

National Consumer Congress
'Win-Win situations – the relationship between business and consumers'
14 March 2007

The industry needs to take a lead on responsible lending

- It is obvious to any observer that the lending behaviour of banks is a growing and significant subject of comment by the general public, many of you here today and key decision makers, and criticism has been focused on the most convenient forms of credit, credit cards:
 - banks are considered to be contributing to 'escalating' levels of household debt through 'pushing' loans and credit cards onto persons who cannot afford them – in particular through unsolicited offers of credit card limit increases
 - the public is looking to banks to take responsibility by controlling unsolicited offers of credit and educating people on the risks of credit card debt – the expectation may even be to stop unsolicited credit card offers altogether
- Public interest in this issue is magnified in the context of rising interest rates, rising petrol prices, growing levels of household debt and increasing rates of bankruptcy
- If the industry does nothing, it will be lose-lose for consumers and the industry:
 - the plight of the vulnerable consumer, whether they be excluded from the market, or trapped in a 'credit trap', will not improve;
 - credit providers will be no better equipped to deal with the next downturn in the credit cycle; and
 - the pressure will build for further regulation of the credit industry
- ANZ is currently the only bank in Australia developing a robust, structured approach to dealing with the issue of responsible lending which is publicly reported and for which we are accountable – we have done a lot of work to understand how we fit into the overall picture of over-indebtedness and are taking some positive and specific steps to improve the situation
- We are driven by a belief that an innovative industry response to responsible lending which is outcomes-focused rather than based on compliance with the minimum legal standard of conduct, will:
 - have a positive effect on default rates among customers
 - reduce the need for regulatory intervention, and
 - improve banks' awareness and response to **all** of its customer base, including those struggling on the margin
- We also know we don't have all the answers. That is why in developing our initiatives we have sought the assistance of those who are close to and understand the issues, including financial counsellors, to provide their advice and experience about how we can best address the issue in a meaningful and productive way

Responsible lending is part of broader framework

- It's important to note that responsible lending, which I will be speaking about today, covers only a small part of how ANZ addresses its social responsibility to understand and respond to issues facing our customers and consumers more broadly
 - Our responsible lending agenda seeks to improve our credit assessment process, improve the way we identify and treat those in difficulty and provide customers with the tools they need to manage their money better
 - And many of you will be aware of ANZ's broader program to improve financial literacy and inclusion. This includes:
 - Regular research into levels of Australian financial literacy
 - Innovative programs to provide financial literacy training and to improve the savings habits of consumers on low incomes
 - A small loans program designed to provide those traditionally excluded from the mainstream access to safe and affordable small loans
 - Our Customer Charter is our public benchmark for service to personal and small business customers
- These initiatives are all part of how we address the social responsibility we have as a bank

The ANZ Customer Charter is our commitment to customers

- A vital feature of our relationship with customers is the ANZ Customer Charter. The Charter broadly covers:
 - **Convenience** – e.g. maintaining our branch presence in rural communities; expanding branch network; Saturday opening and 24 hour call centre
 - **Service** – queue time promises
 - **Complaints** – promise to aim to resolve complaints between 2-5 days; Customer Advocate
 - **Simple products** – free internet banking; maintenance of simple 'all you can eat' and 'pay as you go' accounts; and concessional bank accounts for seniors, under 18s, benefit recipients etc.
 - **Fast account opening**
 - **Simple and clear communications**
- ANZ first released its Customer Charter in 2001 and it was in part a response to the broad concerns expressed to us about bank conduct by our key stakeholders, particularly politicians and regulators
- These concerns were not just limited to lending practices, but included concerns about:
 - rural bank branch closures;
 - complexity of transaction account product pricing; and

- the quality of service in branches, which was perceived to be suffering under a push to low-cost electronic banking
- These concerns were creating an operating environment of significant political and regulatory tension – our view was that if voluntary measures were not taken, minimum standards of conduct and service would be mandated by legislation
- The ANZ Customer Charter was a first for a major Australian bank and is highly regarded among our stakeholders. It has also had tangible benefits for our relationship with customers:
 - ANZ has the highest customer satisfaction rating of all major banks, according to the Roy Morgan Finance Monitor
 - Customer complaints have decreased by almost 36% since the Charter was introduced five years ago
- A key feature of the Customer Charter, and one I will come back to later as vital to any self-regulatory model, is that our promises are public, specific about what the bank must deliver and are measurable:
 - without implementation targets and rigorous reporting and accountability measures in place, such models are unlikely to be taken seriously by an organisation’s stakeholders, in particular government and regulators, as a compelling alternative to regulation

Responsible lending is a key focus

- I would like to focus now on ANZ’s response to more recent concerns about lending behaviour, particularly in relation to credit cards and credit limit increase offers
- This public concern has been the subject of significant media attention and comment from politicians around the country about the need for more responsibility on the part of industry and regulation to enforce that responsibility
- It is worth noting that in reality, credit card debt is a minor contributor to overall debt levels. There is a strong statistical correlation between over-commitment and the size of debt carried by the consumer, and in that light, home loan debt is the key driver of credit defaults
- However this does not mean responsible credit card lending is not an issue that needs to be addressed - there are vulnerable customers at the margins that do get into trouble through use of credit card offers or other small loans – managed properly consumer finance products provide convenient access to funds which improve quality of life, but they can also have the opposite effect when not managed responsibly or when unforeseen circumstances hit the customer
- The question of the need for further credit regulation, particularly in relation to credit card limit increase offers, was raised during the recent Victorian Government review of consumer credit law and the Ministerial Council on Consumer Affairs is currently looking at options to deal with the issue of credit overcommitment

Behaviour scoring and other ‘traditional’ credit practices are effective for managing most customers

- Before explaining in more depth our responsible lending initiatives, I would like to touch on our ‘traditional’ credit practices, including behavioural scoring

- Our responsible lending initiatives do not replace our current practices – rather they supplement what is already a rigorous and sophisticated process
- I would like to focus on behavioural scoring for a moment because ANZ has argued in favour of this form of credit assessment in preference to proposals to require credit providers to manually assess a customer’s capacity to repay a CLI offer based on the information they provide to the bank – in other words, ask the customer for a full statement of financial position before offering a CLI. I would like to explain in more detail why
- In broad terms, behavioural scoring uses historical data about credit performance to identify, and appropriately score, behaviour indicating a high risk of financial difficulty – it predicts the likelihood of customer becoming ‘delinquent’ or falling into arrears, over the following 12 months
- It is extremely sophisticated – using more than 150 variables which have been shown over many years to be statistically relevant to credit performance
- And it is not limited to events of default – it also picks up transactional behaviour which suggests future difficulty even though the customer may still be meeting repayments
- It is also an organic model – regularly refreshed and refined as we learn more about the relevance of some factors over others, or new factors
- Some of the information built into behavioural scoring and factored into credit assessments includes:
 - the number of times a customer has exceeded their credit limit
 - length of banking relationship with ANZ
 - use of credit card – e.g. cash advances or retail purchases
 - proportion of closing balance paid off each month
- ANZ generally does not assess a customer for a credit limit increase using behavioural scoring until that score can be based on between 9 to 12 months of transactional and repayment data – new customers are therefore quarantined from CLI offers until they have generated enough behavioural data upon which we can base an offer
- In our experience, behavioural scoring is statistically more reliable than manual assessment when it comes to credit limit increase offers – this is based on some analysis of our customer data, comparing new customers, assessed using manual assessment and those assessed using behavioural scoring techniques

ACT’s credit limit requirements have not reduced defaults

- In addition, analysis of our customer base in the ACT (where manual assessment for CLI offers is prescribed) shows this legislation has not reduced the rate of defaults in the ACT
- In ANZ’s view, prescription of credit assessment methods is not the best way forward. Credit providers should be able to apply the most effective and sophisticated techniques to assess capacity available – this need for flexibility is recognised in the UK Banking Code which establishes as best practice the consideration of at least two of:
 - the customer’s income and financial commitments
 - how the customer has handled finances in the past

- information from credit reference agencies and
- credit assessment techniques like credit scoring
- What is important is the application of those assessment methods in a responsible way:
 - For its part, ANZ has gradually incorporated its responsible lending promises into its behavioural scoring models, meaning the considerations which prompted the initial promises are becoming part of 'business as usual' processes
- This issue and others are currently being examined by the Ministerial Council on Consumer Affairs (MCCA) and we look forward to being further involved in the process – as an organisation with operations across the country, we are pleased the issue is being considered at a national level

ANZ research highlighted financial difficulty arises from a combination of factors

- Our response to the concerns about lending standards was guided by a mixture of research and what we were hearing from our stakeholders – in particular from the financial counselling community
- ANZ conducted research in 2005 into the causes of financial difficulty which shed some light on the role of banks in creating financial difficulty and overcommitment. The qualitative research was conducted as part of the updated quantitative research into the levels of financial literacy among adult Australians
- Focusing on the 2% of the population who 'feel out of control with their finances' and 'have some borrowings of some type', the research found that financial difficulty was most often associated with the behaviour or traits of the individual, circumstances beyond their control or a combination of both. Lack of financial skills, information or knowledge was only a small component
- Many in difficulty were found to have a reasonable level of financial literacy but were over-ridden by unhealthy ways of thinking about money, or hit by an unexpected event

Responsible lending requires increased sensitivity to 'marginal' customers

- This tells us that people are particularly vulnerable where they do not have a 'buffer' to protect them from financial stress
- The research also told us that lenders indirectly influence a person's path to financial difficulty:
 - CLI offers provide the opportunity to access credit for people with a tendency toward unhealthy ways of thinking or those facing a financial emergency; or
 - by creating an impression through CLI offers that 'if the bank sent it to me, I must be able to afford it'
- In both cases, the offer can be accepted by vulnerable consumers without a deep consideration of their own financial situation
- These findings gave us valuable information about a lot of things, including the role of disclosure. But it also reaffirmed for us the view that consumers sometimes make bad choices even with all the information available to them, and that we should be responding in a way that recognises this

- While we cannot identify in advance customers with 'unhealthy ways of thinking' or customers about to encounter an unexpected life event, our approach through our responsible lending promises, was to protect from unsolicited CLI offers those customers who are already 'close to the edge' financially and may struggle to deal with financial pressure when it arises –
- This also matched the feedback we were getting from financial counsellors that those without a 'buffer' were particularly 'vulnerable' to CLI offers

So, we have additional promises and business practices to protect some customers from limit increases

- Many of you are aware of the responsible lending promises, which were released in November 2005. In short, they ensure that ANZ will:
 - not offer a CLI to those with poor recent credit performance or are struggling to meet repayments
 - not offer a CLI to customers we know are on a fixed income (e.g. a government benefit)
 - with any CLI offer, outline how much the minimum monthly payment would increase if the offer was accepted
- Consultation with our stakeholders, in particular, financial counsellors, identified these customers as most prone to falling into difficulty as a result of these offers – the underlying philosophy is we should extend credit only to those we believe can repay
- This means customer go through an enhanced **filtering process** before they are selected for a CLI offer. Customers are excluded if:
 - they have within the previous 6 month period, fallen two months past the due date for making the minimum payment on their card;
 - they have only made the minimum payment (lesser of 2% of closing balance or \$10) or slightly more than the minimum payment on their card for the last 6 consecutive months;
 - they have an ANZ deposit account receiving Centrelink, DSS or DVA benefits (which we can identify through specific transaction codes)
 - they have a deeming account or other ANZ account specifically designed for benefit recipients, whether or not the account is currently receiving benefits
- Customers who are not removed through these filters are then subjected to a second set of discriminating criteria based on the behavioural scoring model I have described

These simple but effective steps have brought good results

- The responsible lending promises, along with ongoing improvements to our behavioural scoring tool, has effectively reduced by 11% the pool of customers otherwise eligible for a CLI offer
- Of that 11%:
 - 7% reduction is due to the exclusion of customers on fixed incomes
 - 2% is due to enhancements to the behavioural scoring filters (and this number is rising as the promises become further embedded into business as usual processes and

- 2% is due to the exclusion of customers with missed payments or who have made only minimum payments in the last 6 months
- ANZ is still the only bank to commit to formal, public, auditable responsible lending promises – ANZ’s performance is independently audited and reported each year
- The promises are not ‘rocket science’ but judging from the overwhelmingly positive response from stakeholders, this simple step accords with the community’s expectations of banks to take responsibility for what role they have in credit overcommitment
- However credit assessment is but one aspect of the responsible lending issue
- Regardless of the quality of a credit provider’s credit assessment or the information provided to its customers, there will always be customers who fall into financial difficulty with their credit facility(ies)
- ANZ is currently working on its next phase of responsible lending program, focusing on:
 - Identifying and assisting customers in difficulty before it becomes unmanageable;
 - Providing customers with the information and tools to help them take more control of their finances

Early assistance helps customers having difficulty

- At Consumer Finance, we think there is a lot we can do to minimise the effect of financial difficulty for our customers if we understand their needs and respond in a timely way
- By the time we know a customer is struggling with their finances, they are often already missing payments on their credit facility and losing control of their overall financial situation - many consumers may not be in a position to acknowledge their financial circumstances until crisis stage – when there is nothing left to do but call their bank and seek alternative arrangements
- To date, our experience is that it is difficult to reverse the effects of financial difficulty once a customer has begun defaulting on their credit facility(ies)
- Our aim at ANZ is to change the relationship and get better at identifying customers in difficulty before it becomes unmanageable. If we know a customer is having trouble paying their card, we can assist by:
 - Rescheduling repayments
 - Offering a repayment holiday
 - Amending payments dates to coincide with the customer’s pay days
 - Provide information about external assistance – e.g. a financial counsellor
- In our view, and in the view of our stakeholders, this intervention will be more useful in preventing overcommitment if provided at an early stage – even before the customer begins missing payments. Our objective therefore is to:
 - create an environment where customers can discuss with us their financial circumstances, especially when they are having problems and

- build our capacity to identify customers in difficulty, offer assistance early, and hopefully pre-empt over indebtedness and its consequences
- This ensures we are **informed** about our customers – and we can receive this information by identifying the customer ourselves or by being contacted early by a customer experiencing early stages of difficulty
- So how are we doing this?

Early assistance is good for business and customers

- This is the subject of a focused project in ANZ's credit card business and it involves a few elements:
- The first is **identifying** customers in early difficulty and creating an environment where the customer is comfortable self-identifying
- A credit card business is in a special position in that it holds a large amount of data about a customer's daily transactional behaviour. We have analysing this data to identify the type of behaviour which is statistically shown to lead to future financial difficulty
- This is not limited to defaulting behaviour – it may include a gradual increase in the credit limit utility from month to month, acceptance of a credit limit increase closely followed by use of the cash advance facility, or a sudden drop in the monthly payment
- The second and most challenging element of this process is what to do with that information. How do we **approach customers proactively** and offer assistance where they are not in default on their facility and may not appreciate the intrusion?
- We are working closely with a financial counselling organisation (Kildonan Child and Family Services), with input from AFCCRA, the national association of financial counsellors, in building our staff's capacity to approach customers proactively and offer assistance in a way that is respectful and sensitive to how such an approach might be received by some customers
- This is a very different conversation with customers than we have had before – it is important to understand that this is not about debt collection – it is about our present and ongoing relationship with our customers and offering customers flexible arrangements at an earlier stage in order to pre-empt future financial difficulty, and all the consequences that go with that (for the bank as well as the customer)
- If this works, it is clearly a win-win situation for the bank and its customers:
 - it will provide timely assistance to selected customers – this assistance can financially stabilise the customer's financial situation at the earliest point before overcommitment further disadvantages the customer
 - it will improve the reputation of the bank for being truly responsive to customer needs. We are a custodian of a lot of behavioural information and this information should not only form the basis of credit decisions, but be used to identify and provide assistance to customers who need it
 - finally, it makes sense from a business perspective – it is in ANZ's financial interests to arrange realistic repayment arrangements with customers before the situation progresses to lengthy hardship processes, voluntary arrangements and bankruptcy – especially in a climate of rising default rates, a 20% rise in bankruptcy over the last

12 months and the increasing presence of debt consolidation and management companies. We are more likely to recover more from a client through a mutually satisfactory repayment arrangement earlier in the piece than voluntary bankruptcy proceedings down the track

- We also see a successful prevention program as potentially alleviating some of the strain from the financial counsellor sector, which, as reported in this morning's *Age*, is currently struggling with a 76% increase in calls for help from consumers in the last 12 months
- A small number of ANZ staff will be trained by Kildonan to commence a pilot of contacting customers identified by our systems as potentially showing early signs of difficulty
- The 3 month pilot will commence in April. We will be reporting on the outcomes of the pilot after a post implementation review as part of our regular reporting on the responsible lending program

New Product to assist money management

- Our next phase of initiatives also includes products and services that can assist consumers manage their money more effectively
- The first is a new product, ANZ Paydown Plan, which allows a customer to isolate a portion of their credit card balance and pay down that portion by instalments
- Customers can set themselves a target and choose a fixed repayment amount that they can manage at a slightly reduced interest rate. As the instalment plan is listed separately on their credit card statement, they can track their repayment progress separately from their credit card activity
- The aim of the product was to merely provide customers a tool to achieve their own repayment goals – it is not a forced repayment regime and does not result in a decrease in their overall credit limit, so it relies on the self-discipline of the customer
- The 3 month pilot commenced in October 2006 and we have reviewed the product, including how customers were using the product, including whether the net effect was positive for the customer
- The first observation is that it was rather popular – the acceptance rate for the product was high compared to other similar offers we make to customers. This is reflected in the anecdotal evidence from the call centre, which reported that customers were pleased with the innovation of being able to organise their credit card repayments in a more structured way
- Second, it was observed that most customers who took out the product opted for the longer term repayment plan options (12 and 24 months). This suggests that those who take up the offer have relatively low capacity to repay
- We are still in the process of analysing the product, but possible changes to the product to make it more effective include:
 - lowering the customer's overall credit limit by the amount isolated to the instalment plan, or
 - offering this limit decrease at the time the customer takes up the offer
- Customers who take up this product are willing to take more control over their finances –ultimately, this product may provide us with an opportunity to

identify those customers who may be amenable to talking about how they are coping with their credit card and whether we need to explore alternative repayment arrangements before they experience difficulty managing their debt

Online calculator to provide tailored information

- We have also developed an online calculator which will provide customers with tailored information about credit card repayments
- We developed this tool partly in response to a proposal raised during the Victorian review of credit laws to require credit card providers to include on all statements, contracts and CLI offers 'health warnings' setting out how long it would take the debtor to repay the credit limit if fully drawn, based on minimum payments
- Our view is that this information is relevant to a very small proportion of customers – we estimated around 2.5% of customers were in the habit of making minimum only payments
- We wanted to create a flexible tool for customers to find the information relevant to them when they want
- We developed a calculator that, while still simple to operate, allows the customer to request not only information about how long it would take them to pay an amount with a set monthly payment, but also the monthly payments required to pay off their current balance, or fully drawn limit, within a specified time frame
- The calculator will be live on anz.com by the end of March

ANZ is committed to financial literacy

- I would again like to remind everyone that responsible lending is one investment ANZ makes in fulfilling its social responsibility to its customers and consumer generally
- Our investment in our well recognised programs addressing financial literacy and inclusion continues

Conclusions

- The current regulatory focus on credit regulation provides an opportunity for industry to take a proactive, innovative approach to overcommitment rather than 'waiting for regulation'
- As I hope I have demonstrated today, tackling the issue of credit overcommitment proactively does not mean acting to the detriment of the business – indeed, in the case of pre-empting financial difficulty and bankruptcy rates among customers, it is about business protection
- ANZ is still learning how best to respond to this issue. We are at the beginning of the journey and there is a fair bit of trial and error involved. But the guiding principles for this work should be to:
 - become more responsive to changing customer circumstances and needs, and
 - create an environment where customers are informed about their credit facility and feel comfortable to approach their bank when things go wrong

- These objectives, if achieved, can only be of benefit to both the bank and the customer

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