

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

REVIEW OF THE FOUR MAJOR BANKS (SECOND REPORT)

Australia and New Zealand Banking Group Limited

ANZ20QW: Loans—Non-monetary default clauses

At the Public Inquiry you stated that your bank was considering removing non-monetary default clauses for loans of up to a total of \$3M to an individual customer. Please advise your position on this.

Answer: Our response to the Carnell recommendations sets out two types of non-monetary default clauses:

- **specific event covenants**, examples of which include:
 - an insolvency event (e.g. a voluntary administrator or liquidator is appointed to the company) or other creditors taking action
 - a material misrepresentation or fraud by the customer
 - the loan being used for a purpose different to that for which the bank approved the loan
 - a material change in control or management; and
- **financial indicator covenants**, such as a breach of a loan to value ratio, interest cover ratio, or debt/EBITDA ratio.

ANZ is reviewing **specific event covenants** used in contracts for customers with total business lending up to \$3 million and will reduce the number of these covenants that may be used in these contracts. We agree that these should be set out in clear language and included in a summary of covenants.

As the Ombudsman has acknowledged, we believe there are important reasons to retain certain specific event covenants as potential default events in small business contracts.

We expect to include these revised specific event covenants in the new contracts we are developing in response to recommendation 7 of the Carnell report.

ANZ does not generally use **financial indicator covenants** where a customer's business lending is less than \$1 million. For almost all of these customers there is no contracted review by the bank once lending has been approved and drawn down by the borrower.

For small businesses with total business lending between \$1 million and \$3 million it is common for them to monitor their performance against financial indicator covenants as these financial indicators serve as an early warning sign about the health of the business.

We include financial indicator covenants in some but not all these customers' contracts. Where these indicators are included in contracts and the customer breaches one, then we would issue a 'default notice' and ask the customer to talk to us about how they are addressing the weakening financial health of their business and what we can do to assist. Engagement and, if necessary, intervention at this point is in everyone's interests.

This is consistent with recommendation 48 of the independent Code of Banking Practice review that banks should do more to identify and contact customers at high risk of future financial difficulty to try and assist those

customers. Financial indicator covenants serve this purpose in small business lending.

We have proposed classifying breaches of financial indicator covenants as 'review' events rather than default events and are working through how this would work.

Where we use financial indicator covenants today, it is a factor in the bank's decision to make finance available and under what conditions. Removing the option to include financial indicator covenants in these cases is likely to have impacts on ANZ's risk and lending appetite, pricing, and how long we would lend for.

We indicated that subject to consultations with regulators we would review the use of security revaluation where the loan term is less than three years and total business lending to the customer group is less than \$3 million. We have previously understood that APRA sees revaluation of security during the term of a loan as an important part of how credit risk is managed. We are seeking further consultation on this.