



Suncorp Group Limited
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The Honourable Kenneth Madison Hayne AC QC
Royal Commission into Misconduct in the
Banking, Superannuation and Financial Services Industry
Bourke Place
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MELBOURNE VIC 3000

Via email: FSRCsolicitor@royal.commission.gov.au

25 October 2018

Dear Mr Hayne,

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

We refer to the interim report dated 28 September 2018 ("**Interim Report**") published by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the "**Commission**"), which identifies issues that have emerged in the course of the first four rounds of hearings conducted by the Commission.

Suncorp-Metway Limited ("**Suncorp Bank**") refers to and generally supports the submissions made by the Australian Banking Association ("**ABA**"), of which Suncorp Bank is a member, and the submissions made on behalf of the six regional bank members of the ABA. Given the breadth of matters canvassed by those submissions, this submission addresses only those topics in respect of which Suncorp Bank makes an individual submission. Those topics are:

- (a) mortgage broking;
- (b) responsible lending;
- (c) agricultural lending; and
- (d) regulation.

MORTGAGE BROKING

The Commission has highlighted instances of potential misconduct by brokers and banks (and borrowers) in the home loan origination process, which call for scrutiny and possible reform of remuneration and regulation practices in the broking industry. Suncorp Bank supports reform of remuneration and regulation in the interest of maintaining a viable and sustainable mortgage broking channel and the benefits this channel brings to customers and competition. Any such reforms should be carefully designed and considered with the following goals in mind:

- **maintaining customer access to responsible broking** – any reform which rendered mortgage broking unviable, or which led to significant reduction in the number of loans originated through mortgage broking, would reduce the number of customers benefitting from the services of mortgage brokers, be liable to decrease competition in the home lending market, entrench the market dominance of the "big four" banks and ultimately lead to consumers paying higher rates of interest;

- **prohibition of incentives that could cause bias** – in recommending a bank and home loan product to their client, a mortgage broker should not be influenced by factors unrelated to the question of what will best suit their client's needs (e.g. the availability of a higher rate of commission from a given lender); and
- **facilitation of responsible borrowing** – any reform should deter mortgage brokers from recommending unsuitable loans to their clients (e.g. recommending an excessively large loan risking customer detriment over the medium term).

Suncorp Bank's primary submission is that each of the three goals above should be met by any proposed reform. There may be more than one way of doing so. The following practical considerations should inform the design of any proposed reform.

Maintaining customer access to responsible broking

Any proposal to remove commissions altogether and to transition to a "flat fee" or direct "borrower pays" model is likely to render the mortgage broking industry unviable (either in whole or in substantial part). This would not be in the best interests of consumers.

Responsible mortgage brokers perform a key role in facilitating competition (thereby exerting downward pressure on the price of home loan products) in the face of the relative market dominance of the "big four" banks. Such brokers also provide expertise, convenience and choice for borrowers in navigating the largest financial commitment that most Australian consumers will make. Brokers can ameliorate the information asymmetry and bargaining power imbalance which can exist as between borrower and bank. At present, there are approximately 17,000 mortgage brokers operating in the Australian financial services market. These mortgage brokers facilitate 55.7% of all residential mortgages written in Australia.¹

While the vast majority of consumers consider that mortgage brokers provide a valuable service, many consumers are unwilling to pay up-front for financial advisory services of that kind.²

Prohibition of incentives that could cause bias

The introduction of a system of standardised payments to brokers may meet the goals identified above. Brokers could be paid an industry standard percentage or fixed amount for each loan (of the same type, for example owner occupier or investor, lower or higher loan to value ratio) brokered by them irrespective of the lender. This would remove the possibility of brokers being incentivised to prefer the bank which paid the highest commission and instead provide a simple, transparent system of broker commissions that is easy for customers to understand.

Facilitation of responsible borrowing

The problem of some brokers recommending unsuitably aggressive borrowing might be addressed in a number of ways. One option would be to introduce tiers or caps in the standardised commissions, although this would need to be carefully considered in order to avoid unnecessary complexity. The second would be to extend the obligations imposed under the *National Consumer Credit Protection Act* ("NCCP Act") to introduce an equivalent of s 133 for brokers. Such a reform, if properly implemented and enforced, would have a minimal impact on the majority of responsible brokers (who already ensure that their clients do not take out unsuitable loans), whereas it may weed out or deter the minority of unscrupulous or irresponsible brokers who facilitate fraud by borrowers or place their clients in unsuitable loans. Suncorp considers the policy goal of facilitating responsible borrowing to be important, but it may be that there is more than one way in which that goal could be achieved.

¹ MAFAA, "MAFAA Industry Intelligence Service Report", Fifth Edition, pp 6, 8 and 9.

² Deloitte, "Customer experiences of using mortgage brokers", (2016), p 5.

RESPONSIBLE LENDING

Reasonable inquiry and verification

Under the NCCP Act, banks are obliged to make reasonable inquiries about a customer's financial situation and to take reasonable steps to verify the customer's financial situation before assessing the (un)suitability of a loan or credit increase. Similarly, for small businesses, clause 51 of the ABA's Banking Code of Practice (2019) (the "**Code**") requires the bank to consider appropriate circumstances reasonably known to the bank in assessing whether the business can repay a loan. Suncorp Bank considers these standards, each of which is subject to a qualification of "reasonableness", to strike an appropriate balance between principles of individual responsibility, consumer protection and freedom of contract.

The responsible lending obligations in the NCCP Act were cast in deliberately general terms so as not to frustrate innovation or efficiency, or to restrict unduly the availability of credit (including by rendering it more expensive). What will be reasonable by way of inquiry or verification will necessarily vary depending upon the circumstances of individual cases. The Interim Report suggests that "[v]erification calls for more than taking the consumer at his or her word". This may be generally, but not necessarily, true. If a reputable person is willing solemnly to attest to the accuracy of financial information provided in support of a minor credit limit increase, there is no reason why a bank's considered acceptance of that attestation may not constitute reasonable verification in the circumstances. To require a detailed or forensic examination of a borrower's finances in every circumstance would go well beyond the dictates of reasonableness, may significantly increase the cost of credit to the consumer and would provide no corresponding benefit by way of consumer protection.

The suggestion that responsible lending obligations do (or should) oblige lenders to interrogate transaction bank accounts to verify financial information attested to by a borrower (if accepted as a general proposition) would have serious ramifications for the availability and cost of credit to consumers. No doubt, in some circumstances, verification may require such an examination in order to be classed as "reasonable". However, given the variety of circumstances in which credit is extended (e.g. in large or small amounts; to long-standing or to new borrowers), the Commission should not seek to lay down prescriptive measures of what is (or is not) required by way of reasonable inquiry and verification in all cases.

Use of benchmarks in loan assessment

Independent benchmarks can be an important tool in the loan assessment process. Borrowers sometimes have difficulty in estimating the full extent of their own expenses, and benchmarks may mitigate this risk. That is not to say that benchmarks should be used in isolation or should be used in preference to declared living expenses where those expenses exceed a given benchmark. Ultimately, lenders are subject to a robust prohibition in s 133 of the NCCP Act against entering into unsuitable credit contracts. That prohibition is sufficient to ensure that assessments are conducted properly and that undue reliance is not placed upon benchmarks.

Implications of extension to responsible lending laws

To extend or to strengthen responsible lending laws as they apply to home mortgage lending by ADIs (including by paying insufficient regard to the requirements of "reasonableness") would create significant risks of unintended, adverse policy outcomes. It would become far too easy for borrowers in default to challenge as "unsuitable" the loans they have voluntarily requested, accepted and benefited from. This would, in turn, diminish the incentive for borrowers to ensure that they repay their loans on time. Over time, increased rates of arrears and default will affect the credit rating of banks and their ability to access funding. When defaulting borrowers' loans are written off or written down, it may be non-defaulting borrowers who subsidise those losses (through higher rates of interest) and deposit-holders who bear the ultimate risk. In turn, lending standards would tighten further which would have broader impacts on the Australian economy. Given the relatively low rate of default in the Australian mortgage market at present, there is no persuasive case for the making of such reforms.

The Commission should not recommend any change to responsible lending laws (or to the relevant provisions of the Code) without carefully considering the ramifications for the cost and the availability of credit.

AGRICULTURAL LENDING

Suncorp Bank has proudly supported the agricultural sector for more than 110 years, and with our base in Queensland is alive to the risks faced by this sector, particularly those related to weather. Prolonged drought can have a devastating effect on farms and rural communities more broadly. The Interim Report suggests agricultural businesses are subject to uncontrollable and unforeseen events. This is true across many industries – a small retail business may find itself facing a new competitor next door, manufacturing business may be at the mercy of fluctuations in the prices of currency and raw materials driven by other than purely economic factors.

Suncorp Bank believes the uncontrollable events which are commonly associated with the Australian agricultural industry are largely “known unknowns”. The vagaries of weather, pestilence and disease are not always controllable but are inevitable and foreseeable (save for when they will strike).

Droughts, floods, cyclones, frost, bushfires etc are endemic to Australian conditions. They can have a drastic impact on crops, livestock and (consequently) the ability of the agricultural businesses to meet their financial obligations. These are risks which need to be planned for and managed by borrowers and lenders alike. Suncorp Bank believes it is the way in which borrowers and lenders respond to these risks before and after they manifest that makes agricultural lending different to other business enterprises, not the risks themselves.

Farm Debt Mediation

Suncorp Bank is a strong proponent of farm debt mediation and supports the introduction of a uniform national farm debt mediation scheme. We regard farm debt mediation to be a critical stage in negotiations before any enforcement action is considered. A national scheme would ensure that lenders adopt and apply a uniform approach to all agricultural lending customers, recognising the fact that agricultural businesses don't always operate according to state boundaries – cotton, grain, and beef farmers often have holdings that cross borders between Queensland and NSW and sheep-graziers may straddle the Murray between NSW and Victoria. Applying a uniform national approach would ensure consistency for both customers and lenders. Suncorp Bank suggests that the national scheme should be based on the model currently in force in NSW because our experience is that the NSW farm debt mediation model is simpler for customers.

If a uniform national farm debt mediation scheme is implemented we would see consistency in use and effectiveness of outcomes. That is not to say that the scheme should be mandatory (there may be exceptional circumstances where the parties agree on a way forward the timing of which would be affected by going through the farm debt mediation process) but there should be clear guidelines as to the circumstances in which farm debt mediation would not apply (and these circumstances would be an exceptions-only basis), clear guidelines on processes, documentation and obligations to inform borrowers.

Code of Banking Practice

Suncorp Bank considers that the provisions of the Code applying to small business are well suited to meet the needs of agricultural small businesses. We do not see a need for bespoke regime of protections to apply to agricultural businesses. Such a regime would, in all likelihood, result in an additional loading on the cost of agricultural finance relative to other areas of small business activity.

Valuations

Valuations should be undertaken by a third party independent to the lender (inclusive of the use of the Valuer General's Unimproved Value method which Suncorp Bank currently adopts in the case of certain low-risk exposures, which generally fall under \$1 million in lending exposure). The appropriate basis for valuations is a direct comparison approach using sales of similar agricultural properties. Valuers are instructed by the bank to provide the market value of a property as at the date of valuation for mortgage security purposes.

The prospect of external shocks should be taken into account in credit assessment (as part of the servicing calculations by sensitising prices and interest rates at appropriate levels) rather than as being solely a question relevant to valuation. The current market value which is adopted at the date of the valuation (both at the commencement of the loan and on review) can only be relied on at that point in time and therefore will not be able to account for external future shocks. Of course, in the case of a shock, a new valuation may become appropriate.

REGULATION

Simplification

There are opportunities to simplify the legislative and regulatory regime applying to the manufacture and distribution of financial products and services. A simpler regime would be preferable to the current system of overlapping obligations (subject to inconsistent exceptions) which can obscure rather than elucidate the core obligations owed by banks to customers.

Any reforms of this kind should be designed to ensure that they enhance (rather than diminish) competition in the banking sector. Due to their scale, the “big four” banks are more easily able to absorb the one-off and ongoing costs of legislative and regulatory reform.

Code of Banking Practice

The Interim Report raises the possibility that a contravention of the Code might become a contravention of law, and goes on to propose that:

If contravention of codes becomes a contravention of law, it will be even more important that the regulator makes its own decisions about how the relevant provisions of the Code should be framed.

Acceptance of this proposition would confer a legislative power on an executive regulatory body and may lead to convolution rather than simplification of the regulatory regime.

The preferable course (rather than rendering a contravention of the Code a contravention of law) would be to review the extent to which core obligations contained in the Code are captured by existing statutory obligations and, if necessary, amend the existing laws to ensure that they contain all core obligations. As recognised elsewhere in the Interim Report “[i]t is laws, and not codes of ethics, that are the proper repositories for basic norms of conduct”.

The Interim Report notes the “sharp contrast” between the Code and other industry codes of practice which are given statutory force under Part IVB of the Competition and Consumer Act 2010 (Cth). That difference is explained by the fact that those other industries are not already subject to the considerable degree of prescriptive legislation, regulation and oversight which currently applies to the banking industry under the *Corporations Act*, the *ASIC Act*, the *NCCP Act* and the *Banking Act*. The Code serves a different role. It contains a number of broad and/or aspirational promises, which are ill-suited to be enforced as law. For example, it is important that banks strive to act with sensitivity, respect and compassion (Code, cl 33, 39, 41, 161), but the levying of civil penalties for breach of those standards would introduce undesirable subjectivity and uncertainty into the law.

The Interim Report is frank in acknowledging the extent and scope of the existing legislative regime and raises legitimate concerns that this may encourage a “box-ticking” approach to compliance which does not advance actual compliance. To give legislative force to the Code would add further complexity to that regime. To then give a quasi-legislative power over the Code to a regulatory body charged with enforcing existing laws may distract the regulator from enforcing the existing law and result in over-prescriptive regulation subject to an at-large enforcement discretion.

Prudential regulation

Suncorp Bank considers that any changes proposed to the regulation of consumer protection and other conduct obligations should be designed so as not to affect the current system of prudential regulation, which functions well. Trust in Australia’s system of prudential regulation is essential to the availability of foreign finance which enables Australian institutions to offer financial services and products and to support continued economic growth.

Enforcement

Suncorp Bank agrees that it is necessary for regulators to act quickly and effectively in enforcing compliance with financial services laws. One factor which is unique to the Australian financial services industry (in contrast to the position globally and in most other Australian industries) is that financial service providers are required to self-report significant contraventions of their statutory obligations (whether those contraventions were the result of a mistake, negligence or deliberate wrongdoing). While the Commission has identified real shortcomings in the promptness and adequacy of self-reporting by

some entities, it remains the case that financial services providers in this jurisdiction self-report a very large number of contraventions to the financial services regulators. That fact must be understood when assessing the enforcement approach adopted by those regulators as compared with regulators of other industries. In addition to enforcement imperatives, financial regulators must also consider the promotion of efficiency, the reduction of business costs and the protection of the Australian financial system.

It is important that serious contraventions (which involve dishonesty, conscious contravention, significant consumer harm or deliberate concealment) are subject to sufficient punishment to deter future wrongdoing and register public disapproval. That said, a full gamut of enforcement options should remain available to regulators in their discretion. No public policy goal is advanced by requiring court action to address innocent or inadvertent contraventions of law, where they are promptly self-reported and have caused limited public harm (or harm which has been promptly and proactively remedied). In many cases of that kind, out-of-court outcomes will allow for a faster and more comprehensive response to contravention than can be achieved through court orders and will be more consistent with the other policy objectives which financial regulators are required to advance.

Conclusion

Suncorp Bank acknowledges the role of the Commission in bringing attention to key issues across the banking, superannuation and financial services industry. Suncorp Bank is committed to reviewing all changes proposed by the Commission in its final report and working collaboratively with government, stakeholders and industry to facilitate effective consideration and implementation of proposed reforms.

Yours sincerely



David Carter

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