Australian Banking Association

08 June 2018

The Hon. Kenneth Hayne AC QC
Commissioner
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry
By email FSRCenquiries@royalcommission.gov.au

Dear Commissioner

Thank you for providing an opportunity to make a submission on the General Questions from the Round 3 Hearings on Small Business Lending.

This submission addresses a subset of the questions, with a focus on the issue of the regulation and self-regulation of the SME lending sector.[1]

The submission puts forward the view that self-regulation of the banking industry through the Banking Code of Practice (**the Code**) is adequate to address any residual concerns raised in the context of the Round 3 Hearings about the coverage of obligations imposed on the banks. Further, the Code also adequately addresses issues concerning responsible lending; guarantees by third parties; consumer redress; and power and communication in business lending.

The New Draft Code, currently awaiting ASIC approval, has been completely rewritten and updated to better meet community standards and will be binding and enforceable. This Code will deliver changes across the board with plain English contracts, and includes, among other things, more transparency for guarantors, and the removal of non-monetary default clauses from standard form lending to small businesses.

There is a risk that a gap in consumer protection exists as non-ABA lenders are not subject to the Code. The ABA considers that community expectations could be better met if uniform consumer protections, equivalent to those in the Code, were applied to non-ABA member lenders.

Regulation and self-regulation of the SME lending sector

This section addresses Question 17 (T3059:12-14) of the general questions:
Is the proposed code – whether or not it is approved by ASIC – adequate to address any residual concerns about the coverage of obligations imposed on the banks? Would the absence of ASIC approval undermine the effectiveness of the code?

Adequacy of self-regulation through the Code

The Code expresses the banking industry's key commitments and obligations to individual and small business customers on standards of practice, disclosure and principles of conduct for their banking services.

The ABA considers that self-regulation through the Code is an important supplement to the regulatory framework and sets a higher minimum standard of practice in many areas.

---

[1] Transcript 1 June 2018, T 3034:18 – 3059:19, specifically questions 18 (T 3059: 11 – 14), 2 (T 3034: 21 – 23), 3 (T 3035: 10 – 13), 4(T 3032: 42 – 47), 5 (T 3040: 23 – 25), 9 (T3052: 40 – 45) and 12 (T3053: 12 – 19)

Australian Banking Association

Self-regulation has a number of advantages:

- It is responsive – enabling changes to practice which keep pace with changing consumer expectations and preferences as well as technological change.
- It is not a cost burden on government.
- It provides a mechanism for industry to engage with key stakeholders (including consumer advocates and regulators) to understand emerging issues and establish and promote good practice.
- It allows for continuous improvement, and
- It provides another avenue for industry buy-in and engagement.

The New Draft Code currently represents the appropriate standard to protect small businesses

The current Code provides protections for small businesses.

These protections have been reviewed and improved in the New Draft Code.[2]

The New Draft Code was developed through an extensive and carefully considered process, which commenced with the independent review conducted by Mr Khoury[3]. This involved extensive consultation with ABA members and stakeholders[4], and included engagement with ASIC aimed at obtaining approval pursuant to ASIC Regulatory Guide, Approval of financial services sector codes of conduct (**RG 183**)[5].

The New Draft Code will require banks to provide small business customers with longer notice periods around changes to loan conditions or a bank's decision to renew/not renew a loan facility, as well as simpler "covenant light" contracts. This will provide very real benefits to small businesses such as more flexibility in their loan arrangements and greater protections.

Addressing residual issues

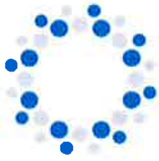
Counsel Assisting Mr Hodge identified five key issues that had been identified by small businesses in their submissions.[6] The ABA considers these are the "residual issues" noted in this question. These issues are:

- Process for assessing and approving applications for credit made by small businesses
- Circumstances in which they have provided personal guarantees or used their family home as security for their business loan, and the consequences that follow from such requirements
- Processes for rolling over or renewing business facilities
- Business loans that have been placed in default or terminated for breach of non-monetary obligations by the borrower, such as reporting obligations or loan-to-value ratio covenants; and
- Availability of adequate dispute resolution mechanisms for small businesses in their dealings with financial services entities.

How the New Draft Code specifically addresses these five issues is detailed below.[7]

---

[2] Exhibit 3.144 Statement of Ms Bligh with its exhibits
[3] Statement at [86]
[4] Statement at [88]-[96]
[5] Statement at [97]-[105]
[6] Transcript 21 May 2018, T 1993:26 - 2001:10
[7] Exhibit 3.144 Statement of Ms Bligh with its exhibits



Australian Banking Association

Small business lending application process

Clause 73 of the New Draft Code requires banks to provide a simple, plain English summary of the key aspects of the loan contract for the small business customer. The improvement to the Code is consistent with the Khoury Review recommendation and is considered by Mr Khoury "as a step in the right direction" in his transcript.[8]

In the event that a credit application is not successful, clause 74 of the New Draft Code adopts Mr Khoury's recommendation to provide small business with information to understand why the credit was refused, where possible.

Personal guarantees

Mr Khoury's evidence was that the New Draft Code goes a fair way towards strengthening protections for guarantors.[9] These improvements are detailed in the section headed 'guarantees by third parties'.

Rolling over or renewing business facilities

Currently, the Code requires banks to give 30 days' notice of a decision not to extend the loan where the loan is not in default. The New Draft Code, Chapter 23, increases this notice period to three months, to be given prior to the expiry of a loan term.[10] The increase in the notice period will provide small businesses with more time to arrange alternate financing.

The ABA considers the three-month notice period to be a minimum requirement. Individual ABA members may provide longer notification periods.

Non-monetary default

The current Code has no limits on the use of non-monetary defaults as a trigger for enforcement action.

The New Draft Code will limit a bank's ability to enforce non-monetary defaults. For example, a bank will not be able to rely on a non-material negative change in financial indicators such as loan-to-value ratios.

New Draft Code Clause 80 lists a limited number of specific events where non-monetary default could be relied upon to reflect legal obligations. These comprise:

a) Where a guarantor is insolvent, goes into bankruptcy, voluntary administration, other insolvency process or arrangement, or no longer has legal capacity

b) Enforcement proceedings are taken against you or a guarantor, or your or their assets by another creditor

c) Early repayment is required under a separate financing arrangement you or a guarantor has with us or default-based action is taken against you or a guarantor by us, due to an event of default which is described in this chapter

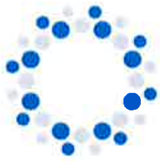
d) We believe on reasonable grounds that you, your agent or a guarantor has not complied with the law or any requirement of a statutory authority, or it becomes unlawful for you or us to continue with the loan

e) You or a guarantor gives us information or makes a representation or warranty to us which is materially incorrect or misleading (including by omission);

f) You use the loan for a purpose not approved by us

---

[8] Transcript 21 May 2018 (Khoury), T 2031:38
[9] Transcript 21 May 2018 (Khoury), T 2033:12
[10] Exhibit 3.144 Statement of Ms Bligh with its exhibits



Australian Banking Association

g) Your assets or a guarantor's assets are dealt with, or attempted to be dealt with in breach of the loan, or any security or other agreement with us without our consent

h) You or a guarantor do not provide financial information required by your agreement with us

i) You or a guarantor do not maintain a licence or permit necessary to conduct your business

j) You or a guarantor do not maintain insurance required by your agreement with us

k) Legal or beneficial ownership, or management control of a borrower or guarantor or their business changes without our consent; or

l) The status, capacity or composition of you or a guarantor changes without our consent.

Taking default-based action is further limited by the following conditions:

- Clause 81 provides that a bank, where reasonable, provides an opportunity for the customer to resolve a breach.
- Clause 82 requires that the event should be material, or the bank reasonably considers the event has had, or is likely to have, a material impact on the business or its guarantor's ability to meet their financial obligations, credit or security risk or legal or reputational risk.

Dispute resolution mechanisms

The current Code requires signatories to be a member of an external dispute resolution (**EDR**) scheme. Currently that is the Financial Ombudsman Service (**FOS**) (soon to be the Australian Financial Complaints Authority (**AFCA**).

AFCA will have expanded jurisdiction over small business disputes, including higher monetary thresholds and compensation limits.

It is current practice that FOS takes the provisions of the Code into account when considering a customer's complaint, whether or not the bank concerned is a signatory to the Code.[11] The ABA expects AFCA will continue this practice.

ASIC approval and effectiveness of the New Draft Code

The ABA supports the New Draft Code being approved by ASIC. The Terms of Reference for the Khoury Review expressly referred to RG 183 as the ABA had contemplated ASIC approval of the Code from the outset.[12]

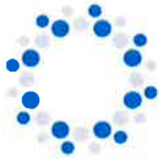
It is the ABA's view that ASIC's approval of the New Draft Code will provide additional benefits. The ABA recognises that where approval by ASIC is sought and obtained, it is a signal that consumers can have additional confidence in the Code and trust that it is one that responds to identified and emerging consumer issues and delivers substantial benefits to consumers. The ABA has submitted the New Draft Code to ASIC for its approval and is currently consulting with ASIC.

That said, the ABA considers that the New Draft Code would be effective without ASIC approval. This is because the ABA considers it meets the ASIC criteria in RG 183 for an effective code which are:

- A comprehensive body of rules developed in consultation with stakeholders
- Enforceability against subscribers to the Code
- Adequate provisions for dispute resolution, remedies and sanctions

---

[11] Statement at [30]; Transcript 31 May 2018 (Bligh), T 2921: 32-42
[12] Ex 3.144.30 AB-1-58 [ABA.001.001.5280 at 201-202] (Khoury review)



Australian Banking Association

- Effective and independent administration, including compliance monitoring.

How the New Draft Code meets the criteria is outlined below.

Consultation: Consultation was undertaken throughout the Khoury Review and in the development of the ABA's response to the Review.[13] Consultation continues with stakeholders on a regular basis as part of the ABA's 'business as usual' practice.

Enforceability: At present, an ABA member does not have to adopt the Code.

When a member adopts the Code, the Terms and Conditions of that bank for all banking services and guarantees to which the Code applies, include a statement to the effect that the relevant provisions of the Code apply to the service or guarantee. The Terms and Conditions need not set out those provisions.

In addition, disputes can also be taken to Court for determination where the Code will be incorporated into the contract terms between the bank and the borrower.

The ABA Council resolved in March 2018 that subscription to the new Code by banks with a retail presence in Australia should be a mandatory requirement of ABA membership.[14]

Dispute resolution, remedies and sanctions: The FOS (soon to be AFCA) is expected to continue to take the provisions of the Code into account when deliberating a customer's complaint as part of the product Terms and Conditions with the bank, whether or not the bank concerned is a signatory to the Code.

The current Code sanctions are limited to empowering the independent Code Compliance Monitoring Committee (**CCMC**) to name a bank in the annual report and on the CCMC website. At present, the CCMC independently monitors compliance with the Code and can make a determination as to whether a breach of the Code has occurred. It is not the role of the CCMC to provide bank customers with redress. Redress can be sought through internal dispute resolution (**IDR**) processes and external dispute resolution (EDR) schemes.

In the future, the New Draft Code will strengthen and increase the type of sanctions available. These include:

- Requiring the bank to rectify or take corrective action on the breach identified
- Requiring a bank to undertake a compliance review of their remediation actions
- Formally warning a bank
- Requiring a bank to undertake a staff training program on the Banking Code
- Naming a bank in the new Banking Code Compliance Committee (**BCCC**) annual report or website; and
- Reporting serious, systemic and ongoing instances where a bank has been non-compliant to ASIC.

Under the New Draft Code the BCCC will replace the CCMC and will be given additional powers to oversee this process.

Effective and independent administration: While the ABA is responsible for the development and updating of the Code, responsibility for monitoring compliance with the Code rests with the independent CCMC.[15]

Currently, the functions of the CCMC are to:

---

[13] Exhibit 3.144 Statement of Ms Bligh [WIT.0001.0048.0001
[14] Statement at [29]
[15] Statement at [21]

Australian Banking Association

- Investigate, and make a determination on any allegation within the CCMC's jurisdiction from any person, that a member that has adopted the current Code (subscribing member), has breached it. The CCMC does not however, resolve or make any determination on any matter
- Monitor compliance with the current Code by subscribing members
- Monitor any other aspects of the current Code that are referred to the CCMC by the ABA.

The new BCCC will have greater powers to monitor compliance and investigate breaches. This includes the following:

- Risk-based approach that prioritises the BCCC's investigative function on serious or systemic breaches
- Ensuring small business representatives are represented on the BCCC
- Collaborative approach premised on driving improvements in compliance with the Banking Code, to achieve best practice
- Engaging with the ABA Council and escalating any areas of concerns
- Responsible lending.

The New Draft Code contains a broad requirement for banks to comply with Chapter 17 titled 'A responsible approach to lending'.[16] This section of the New Draft Code outlines the obligations between a bank and small business borrower as follows:

- (Current provision incorporated in the Code): If we are considering providing you with a new loan, or an increase in a loan limit, we will exercise the care and skill of a diligent and prudent banker
- (New provision in the New Draft Code - Clause 51): If you are a small business, when assessing whether you can repay the loan we will do so by considering the appropriate circumstances reasonably known to us about:

  a) your financial position; or

  b) your account conduct

  Where reasonable to do so, we may rely on the resources of third parties available to you, provided that the third party has a connection to you. For example, where the third party is a related entity of yours (including, but not limited to, your directors, shareholders, trustees, beneficiaries or related body corporates), or is a partner, joint venturer or guarantor of yours.
- (New provision in New Draft Code- Clause 52): We also owe an obligation to any guarantor of the loan to comply with the above paragraph in assessing the borrower's ability to repay the loan.

It is also a requirement of the Australian Prudential Regulation Authority for banks to make prudent lending decisions. This means, for every loan application, a bank must consider the risks for itself and the applicant, including the applicant's ability to repay the loan. Although the prudential requirements are complex, and can differ between banks, in broad terms the greater the risk for the bank, the more capital it is required to hold against a loan. In short, banks have to consider risk and return, and assess whether the application is a viable proposition.

This next section addresses the general questions relating to responsible lending.

Question 1- T3034:18-20

How much responsibility does the borrower and lender bear in assessing the cash flow forecasts and other factors when deciding whether to enter into the loan contract?

---

[16] Statement at [21]

As a starting point there is a broad obligation in the transaction between lender and borrower that the borrower agrees to repay the loan.

The borrower is in the best position to know their cash flows and assess their capacity to service and repay the loan.

Taking a bank loan will increase the financial risk to the business, so an applicant needs to ensure that the term of the loan is understood and that the risk can be managed. The bank has an exposure to the business and the business owner must ensure there are adequate cash flows available to repay the loan over the agreed term.[17]

Having said that, a bank needs to reassure itself that the financial information and projections provided by the loan applicant are accurate and obtain other protections where suitable that the loan will be repaid. A loan applicant needs to satisfy the lender that the loan can be serviced and repaid and meet any other requirements that are specified in the loan agreement. This could include regular financial reporting to the bank and demonstrating that the business meets, and will continue to meet, all compliance requirements, including the timely lodging of tax returns and tax payments.

Question 2- T3034:21-23

What are the outer limits of a bank's duty to act as a prudent and diligent banker in assessing a business loan application? Should that outer limit – or should the outer limit of this duty be codified? What exactly is the content of the duty of prudent and diligent banker? Address that part about what exactly is the content of this standard, but perhaps guided by the fact that it's also a duty that is then imposed in an obligation to the borrower.

Chapter 17 of the New Draft Code continues to require bankers to "exercise the care and skill of a diligent and prudent banker".[18]

The development of the New Draft Code considered whether "what is expected of a prudent and diligent banker" needed more explanation. As a result, the New Draft Code now includes a specific provision in clause 51 about assessing appropriate circumstances for small businesses. Mr Khoury concluded in his transcript that clause 51 sets out what is expected of a diligent and prudent banker test and that "it's a step in the direction we recommended".[19]

In addition to the New Draft Code, the limits of the duty have been considered by the Courts. In the CBA v Doggett case (Victorian Supreme Court 2014 and Court of Appeal), the Court of Appeal clarified the scope of the duty to exercise the care and skill of a diligent and prudent banker. The Court of Appeal ultimately found that the failure of the bank to exercise due care and skill went to the manner in which it applied its credit assessment methods and formed its opinion in evaluating the company's financial position, but not necessarily to the decision to advance the loan. Given this, it concluded the duty is concerned with the processes and forming the opinion.

The ABA does not consider that the definition of a diligent and prudent banker - or its outer limit - should be codified further. This requirement is deliberately principle-based and its interpretation is subjective. Principle-based requirements allow FOS or the courts to reflect current practices and circumstances on a case-by-case basis. It also avoids the potential unintended consequences which can result from more prescriptive regulation being applied to processes that experience continual innovation and change.

---

[17] Transcript 31 May 2018 (Bligh), T 2916:10
[18] Statement at [63]
[19] Transcript 21 May 2018 (Khoury), T 2031:35

Australian Banking Association

Question 3 - T3035:10-13

Should any of the provisions of the National Credit Act which apply to consumer credit contracts also apply to credit contracts with small and medium sized business commerce? If so, why and to which small and medium business customers? If not, why not?

The ABA agrees with Counsel Assisting's submission to the Commissioner that no further statutory obligations should be imposed with respect to the making of loans to small businesses.[20]

The New Draft Code improves lending protections for small business and the industry should be given time to implement the New Draft Code and assess its impacts ahead of consideration of new statutory obligations.

There are dangers in expanding the National Credit Act to include small business lending. The ABA agrees with the recommendation in the Khoury Review.[21] Mr Khoury found that "the National Consumer Credit Protection (**NCCP**) Act's responsible lending provisions would restrict flexibility in a way that I think would be undesirable. I am not recommending that the Code mandate this for small business customers".[22]

Guarantees by third parties

This section addresses the two general questions relating to guarantees by third parties.

Question 4- T3040:23-25

Is there any inadequacy or gap in those established protections? If so, what is it? If not, would the protections apply in the case of Ms Flanagan?

Question 5- T3041:13-19

Is it desirable to take steps to increase the likelihood that a third-party guarantor of business borrowings will be properly advised and make an informed decision before entering into a guarantee? And, if so, what might those steps be? Secondly, what difficulties will be created for banks or borrowers by steps that require more information to be provided to legal or financial advisors of a guarantor before the guarantee is signed?

Counsel Assisting noted three points about guarantees by third parties. First, that there are established equitable principles in relation to unconscionability as outlined in cases, including Amadio and Garcia, that will protect guarantors. Secondly, there is also a national statutory prohibition on unconscionable conduct in relation to financial services. Thirdly, there may be statutory remedies available for contracts made in New South Wales under the *Contracts Review Act*.[23]

The Khoury Review identified guarantors as an important issue which needed to be addressed as part of the Code.[24] As a result, new provisions specifically protecting guarantors have been developed as Part 7 of the New Draft Code.

There are provisions in the Code that are set out to protect prospective guarantors to ensure they are informed about the guarantee and the borrower's loan contract.

In the **Current Code** there are substantive disclosure requirements which are:

- Guarantor should seek legal and financial advice

---

[20] Transcript 1 June 2018, T 2031:35
[21] Ex 3.144.30 AB-1-58 [ABA.001.001.5280] (Khoury review)
[22] Ex 3.144.30 AB-1-58 [ABA.001.001.5280 at 50] (Khoury review)
[23] Transcript 1 June 2018, T 3040:17-21
[24] Ex 3.144.30 AB-1-58 [ABA.001.001.5280 at 106] (Khoury review

Australian Banking Association

- Guarantor can refuse to sign the guarantee
- There are financial risks involved with the guarantee
- Information can be requested about the transaction or the loan
- Bank will tell the guarantor:
  - about any notice of demand they have made on the borrower for the guaranteed loan, or any loan the borrower has (or has had), within the previous two years; and
  - if any existing loan the bank has given the borrower will be cancelled if the guarantee is not provided.
- Bank will provide the following documents to the guarantor: loan contract, list of related security contracts, any related credit report, current insurance contracts, financial accounts or statement of financial position that the borrower has given the bank, latest statement of account relating to the loan for a period which a notice of demand was made by the bank and any other information reasonably requested.
- During the guarantee, the bank is required to give the guarantor information about the borrower's deteriorating financial position within 14 days:
  - A copy of any formal demand or default notice
  - Notice if the borrower is experiencing financial difficulty which has resulted in a change to their loan
- There are also specific execution requirements that if a bank attends signing of the guarantee, this will be done in the absence of the borrower. Guarantee documents will be given to the guarantor directly.

The **New Draft Code** extends these protections in the following ways. It provides:

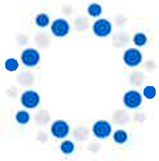
- Notice if the borrower is in continuing default for more than two-months;
- Without independent legal advice, the bank will not accept a guarantee until three days after the information has been provided.

In addition, Chapter 14 of the New Draft Code provides stronger protections for vulnerable customers.

- Banks are required to take extra care with vulnerable customers, including prospective guarantors. Taking extra care will be exercised on an individual case-by-case basis.
- If the circumstances before the bank warrant consideration about the guarantor and their vulnerability, this new section includes new obligations on banks to protect their customers.

These provisions will provide assurance at the time of the loan application by informing a guarantor and their advisor about the suitability of the applicant and providing additional time to consider giving a guarantee where legal advice has not been sought. In the unfortunate event that a borrower's loan goes into default, guarantors will be informed and the borrowers security will be used by the bank to pay off the loan before using the security provided by the guarantor, such as a home.

In the case of particularly vulnerable customers, such as those examined in the case studies, these provisions would have provided more information; allowed more time for customers to consider the implications and imposed a duty on banks to take extra care.


Australian Banking Association

Bankwest business lending

This section addresses two general questions relating to Bankwest business lending.

Question 9 -T3053:1-5

Is there any reason why valuations or investigative accountant's reports ought not be provided to customers in circumstances in which the reports have been paid for by the customer and the bank wishes to take reliance, at least in part, on such reports? Is there any reason why such transparency obligations should be limited by the size of the loan or limited to providing only parts of the report?

Chapter 24 of the New Draft Code requires banks to be fair and transparent when using an external property valuer or appointing an investigating accountant or insolvency practitioner.[25]

In addition, the ABA published industry guidelines on 24 November 2017 to introduce fairer and more transparent practices in the appointment and use of third party experts.[26] While guidelines are not enforceable and their implementation is voluntary, guidelines provide an industry benchmark which will be considered by FOS in its decision-making.

The two relevant industry guidelines are:

- Industry guideline for appointing property valuers when lending to small businesses and primary producers.
- Industry guideline for appointing insolvency practitioners and investigating accountants to small business and primary producers.

The guidelines reflect significant changes in industry practices. The industry guidelines emphasise:

- Improved communication and engagement with the customer, for example, by ensuring that the purpose and reasons that banks use independent third party experts is clearly explained and roles understood,
- Greater transparency:
  - Allowing the customer to select a valuer from a subsection of a qualified panel of valuers who have provided estimates
  - Providing customers with copies of instructions and valuations (except where enforcement action has commenced)
  - Ensuring only qualified and experienced experts are used by banks. The experts are required to be members of professional organisations with Codes and monitoring procedures e.g. the Australian Property Institute, Royal Institution of Chartered Surveyors, CPA Australia, the Australian Restructuring and Turnaround Association (ARITA).
- Measures to reduce perceived conflicts of interest - valuers:
  - A customer can select from the bank's panel of approved expert valuers
  - If the customer queries a valuation – a review of the valuation with the option of a new valuation if the customer is not satisfied (paid for by the customer)
- As regards the provision of reports, the ABA's view is:
  - A full copy of a valuation is not required to be provided to customers when an enforcement action has commenced. The information in the valuation is commercially sensitive, e.g. the customer could potentially pass the information to a prospective bidder

[25] Statement at [72]
[26] Statement at [69]-[71]

- Where enforcement action is underway, the valuation would be provided to the customer at a later stage. This is explained in the guideline.

Measures to reduce conflicts of interest around the appointment of investigative accountants as subsequent valuers include:

- Investigating accountants can by law be appointed as the subsequent receiver and there can be cost and efficiency advantages to the customer in this
- The industry guideline includes procedures to reduce the potential conflicts of interest including:
  - Only appointing qualified practitioners who are members of professional organisations with appropriate codes of conduct
  - Requiring an additional internal oversight of the appointment of investigating accountants as receivers, to ensure that the decision is necessary and to review the circumstances leading to the appointment
  - If the relationship between the bank customer and the investigating accountant has deteriorated (for example has become unworkable) the guideline recommends that the bank considers the appointment of an alternative qualified practitioner.

As regards the provision of reports, the ABA's view is to provide the customer a full copy of the instructions for the investigating accountant's report, but only some sections of the final report. The security assessment and findings section includes sensitive commercial and legal information which is provided to the bank on a confidential basis. Examples include assessments of the competence of the management or indications of criminal activity such as fraud, misappropriation, and compliance issues with anti-money laundering or counter terrorism obligations. These sections may be provided to the customer at the discretion of the bank but the ABA does not support this being mandatory.

Question 10- T3053:5-9

Is it appropriate for a bank to take enforcement action when no monetary defaults have occurred and the bank can rely only on non-monetary defaults? Why or why not? Should there be some additional protection for borrowers in these circumstances and ought the bank be obliged to explain such matters?

As outlined above in response to question 17, the New Draft Code provides additional protections to small business borrowers by limiting banks' ability to enforce non-monetary defaults.

While financial indicators will no longer form part of the standard contract as a trigger for enforcement action, they may still be used by the bank to monitor the health of the business.

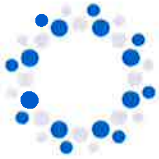
Such indicators determine if the business proposition is viable and the loan can be serviced. The indicators are also monitored throughout the life of the loan and can help both the bank and the business to identify emerging stresses and allow early intervention and support.

Power and communication

This section addresses one general question relating to power and communication.

Question 12- T3055:13-15

Should the sales culture for small business reflect that of consumer lending in that business bankers are discouraged from focusing primarily on financial incentives in their key performance indicators?



Australian Banking
Association

The Sedgwick Review examined and made recommendations on product sales commissions and product based payments received directly or indirectly by people selling retail banking products. A key point is that products that were in scope **included small business lending**.

The Review made 21 recommendations across three areas: remuneration structures for bank staff; governance, culture and performance management; and third parties.

Of particular note is the Sedgewick Review recommendations for the progressive phased reduction of financial incentives. Recommendations 3 and 4 provide that employees should be assessed against a range of factors which can include financial incentives, but that any financial incentives should be:

- Product neutral (i.e. not encourage the sale of one product over another); and
- In the case of a scorecard, together attract a maximum effective weight of 50 per cent as quickly as systems and other changes can be introduced, falling to 33 per cent or less by 2020.

The banking industry endorsed changes to remuneration, governance, and performance management arrangements to ensure payments to employees and third parties align with good customer outcomes and the structures around those payments promote good bank culture.

All 21 recommendations were accepted by banks and banks committed to implementing them in full as quickly as possible. All banks have agreed the reforms will be in place no later than the performance cycle which falls in 2020. After that point, the incentives for bank employees engaged in small business lending will be in line with those for employees selling other retail products.

If the Commissioner would like further information on any of these issues please do not hesitate to contact Tony Pearson, Executive Director and Chief Economist tony.pearson@ausbanking.org.au.

Yours sincerely

Signed for

Anna Bligh, AC
Chief Executive Officer

Tony Pearson
Executive Director and Chief Economist