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House of Representatives Standing Committee on
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INQUIRY INTO HOME LOAN LENDING PRACTICES AND PROCESSES

The Finance Sector Union of Australia (FSU) welcomes the opportunity to contribute to the consultation process for the inquiry into home loan lending practices and the processes used to deal with people in financial difficulty

The FSU represents 55,000 members employed in the finance sector across Australia. Our brief submission focuses primarily on the implications of lending practices for finance sector staff and the wider implications for consumers and the Australian economy. We have primarily addressed the questions relevant to the FSU and its membership.

1. *To what extent have credit standards declined in Australia in recent years?*

The FSU notes the recent observations by APRA that "The departures from traditional lending practices have signalled an increased appetite for risks on the part of our lenders and these risks need to be identified and carefully managed"[1]. Unfortunately this 'appetite for risk' has been accompanied by increased pressure on finance sector staff to make sales. This pressure generally takes the form of sales targets that must be achieved to gain pay rises. These targets often apply to all types of finance products and include home loans and associated lending.

Purchasing any financial product is a serious matter, especially a home loan which is usually the biggest financial commitment a person will make in their lifetime. The financial regulatory system should try to ensure that the majority of loans are appropriate and do not result in people becoming overly financially committed, however the culture of sales targets is, by definition, designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring. If staff are constantly under pressure to achieve sales then this will inevitably lead to some consumers being sold products that they may not be capable of repaying or may not even need. *(Attachment 1 contains a case study regarding Home Finance Mangers from a leading financial institution.)*

Unfortunately there is an inherent clash between a public interest regulatory system that should prevent some products being sold and a commercially orientated culture that aims to try and achieve sales at every opportunity. Targets carry the implicit message that ever increasing sales are good and desirable – the FSU does not share

[1] *Credit Standards in Housing Lending – some further insights*, speech by John F Laker, 20 June 2007.

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this view and believe it is detrimental to consumers, finance sector staff and the provision of good customer service.

FSU members constantly report difficulties with achieving their sales targets, the impact this can have on their relationship with customers and often express unease about the lack of consultation that occurs regarding how these targets are set.

The following FSU survey results highlight some of these issues.

- A 2005 survey of three thousand FSU members revealed that over half the respondents (52%) did not believe their targets were reasonable or achievable and over 60% did not feel they had any input into the setting of their targets.
- The most recent survey of two thousand FSU members conducted in July 2007 shows disturbingly similar trends. Over half the respondents (52%) felt obliged to try and sell products even if they were sure the consumer didn't need them and 75% disagreed that management had realistic expectations in relation to targets. Perhaps the most troubling result was that 24% of people surveyed were aware of inappropriate lending practices being undertaken to achieve sales targets.
- 94% of staff agreed that local factors should be taken into account when targets are set. However, our anecdotal evidence continues to show that local demographics are not always taken into account with a one-size fits all approach often adopted by management. Hence, 76% of staff agree that the number of sales they make depends mainly on the sort of customers they have, not how much effort they put into making the sale.

The FSU does not yet have a definitive view on how the issue of credit pushing and declining credit standards should be addressed. Stronger regulation to minimise inappropriate sales could be introduced and, if effective, should reduce the level of inappropriate sales and enhance consumer protection. Such a requirement could take the form of a mandatory upfront assessment of a consumer's capacity to pay based on certain minimum criteria.

However, stronger regulation to reduce inappropriate sales would not necessarily flow through to reduced sales targets for finance sector staff and (in a worst case scenario) may simply make a difficult situation harder for staff as lenders find new ways to maintain sales growth.

The problem of unrealistic targets appears to be primarily driven by an aggressive commercial culture that is unlikely to be changed by Government regulation alone.

We believe that an essential part of any solution is for finance sector staff to receive pay rises that are not dependant on meeting targets. The FSU's policy on performance pay and targets is that they should only exist once a guaranteed CPI type increase system is securely in place. If finance sector employees are secure in the knowledge that their wages cannot go backwards, then the pressure to meet sales targets will inevitably be lower.

The FSU believes that the trend towards linking all pay increases to sales targets is disturbing and hopes that it ceases. However, regardless of whether targets are linked to pay increases or used as a bonus scheme we believe serious consideration needs to given to some form of disclosure that informs the consumer there is a financial incentive for the employee to sell them a product.

The principle and practice of disclosure is widely accepted in many industries, and well established in other areas of the finance sector. There may not be the same direct link between the individual sale and the specific financial incentive that exists in other areas; however the fundamental issue is that targets do create a link which should be made transparent to the consumer.

We accept that the a major aim of any business is to maximise profits, however, we would argue that the sale of major credit products such as home loans has ethical dimensions as well as wider implications for society particularly as inappropriate lending practices become widespread. Institutions that engage in riskier home lending practices may lose a percentage of profits when things go wrong, however they will almost always have some form of security or mortgage insurance to minimise these losses. In contrast, the potential impact on a consumer may be devastating and have wide ranging effects such as increased demand for welfare services, lower work productivity due to stress and absenteeism, and greater reliance on support networks to survive. The majority of the negative impacts when things go wrong are primarily absorbed by the consumer and society – not the institution engaging in the practice.

We believe this type of risk shifting away from management and onto employees is also inherent in the culture promoted by the WorkChoices legislation. The mantra of 'increased flexibility' largely shifts the risk away from management and onto employees through mechanisms such as the removal of unfair dismissal protection, AWAs and the removal of employees' bargaining power.

The use of AWAs in the Commonwealth Bank has removed employees' rights to negotiated, across the board pay, annual pay increases. For the five year term of these agreements, employees' wages are subject to an annual review being conducted principally on their performance which directly relates to their capacity to meet sales targets.

The ability to use AWAs that remove guaranteed pay increases and the refusal by employers in our sector to bargain with employees in good faith, has given rise to a move to pay increases being totally dependent on performance, and therefore sales target, outcomes.

2. *Have declining credit standards caused an increase in the number of loans in arrears and the number of repossessions?*

- ***Lack of accurate data on repossessions; 'agreed' sales hiding true rate of defaults.***

APRA observed that – "Housing arrears have been edging up over the past couple of years, albeit slowly and from a very low base, and this trend could deteriorate markedly if the economic climate were to sour."[2] Or as the Minister for Workplace Relations, Mr. Joe Hockey stated "it will end in tears if the economy slows down."[3]

Increasingly a number of the major banks are reporting against various indicators of corporate social responsibility (CSR). One possibility could be to require all lending institutions to report the number of repossessions or foreclosures each year to increase

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[2] *Credit Standards in Housing Lending – some further insights*, speech by John F Laker, 20 June 2007.

[3] *Work and Family Awards*, speech by Joe Hockey, 18 July 2007.

transparency in this area and encourage a public commitment to minimising such events. This type of data is collected by every lending institution – it can and should be a matter of public record and debate. The trend in arrears or repossessions should always be downwards and the lending policies and practices of responsible institutions should aspire towards achieving this.

The language of CSR often refers to managing stakeholder impact or ensuring that all aspects of a business are sustainable. Declining credit standards will inevitable lead to unsustainable lending practices and should be a major issue for all lending institutions. Unfortunately as one commentator observed "the CSR formula usually produces some tokenistic philanthropy outside the firm's core activity, while its underlying worldview remains entirely unchanged."[4] We believe that the ongoing and increasing use of sales targets is directly linked to an unchanged worldview.

3. ***Are borrowers in financial difficulty being treated appropriately by lenders?***

- ***Obligations under CBP and/or UCCC; access to superannuation for repayments.***

While industry and consumer sources can better provide statistical and anecdotal evidence about borrowers in financial difficulty, we would seek to highlight the professional manner that our members seek to carry out their duties in respect of credit collections.

Finance employees in this field consistently demonstrate a compliance with the UCCC in regards to following timeframes and providing assistance to borrowers in financial difficulty.

However, it is worth noting that industry will often attempt to keep the collection function one step removed from its brand or business. The use of shelf companies for the purpose of carrying out collections activities is well known in our industry.

The propensity for outsourcing the collections function is also gathering pace across the industry. Some of the major banks have outsourced their collections function and offshored the roles to India. Our concern with this process is that the further removed from the customer those carrying out the collections activities are the more likely they may be take a less compassionate view in attending to the consumer.

We believe that accessing Superannuation for the repayment of home loans would only fuel the practice of reckless lending, opening a trillion dollar equity market to credit providers. The purpose of Superannuation is to provide for people's retirement, not to be speculated with using various investment vehicles.

4. ***Are declining credit standards likely to have any long-term implications for the Australian financial system?***

Yes, ever increasing levels of debt, particularly risky debt, are unsustainable. Possible long term implications are well documented in the Debt Freedom Day Report 2007 by the University of Western Sydney's Associate Professor of Economics & Finance, Steve Keen that examines the economic crisis suffered by Japan throughout the past 15 years and draws parallels for the Australian economy[5].

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4 Tony Cutcliffe, AFR, 1 November 2006.

5 Steve Keen, Debt Freedom Day Report 2007, Centre for Policy Development

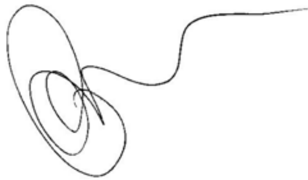
The current 'subprime' loans crisis in America is also an unfortunate example of what can happen when credit standards are lowered and the economy turns sour. Losses from this crisis are expected to reach as much as $US150 billion.[6]

Conclusion

The issue of declining credit standards and inappropriate lending is a complex issue with many causes. However, the use of sales targets to determine salary increases can only put downward pressure on credit standards and increased pressure on finance sector staff. These pressures can, and should, be removed.

If you have any questions in relation to this submission please contact Rod Masson, National Communications and Policy Manager, on (03) 9261 5330 or James Bennett, Senior Policy and Research Officer on 0410 142 435.

Yours sincerely



Paul Schroder
National Secretary
30 July 2007

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6 *Sydney Morning Herald*, 27/28 July 2007, p39.

Attachment 1

Practical Example

Home Finance Managers (HFMs) with one of the countries leading financial institutions have raised a range of concerns about the management practices in their organisations. Specifically, they recite concerns about management's total focus on making sales that has led to a decline in the 'professionalism' of their occupation.

In one state there remain only 30 out of 180 HFMs still occupying the role after three years. The constant turnover of staff is a direct consequence of the pressures placed on them to meet sales targets.

In order to replace staff, the institution no longer seeks to recruit people with a banking or lending background but uses the criteria of whether the applicant is prepared to work unsociable hours and weekends as the principle suitability measure.

New staff are inducted and trained rigorously in a 'how to sell and cross-sell' course. It is estimated that this training takes up to 90% of the new entrant's induction training. The other 10% is dedicated to systems and FSR training, with an online assessment on the Consumer Credit Code undertaken. New entrants in the HFM role are explained that the institution's Credit Policy is available online, but are left to acquaint themselves with it in their own time. It is the Credit Policy that outlines why the institution lends money and the responsibilities it carries in doing so.

HFMs receive constant reinforcement from their Regional Managers, many of whom have never been in lending or credit roles and do not have a practical understanding of the institutions credit practices, about the need to write one application for a home loan every day. They are also instructed to try and 'upsell' loans – meaning that even though the customer may only want to lend a certain amount, the HFM should try and convince them to borrow more.

HFMs have dollar targets that they must meet each week. In order to meet this they are set a guide for how many applications they must write each week. They are also monitored on the percentage of conversions (sales) they make from customer interviews conducted. They are encouraged to make the conversion on the day of the interview, often leaving them feeling that they must pressure the customer to make the purchase of the property ahead of what would be a reasonable consideration time.

The Regional Managers do not reinforce credit policy, code of conduct or ethical behaviour messages in their frequent briefings or debriefings of staff.

HFMs report that they are provided with "Lead Generation" reports that are generated from the banks data held on customers. Such 'leads' will include customers who may have repaid loans or are ahead of repayments or have made significant deposits. The HFMs are instructed to make contact, unsolicited and often on the pretence of a new sales campaigns, with the customer to see if they would like a new mortgage, to refinance existing mortgages etc.

The more experienced HFMs are often astounded at the loan applications completed by new staff. These applications reflect a complete ignorance of Credit Policy or principles. They are frequently excessive in size and unsustainable for the customer. Thankfully, most of these are knocked out by the credit assessment system.

However, the credit assessment system does afford flexibility in its assessment and loan applications can be referred to credit managers for reassessment and approval, overriding the system.

HFMs can lend up to 85% of the mortgage value without mortgage insurance, this used to be 80%. They can lend 100% of mortgage value with total mortgage insurance. In order to qualify for mortgage insurance a customer has to demonstrate a capacity to maintain savings of 5% of the mortgage over a 3 month period, this was previously a 6 month period.

HFMs understand the business imperative of having an emphasis on sales. However, they are concerned about the sustainability of the banks practices of 'burning and churning' staff, not providing adequate training on credit policy, over emphasising the need to write business against customer service and care and the increased pressure of imposed targets.