Likewise, any changes to the Code arising from the current review may require the CCMC to make changes to its guidance notes.

The CCMC will also continue to monitor banks' compliance with the provision of credit obligations under the Code through its investigations into alleged Code breaches and its ACS program. The CCMC may also consider conducting a follow-up Inquiry in the future.

## Appendix 1: Code obligations

### Code obligations within the scope of the Inquiry

<b>27</b>	<p>Provision of credit</p> <p>Before we<sup>21</sup> offer, give you<sup>22</sup> or increase an existing, credit facility, we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay the credit facility.</p>
<b>3</b>	<p>Our key commitments to you</p>
<b>3.1</b>	<p>We will:</p> <ul style="list-style-type: none"><li>a) through the ABA, consult with small business and consumer organisations, to continuously work towards improving the standards of practice and service in the banking industry (see also clause 6.3);</li><li>b) promote better informed decisions about our banking services:<ul style="list-style-type: none"><li>i. by providing effective disclosure of information;</li><li>ii. by explaining to you, when asked, the contents of brochures and other written information about banking services; and</li><li>iii. if you ask us for advice on banking services:<ul style="list-style-type: none"><li>A) by providing that advice through our staff authorised to give such advice;</li><li>B) by referring you to appropriate external sources of advice; or</li><li>C) by recommending that you seek advice from someone such as your legal or financial adviser;</li></ul></li></ul></li><li>c) (provide general information about the rights and obligations that arise out of the banker and customer relationship in relation to banking services;</li><li>d) provide information to you in plain language;</li><li>e) communicate with you and/ or your representatives in a timely and responsible manner whether by written or electronic communications (including by telephone); and</li><li>f) monitor external developments relating to banking codes of practice, legislative changes and related issues.</li></ul>
<b>3.2</b>	<p>We will act fairly and reasonably towards you in a consistent and ethical manner. In doing so we will consider your conduct, our conduct and the contract between us.</p>
<b>3.3</b>	<p>In meeting our key commitments to you, we will have regard to our prudential obligations.</p>
<b>4</b>	<p>Compliance with laws</p>
<b>4.1</b>	<p>We will comply with all relevant laws relating to banking services.</p>
<b>4.2</b>	<p>If this Code imposes an obligation on us, in addition to obligations applying under a relevant law, we will also comply with this Code except where doing so would lead to a breach of a law (for example, a privacy law).</p>
<b>9</b>	<p>Staff training and competency</p> <p>We will ensure our staff (and our authorised representatives) will be trained so that they:</p> <ul style="list-style-type: none"><li>a) can competently and efficiently discharge their functions and provide the banking services they are authorised to provide in compliance with this Code; and</li><li>b) have an adequate knowledge of the provisions of this Code and its application to banking services.</li></ul>

<sup>21</sup> 'We', 'us' and 'our' means the Code-subscribing bank.

<sup>22</sup> Under the Code, 'you' and 'your' means a person who is an individual or a small business that is a customer of a Code-subscribing bank.

## Appendix 2: Background information

### CCMC Monitoring and Investigations Data

Data collected from the CCMC's ACS program indicates that the provision of credit has been one of the top categories of self-reported Code breaches over the last five years.

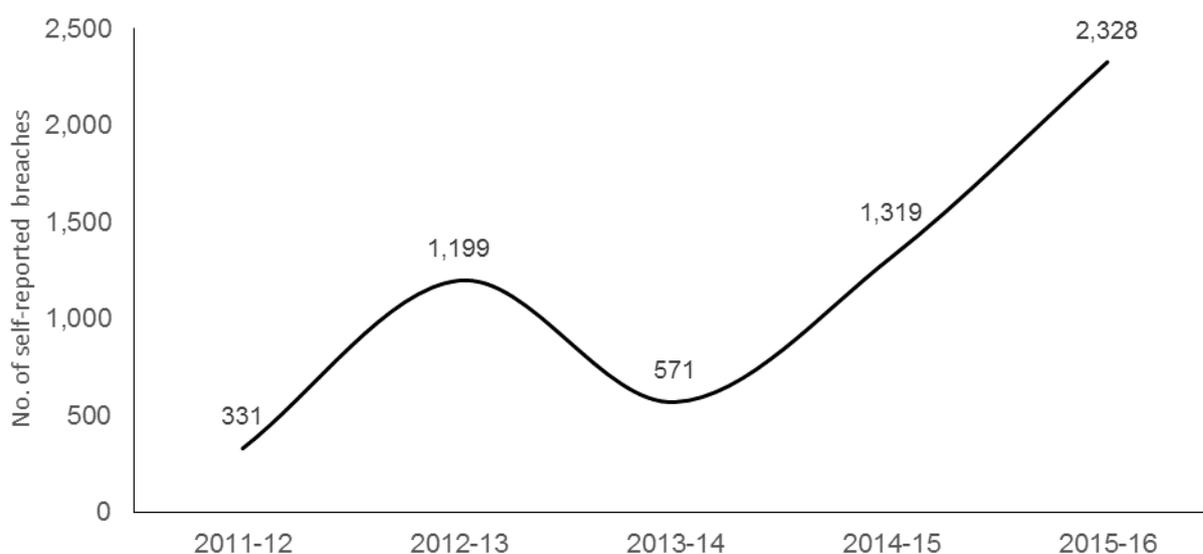
Since 2008, banks have self-reported over 6,000 breaches of the provision of credit obligations. Banks reported 2,328 breaches of the provision of credit obligations in 2015–16. This was an increase of 76% on 2014–15.

One bank accounts for the majority of the breaches self-reported since 2008 and the CCMC is working with that bank to better understand the underlying causes. As part of this Inquiry, the CCMC examined whether other banks have sufficient monitoring in place to identify breaches.

The CCMC also collects data on its investigations into allegations of non-compliance with the Code. In 2014–15, the CCMC closed two cases by determination, finding five breaches of the provision of credit obligations.

All information available to the CCMC was considered in conjunction with the data collected as part of the Inquiry.

**Chart 2: Number of breaches of the provision of credit obligations self-reported between 2011 and 2016**



Allegations of Code breaches regarding the provision of credit are among the most common of all allegations received by the CCMC. It is the area where the CCMC has determined the highest number of breaches over the last few years.

**Table 3: Allegations and breaches of the provision of credit obligations from CCMC investigations**

	2012-13	2013-14	2014-15	2015-16
Allegations	8	11	8	14
Determined breaches	0	9	5	1

Further information regarding this data can be found in the CCMC's annual reports.<sup>23</sup>

<sup>23</sup> [CCMC Annual Reports](#)

## Appendix 3: Questionnaire for banks

Banks were asked to respond to the following questions in April 2016:

### Part A – Unsecured credit products provided by the bank

Please confirm which of the **unsecured** products listed below are provided to individual and small business customers:

#### Individual customers

- a. personal loans
- b. overdrafts
- c. credit cards

#### Small business customers

- a. business loans
- b. overdrafts
- c. credit card

### Part B – Selecting the credit assessment method the bank will apply to the credit facility or credit increase

1. How does the bank make “reasonable inquiries about the consumer’s requirements and objectives” (as considered by CCMC Guidance Note 9 and in accordance with section 130 of Chapter 3 of the NCCP) in relation to the following unsecured products:
  - a. a loan
  - b. an overdraft
  - c. a credit card, or
  - d. a credit card limit increase?
2. How does the bank assess whether the particular credit facility is suitable for the given requirements and objectives?
3. Under what circumstances would the bank not accept an application for a credit card based on its suitability? If the bank does not accept a credit card application on the grounds of suitability, does it direct a customer to a more appropriate credit facility to meet their requirements and objectives?
4. How does the bank determine what the credit assessment method is for different unsecured lending products and that it is appropriate, to assess a customer’s ability to repay the credit facility?
5. Please provide a high level outline of the credit assessment method to each of the following unsecured facilities and highlight the notable differences between them:
  - a. a loan
  - b. an overdraft
  - c. a credit card, or
  - d. a credit card limit increase?

### Part C – Applying the selected credit assessment method to the customer

6. Where the bank uses automated decision making systems to assess applications for unsecured loans, overdrafts, credit cards and credit card limit increases, please provide details and examples of the types of information each system captures and uses to make decisions on whether or not to offer a credit facility?
7. If the bank utilises ‘behavioural scoring’ techniques related to a customer’s previous behaviour and account payment history, how many months of a customer’s history is

taken into account? Is a customer's behaviour in relation to other products that they may have with the bank taken into account? Please highlight where techniques differ for:

- a. an existing customer of the bank, and
  - b. a new bank customer.
8. When using automated assessment methods, what "reasonable inquiries" about the customer's circumstances and financial situation (including income and expenses) are made (as considered by CCMC Guidance Note 9 and in accordance with section 130 of Chapter 3 of the NCCP)? What "reasonable steps" are undertaken to verify the consumer's financial situation? Please highlight where there are variations for different unsecured credit facilities.
9. Does the bank seek information from a credit reporting body regarding a customer's overall credit position for every application? In what circumstances would the bank not request information from a credit reporting body?
10. How does the bank use information received from a credit reporting body when assessing an application for an unsecured credit facility?
11. Which expenses measure or index does the bank use to draw a comparison with actual expenses and is it used to compare information on all applications for unsecured credit received by the bank?

## **Part D – Forming the bank's opinion on the customer's ability to repay the credit facility**

12. What factors would lead to an automated decision making system deciding that an application needs to be referred for a manual decision to be made?
13. What changes does the bank plan to make to improve either automated or manual decision making processes/systems in the next 12 months? Why are these changes being made?

## **Part E – Training**

14. What training has the bank conducted that is associated with the provision of unsecured credit facilities and clause 27 of the Code during the reporting period? Please provide details of the nature of this training.
15. Please outline the differences in training requirements for those staff dealing with secured credit applications and those dealing with unsecured credit facilities?

## **Part F – Monitoring**

16. How does the bank monitor automated decision making systems to ensure they comply with the Code obligations to exercise the care and skill of a diligent and prudent banker, and consequently the NCCP Act and the bank's credit risk policies:
- a. in the collection of appropriate information from a customer, and
  - b. when making decisions on whether or not to approve an application using that information collected from a customer?

17. Please provide an overview of the monitoring and review of approved unsecured credit applications, undertaken by the bank during 2015–16, to ensure that lending decisions were consistent with the bank’s credit assessment method. What issues were identified by this monitoring and what corrective action was taken as a result?
18. If the bank identifies that a credit facility should not have been provided to a customer, what steps does the bank take to rectify the situation with regard to that customer? For example, if the customer experiences difficulty repaying the facility, would the bank take this into account when trying to collect payment or assisting the customer with their financial difficulty?

## **Part G – Quantitative Data**

Under Question 19 banks were asked to complete a quantitative data table with relevant data for the period 1 to 31 March 2016, which covered:

- how many applications for unsecured credit were received by the bank for each product type from individual and small business customers
- how many were:
  - approved using an automated decision making system alone
  - declined using an automated decision making system alone
  - referred for further assessment based on an outcome from an automated decision making system, and
- of those applications referred for further assessment following an automated decision, how many were approved and declined.
- What percentage of all applications for unsecured credit received during March 2016 were from an existing customer of the bank?

## **Appendix 4: Survey of consumer advocates**

The CCMC distributed a survey to consumer advocates in July 2016 asking:

1. What is the most common issue you have identified regarding the provision of unsecured credit by Code-subscribing banks?
2. In your experience, is the level of unsecured credit provided to customers appropriate and affordable, in relation to their income and expenses?
3. What would you estimate is the proportion of cases you deal with where the inappropriate provision of unsecured credit was the main contributing factor to a customer experiencing financial difficulty (as opposed to other causes such as a change in the customer's circumstances)?
4. Are you aware of any issues, related to Code-subscribing banks, where the unsecured credit product provided was inappropriate to the customer's needs and purpose? For example, where a customer took out a credit card to purchase a car.
5. What would you estimate is the approximate proportion of cases you deal with where the customer was asked to provide evidence of income, expenses and liabilities when applying for unsecured credit?
6. In your opinion, what additional information could banks seek or what additional actions could banks take to better meet their obligations to provide unsecured credit that is suitable and affordable to a customer?
7. Are there any further comments you would like to make about the provision of unsecured credit by Code-subscribing banks?

There were also optional questions for providing contact details and the type of organisation the respondent worked for.

**END OF REPORT**