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David Liddy, Managing Director & CEO

11 September 2009

Mr Bernie Ripoll MP
Chair
Joint Parliamentary Committee on Corporations and Financial Services
Parliament House
Canberra ACT 2601
11 September 2009

Dear Mr Ripoll,

Thank you for the invitation to make a submission to the committee's Inquiry into Financial Products and Services in Australia.

As a regional bank that aims to be a real alternative to the major banks in Australia, we have a very differentiated model. BOQ is the only bank in the ASX100 with a 'simple' banking model in the sense that it does not have large financial planning, margin lending or wealth management subsidiaries. Our focus is on housing and small business lending. We do not promote complex or structured products. Thus, our model avoids many of the conflicts that can arise between financial planning, advice, wealth management, and secured lending. At Bank of Queensland we pride ourselves on our relationship with our customers and the exceptional level of service we offer. We recognise that these are difficult times and are committed to helping our customers through the current global financial difficulties.

We offer a Hardship Assistance Package and have invited any customer experiencing financial hardship, including but not limited to those impacted by Storm Financial, to contact us directly to discuss how we can help them.

We have already extended special support to some Storm clients and anticipate that there will be more. BOQ is committed to ensuring that there will be no foreclosures of loans held with BOQ by Storm clients where genuine hardship is involved and where we have the opportunity to agree a support package.

As you are aware, we are in the process of conducting an internal review. This has delayed the completion of this submission. However, the interim findings of the internal review yielded sufficient information on which to base this submission, without any further delay to proceedings.

Based on the information obtained to date in the course of our internal review and legal opinion obtained, we believe that there was no dishonest or illegal practice or conduct by Bank of Queensland in connection with Storm clients.

I trust the committee will find our submission both useful and informative. I look forward to appearing before the committee next week to answer any further questions the committee may have.

Sincerely,

A handwritten signature in black ink, appearing to read 'D Liddy', with a stylized flourish at the end.

David Liddy
Managing Director & Chief Executive Officer



Submission to the Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Financial Products & Services

Bank of Queensland

11 September 2009

EXECUTIVE SUMMARY

Bank of Queensland (BOQ) welcomes the establishment of the Inquiry into Financial Products and Services in Australia. The Bank wishes to thank the Committee for the opportunity to delay lodgement of this submission until its internal review of matters relevant to the inquiry's terms of reference had been substantially progressed.

The conclusions and opinions proffered in this submission draw on the findings of the Bank's internal review, and the broader experience of the Bank's management.

The Bank notes that many of the hundreds of submissions already made to the Inquiry deal at length with the nine original terms of reference set out when the Inquiry was established on the 25th of February 2009.

Given this, and high profile media and other public conjecture over the Bank's involvement in matters relating to Storm Financial and the practice of margin lending, this submission focuses on responding to the additional term of reference announced by the Senate on the 16th of March 2009, namely that:

"The committee will investigate the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses."

This submission is limited to the Bank's involvement in matters relating to Storm Financial and some general observations about the proposed new National Consumer Credit Protection Law. It does not purport to comment on the involvement or actions of other members of the banking and finance sector.

The Bank wishes to advise that, based on the information obtained to date in the course of our internal review and legal opinion obtained to date, we believe that there was no dishonest or illegal practice or conduct by Bank of Queensland in connection with Storm clients.

TERMS OF REFERENCE

Bank of Queensland's provision of finance to customers introduced by Storm Financial

Bank of Queensland (BOQ) is conducting a review of all matters Storm-related and is substantially progressed with this review. As at 10 September 2009, BOQ had 261 current customers who were introduced by Storm and who borrowed from BOQ for the purpose of investing with Storm, with aggregate loans of around \$85.8 million¹.

To put this in context, Storm appears to have had around 14,500 investors², with aggregate investments of around \$4.9 billion as at August 2008³.

Relationship between BOQ and Storm Financial

There was no formal business relationship between BOQ and Storm Financial. BOQ was not a corporate banker of Storm Financial. There was no commission or bonus relationship between the Bank and Storm Financial, nor did the Bank provide financial or investment advice to Storm Financial's clients.

BOQ provided quotes, along with other banks, to provide Storm clients with predominantly home equity loans which were invested in products recommended by Storm Financial, an authorised financial planner. Home equity loans are standard bank products allowing people to access equity in their own homes for other purposes, including for investments.

Loans were made in good faith, and accepted by the parties in good faith. BOQ did not provide opinions or advise as to where or how these funds should be applied. Indeed, under the law as it currently stands, banks and credit providers (unless specifically licensed to provide investment or financial advice) are prohibited from advising their banking customers as to the best use of funds from the home equity loans or other products they provide.

At no time did the Bank provide advice on or manage complex leveraged or geared equities, provide margin loans to Storm Financial customers, or promote Storm Financial products.

The lending process for Storm customers

On the basis of the internal review it is conducting, the Bank's understanding of the general process of providing loans to customers introduced by Storm was as follows:

- Storm sent BOQ, as one of a number of banks, a quotation request for a Storm client who wished to access equity in their home to invest in Storm products
- BOQ provided a quotation to Storm Financial based on the information provided
- Storm made a recommendation to their client on the various quotes obtained
- The Storm client then selected a quotation
- If the Storm client chose BOQ, Storm Financial sent necessary paperwork and supporting documentation to BOQ
- The loan application was developed and processed

¹ ASIC has recently provided the Bank with a list it has sourced from Storm's proprietary database which may contain further Storm clients – this list is still in the process of being verified.

² As per Statement by The Australian Securities and Investments Commission on Storm Financial Pty Ltd – Senate Standing Committee on Economics Additional Estimates Hearing 25 February 2009

³ As per Administrators' Report to Creditors 16 March 2009

- A valuation was ordered, using one of the Bank's panel of valuers. The Bank used independent valuations, sourced from its panel of valuers, when determining the value of a Storm Financial customer's residential security for home equity loan purposes
- The loan documents were issued to Storm Financial, who forwarded the documents to the appropriate Storm financial advisor
- Storm Financial organised for the customer to sign loan documents
- Signed loan documents were returned to BOQ

Nature of the contact between the Bank and customers introduced by Storm

There has been much public criticism of the fact that lenders, including BOQ, had minimal direct contact with borrowers introduced through Storm. With the benefit of hindsight, even though it is common industry practice when dealing through third party referrers, we should have insisted on dealing directly with our customers in line with our strategic direction to avoid broker-referred business in our network. Importantly, many Storm customers directed BOQ and other lenders (via a signed authority) to deal directly with their Storm advisor, and some, when approached, referred BOQ back to Storm. Thus, paperwork was often sent to the customer via Storm, with the result that BOQ did not always have direct contact with the customer.

We are currently reviewing our policy with respect to customers who have agents acting on their behalf.

Income used in loan applications

There has also been much public questioning of how the Bank arrived at the income figures used in assessing the ability of Storm clients to repay their loans. The Bank would like to take this opportunity to provide some clarity on this point.

In assessing loan serviceability, the Bank takes into consideration the usual income sources such as salary and other income. In addition, where an investment loan is concerned, the Bank uses a conservative portion of the projected income from the investment. In the case of the Storm investment plan, the Bank included a reduced estimate of the total returns forecast by Storm Financial (as the customer's financial advisor).

While banks may vary in the conservatism of their calculations, it is standard industry practice to include at least part of the future income from investments in assessing the serviceability of an investment loan. For example, projected rentals form part of the assessed serviceability of an investment housing loan. Similarly, a conservative estimate of historical and forecast income from a small business would be included in assessing the serviceability of a small business investment loan. Without at least some recognition of expected income from the business, many loans to small and medium sized businesses would never take place. Nevertheless, in light of the Global Financial Crisis (GFC) we are reviewing the conservatism of our policy on income calculation for future investment lending.

Internal review interim findings

Interim findings from the still incomplete internal review are that the relationship between BOQ and Storm Financial and between BOQ and Storm's clients was entirely at arm's length.

Based on the information obtained to date in the course of its internal review and legal opinion obtained to date, the Bank believes that there was no dishonest or illegal practice or conduct by Bank of Queensland in connection with Storm clients.

The review has identified aspects of the Bank's policies, practices, and procedures that are in need of improvement. These are by no means unique to the Storm loans. Correcting such deficiencies is part of the normal business improvement program that every bank undertakes. Examination of such deficiencies is to be expected after a systemic shock the size of the GFC, and BOQ is not alone in this respect. The deficiencies relate to internal banking practices but do not relate to the integrity of the way in which the Bank deals with its customers.

The Bank is taking action to rectify these operational matters.

What we are doing for our customers

In the lead-up to the GFC, the majority of Storm clients were able to repay their loans in accordance with their loan contracts. Since the GFC there has not been a significant increase in the number of Storm customers in arrears, although there are a number of customers to whom we have granted hardship assistance following the collapse of Storm.

BOQ has for many years offered a Hardship Assistance Package for customers in financial difficulty. Following the Storm collapse, the Bank invited any customer experiencing financial hardship, including but not limited to those impacted by Storm Financial, to contact us directly about how we can help them. Indeed, we have adopted a more empathetic approach to Hardship Applications in light of the impacts of the GFC and the collapse of Storm Financial. These concessions will continue to evolve as we gain a better understanding of individual circumstances.

As with all our customers, the Bank's policy is to work within the assistance package criteria in dealing with any case of hardship. Inevitably, situations vary widely and are best treated on a case-by-case basis.

To date BOQ has received 45⁴ hardship applications from customers referred through Storm. The Bank has approved 43 hardship applications and loan contract variations, declined one application due to the customer's legal issue and had one application withdrawn due to a change in customer circumstances⁵. The Bank has received interest in hardship assistance from a further 64 Storm customers but has not received application forms as yet in these instances.

Examples of assistance offered to date include:

- Concessional interest rates;
- Restructured loans to extend the period of repayment; and
- Repayment holidays.

To date there have been no foreclosures of loans from BOQ to current Storm clients where genuine hardship is involved and where we have had the opportunity to agree a support package.

⁴ At as 7 September 2009.

⁵ As at 7 September 2009.

We will continue to review individual cases. In this case by case approach we aim to include in our consideration, in addition to the financial hardship of our customers, the particular circumstances surrounding their arrangements with Storm Financial and their dealings with us with a view to extending our range of solutions to assist the worst affected customers. We are committed to working with these customers to find a way to keep them in their homes.

What we have learned and what we are changing going forward

We have learned much from this matter about our own internal risk management and control systems. We have identified that there are areas in need of attention and we are attending to those.

It should also be noted that the review includes areas which will be a focus of the National Consumer Credit Protection legislation. While that legislation is still in draft form, we want to be proactive in bringing our practices into line with the new regime before it is introduced.

In this context we have determined that, under the new law, it would be inappropriate in the future to make low-doc loans to retirees. We are therefore making the policy surrounding low doc loans more explicit by excluding retirees. In addition to this change in policy we will be providing an interest rate concession to all existing retiree customers who were provided low-doc loans, whether for Storm investments or for other purposes.

Opes Prime and other similar businesses

The Bank had no involvement in providing finance for investors associated with Opes Prime or other similar businesses.

BOQ practices in relation to margin lending associated with Storm Financial, Opes Prime and other similar businesses

BOQ did not provide margin loans to Storm Financial clients. Nor did it provide margin loans associated with Opes Prime or any other similar businesses.

Responsible lending

A particular focus of this Inquiry is on the appropriate role of responsibility in lending. Chapter 3 of the draft National Consumer Credit Protection Bill imposes certain responsibilities on lenders, including the need to assess the suitability of the credit contract for each borrower. Suitability is defined in terms of the ability of the contract to meet the consumer's requirements/objectives and the capacity of the borrower to comply with the obligations under the contract without substantial hardship.

While such a responsibility may appear attractive on the surface, and the Bank agrees with the spirit of the concept, it opens up a range of unintended consequences in terms of the cost and availability of finance, the implications of which need to be weighed very carefully.

Banks currently lend to clients for myriad activities including running businesses, purchasing houses and cars, making investments, and personal pleasures such as vacations. Banks have a responsibility under law to protect the interests of their depositors and shareholders; that is, the stakeholders on the liability and equity side of the bank's balance sheet. They also have legal responsibilities in relation to criminal activities such as money laundering and terrorist financing. These latter responsibilities, while potentially in conflict with those of

depositors and shareholders, are intended to uphold the interests of the broader community, and are widely accepted by banks.

At issue is how far responsibility should extend with respect to the bank's borrowers. As is often the case, the answer is very clear in extreme situations, but much less so in the vast majority of cases. Importantly, such an extension of the bank's responsibility creates a much more direct conflict between the interests of stakeholders on the two sides of the bank's balance sheet.

The traditional role of banking has been to assess loan applications from the perspective of the bank as lender, rather than from the perspective of the borrower. That focus ensures that the bank takes responsibility for assessing the creditworthiness of the loan, while borrowers take appropriate responsibility for their own spending decisions. If a banker disagrees with the suitability of a borrower's planned disposition of the funds from a creditworthiness point of view, the traditional response has been to refuse the loan. If the banker agrees, the loan is granted, but the decision on disposition still rests squarely with the borrower.

While the draft Bill refers to "suitability" and provides some guidance, the legal interpretation of this concept will be determined in the courts, and extended in regulations. If pushed to the limit it could conceivably lead to a situation where a bank is held responsible for the borrower who buys a fast car and has an accident, the borrower who has a skiing accident while on holiday, the borrower who loses the funds at the races, and so on. These may be extreme examples, but they illustrate the difficulty of drawing the line between acting as a lender and as a lifestyle advisor.

Even more importantly, there is a material risk that transferring responsibility to the lender could cause access to finance to be significantly withdrawn. Consumer loans involve a high processing cost relative to their yield. For this reason most banks have adopted a statistical approach to assessing credit on the grounds that any additional risks introduced by a lower level of inquiry is balanced by the savings in processing costs and the statistical properties of the overall portfolio of borrowers. The additional burden of assessing suitability under the proposed new law will impose a much greater burden on inquiry and verification by the lender. In combination with the penalties for any failure to assess adequately, this burden is likely to reduce the availability and/or increase the cost of funds in general, but most specifically to some of the sectors of the community who are most in need.

To the extent that small business lending is often extended to individuals it also is likely to be affected, if included in future phases of the NCCP. In fact, the many small business owners who use personal finance and credit cards to fund their businesses would be impacted by the Bill in its current form. "Suitability" in this context could be interpreted to mean a judgement about the viability of the business, particularly if the loan is to be secured against the owner's place of residence. Given the high failure rate of small businesses, any bank will be less enthusiastic about lending to a small business if there is a possibility that it could end up in breach of the law if it were determined that this was not a suitable business for the borrower. The risk is heightened by the clarity of hindsight in assessing suitability after the business has failed.

It is a very fine line to tread, but 300 years of banking experience has shown that there is a sound basis for separating responsibility for the lending and spending decisions.