SHAYNE ELLIOTT | Chief Executive Officer

March 6, 2017

Mr David Coleman MP
Chair
House of Representatives Standing Committee on Economics
Parliament of Australia

By email: economics.reps@aph.gov.au

Dear Chair,

Standing Committee on Economics – *Review of the Four Major Banks: First Report*

Australian Small Business and Family Enterprise Ombudsman – *Inquiry into small business loans*

Thank you for your letter of 15 February 2017 requesting our response to the recommendations of the above reports. We are pleased to set these out in the attached papers.

The reports are important stages in the process of ensuring Australia has a fair and competitive banking sector. While we may debate the merits of individual proposals, ANZ is firmly committed to the process of banking reform. We want a banking sector that Australians trust to look after their money and help them through life.

Our commitment to this process is evident in our recent steps:

- We have cut the rate on our low-rate cards by up to 200 basis points. These rates are at their lowest since 2003.
- We have appointed Colin Neave as ANZ's Customer Fairness Advisor. He will work alongside our Customer Advocate and help ensure our products and services are fair and responsible. He is strengthening ANZ's remediation principles so we can further help customers fairly when something goes wrong.
- We have announced changes to our remuneration practices so that our frontline people are rewarded more for customer satisfaction and less for sales.
- We are reviewing our main lending contract for small businesses to simplify language and shorten the letter of offer and conditions.

These initiatives supplement those of the banking industry more broadly through the six-point plan and of the Government through its various reform initiatives.

Finally, while I acknowledge we must improve how we fairly and responsibly serve all our customers, I also believe it is important to recognise we continue to provide our millions of customers with an efficient and effective banking and financial services system.

I look forward to discussing these matters with you on March 7.

Yours sincerely

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Chief Executive Officer

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ANZ RESPONSE TO RECOMMENDATIONS OF THE FIRST REVIEW OF THE FOUR MAJOR BANKS

Recommendation 1 – Banking Tribunal

The committee recommends that the Government amend or introduce legislation, if required, to establish a Banking and Financial Sector Tribunal by 1 July 2017. This Tribunal should replace the Financial Ombudsman Service, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal.

The Government should also, if necessary, amend relevant legislation and the planned industry funding model for the Australian Securities and Investments Commission, to ensure that the costs of operating the Tribunal are borne by the financial sector.

We agree that external dispute resolution needs to be simple and easy to access.

We support:

- A single way for consumers and small businesses to access dispute resolution; and
- Increasing the thresholds for small business.

  For example, if external dispute resolution were allowed for credit facilities of up to $3 million, 98% of ANZ's business customers could access it and avoid court if they unfortunately have a dispute with us.

The interim report of the *Ramsay Review* supported an ombudsman service over a tribunal. While tribunals can be effective, an ombudsman service is more flexible and less legalistic. The main consumer groups support an ombudsman service.

An enhanced ombudsman service that allowed more small businesses to access it could address current concerns. We look forward to the final report of the *Ramsay Review* on this point.

The industry pays for the ombudsman today and the same could apply for a reformed, single pathway dispute resolution process.

Recommendation 2 – Accountable Executives

The committee recommends that, by 1 July 2017, the Australian Securities and Investments Commission (ASIC) require Australian Financial Services License holders to publicly report on any significant breaches of their licence obligations within five business days of reporting the incident to ASIC, or within five business days of ASIC or another regulatory body identifying the breach.

This report should include:

- *a description of the breach and how it occurred;*
- *the steps that will be taken to ensure that it does not occur again;*
- *the names of the senior executives responsible for the team/s where the breach occurred; and*
- *the consequences for those senior executives and, if the relevant senior executives were not terminated, why termination was not pursued.*

We largely support the recommendation.

AFSL holders could feasibly issue a public report that includes a description of the breach and how it occurred, the steps taken to ensure it does not reoccur and the senior executive responsible for the relevant business. Because the report would be issued soon after the breach report, it would, like those reports, be based on preliminary rather than conclusive findings.

The aspect of the recommendation that may benefit from further examination by Government relates to consequences for individual executives.

The recommendation understandably seeks to establish a regulatory mechanism to ensure that executives are held to account for serious consumer harm or other failings. Government may like to consider, however, whether the breach reporting mechanism is appropriate for that. The breach reporting provision of the Corporations Act, section 912D, is not crafted as a trigger for individual culpability. It is part of ASIC's intelligence gathering, and thus applies irrespective of individual culpability.

Instead, Government may like to consider inserting a new accountability provision into the Corporations Act. This provision could recognise the circumstances in which individual executives should suffer personal consequences for serious failures of the AFSL holder to comply with the law. A new provision could, unlike section 912D, rest on standard criminal and civil liability concepts. These would ensure that individuals are fairly held to account by ASIC for compliance failures that can be traced to their behaviour.

Recommendation 3 – Competition Reviews

The committee recommends that the Australian Competition and Consumer Commission, or the proposed Australian Council for Competition Policy, establish a small team to make recommendations to the Treasurer every six months to improve competition in the banking sector.

If the relevant body does not have any recommendations in a given period, it should explain why it believes that no changes to current policy settings are required.

We agree with this recommendation.

Analysis from a Government agency would help demonstrate the nature and level of competition. For example:

- Returns on assets (rather than equity) show how strong competition is.
    - Competitive discounts on mortgage rates mean we make approximately 67 cents for every $100 lent out, or less than 1%.
- Since 2005, competitive pricing has reduced bank returns on equity by 5.1 percentage points. Banks have worked to provide this better pricing, while maintaining a strong and safe financial system and reasonable returns to shareholders, by focusing heavily on costs.
- The difference between the rate we pay depositors and lenders, and the rate we charge borrowers, (that is the net interest margin) fell to 2 per cent in September 2016, from 2.04% a year before. This ratio has fallen several basis points since then and shows that the market is competitive and customers are benefiting.
- Across Australia's four major banks, the average net interest margin has halved over the last 20 years.

With good official analysis, Australia would have a solid base for further policy discussions.

Recommendation 4 – Open Data

The committee recommends that Deposit Product Providers be forced to provide open access to customer and small business data by July 2018. ASIC should be required to develop a binding framework to facilitate this sharing of data, making use of Application Programming Interfaces (APIs) and ensuring that appropriate privacy safe guards are in place. Entities should also be required to publish the terms and conditions for each of their products in a standardised machine-readable format.

The Government should also amend the Corporations Act 2001 to introduce penalties for non-compliance.

We agree that consumers across all sectors of the economy including banks should have greater access to their data. This could help them choose products and services that best suit their needs, and help competition and innovation.

ANZ embraces innovation and wants to take advantage of greater data access. Secure and well-designed data access arrangements for customers are already, and will continue to be, a source of competitive differentiation. Currently, we make substantial amounts of data available to our customers including through arrangements with accounting software providers for direct data feeds and data downloads through our internet banking portal.

Opening up sensitive data like customer transaction details, however, raises a number of issues that need to be considered and resolved. For example, ANZ deals with an aggressive probe on its network every four minutes. Further, identity theft is the main cause of cyber loss for consumers. If Australia doesn't get this right, we could see large scale data breaches and a loss of confidence in financial services. We have protected our customers' money for almost 200 years and we want to protect their data in the same way. As strategies like these evolve, increasingly the customers themselves will be responsible for decisions affecting their data security rather than organisations such as banks. We continue to see examples where customers are unaware of the value of their data and the need for care.

Government, industry and other groups, including those representing consumers, should work collaboratively through the following issues:

- Security standards – how will businesses receiving customer data protect it and how will this be verified?

- Liability – who will be responsible if customer data is misused or stolen?
- Data sets – what data needs to be available? Some data has been heavily analysed for commercial reasons and other data is highly confidential, like financial crime analysis and alerts.
- Technology – APIs are good today but how will we allow for other methods of data sharing (like data exchanges) and innovation?
- Economics – data is valuable and if it's effectively free to third party companies (including multinational technology companies), then how will we retain incentives to invest and compete? What rights will businesses receiving customer data have to sell it for profit? How can we best implement data policy that promotes local innovation?
- Timing – the UK is targeting open data for certain banks in 2018 but they have been working on it for a while. Australia hasn't yet started on large-scale open data policy and our timelines need to reflect our circumstances.
- Cost – developing APIs (ie the external gateway to access data) is relatively inexpensive but open data would require sophisticated governance and technology systems to support it – this type of infrastructure is much more expensive.

ANZ would like to work with Government and others on solving these questions. It may be possible to proceed in stages that reflect the different issues with different data sets (eg product attribute data carries fewer concerns than transaction data).

Recommendation 5 – Account switching

The committee recommends that the Government, following the introduction of the New Payments Platform, consider whether additional account switching tools are required to improve competition in the banking sector.

We agree with this recommendation.

The New Payments Platform is a powerful initiative paid for by the banks to make it easier and quicker for customers to make payments.

By using an alias, like a phone number, customers will be able to set up payment arrangements that can occur irrespective of which bank they choose. This will mean that if they switch banks, they won't have to redo all their payment arrangements.

We are participating in efforts to improve account switching and look forward to assisting with reforms. We agree that the existing formal process takes too long.

Recommendation 6 – Regulatory barriers to entry

The committee recommends that by the end of 2017:

- *the Government review the 15 per cent threshold for substantial shareholders in Authorised Deposit-taking Institutions (ADIs) imposed by the Financial Sector (Shareholdings) Act 1998 to determine if it poses an undue barrier to entry;*
- *the Council of Financial Regulators review the licensing requirements for ADIs to determine whether they present an undue barrier to entry and whether the adoption of a formal 'two-phase' licensing process for prospective applicants would improve competition; and*
- *APRA improve the transparency of its processes in assessing and granting a banking licence.*

We agree with this recommendation.

Recommendation 7 – Risk Reviews

The committee recommends that the major banks be required to engage an independent third party to undertake a full review of their risk management frameworks and make recommendations aimed at improving how the banks identify and respond to misconduct. These reviews should be completed by July 2017 and reported to ASIC, with the major banks to have implemented their recommendations by 31 December 2017.

Under APRA's rules, banks must independently review their risk management framework at least every three years (see Prudential Standard CPS 220). The results must be given to a bank's Board. These reviews support the annual reviews that we conduct ourselves and which are checked by our internal audit function.

Government could achieve the substance of recommendation 7 by asking the banks to provide the conduct risk sections of these CPS220 reviews to APRA. The major banks should all have completed reviews shortly, as CPS220 started about three years ago.

This may be a quicker way of allowing a regulator to further understand the banks' risk management frameworks.

Recommendation 8 – ASIC collect internal dispute resolution data

The committee recommends that the Government amend relevant legislation to give the Australian Securities and Investments Commission (ASIC) the power to collect recurring data about Australian Financial Services licensees' Internal Dispute Resolution (IDR) schemes to:

- *enable ASIC to identify institutions that may not be complying with IDR scheme requirements and take action where appropriate; and*
- *enable ASIC to determine whether changes are required to its existing IDR scheme requirements.*

The committee further recommends that ASIC respond to all alleged breaches of IDR scheme requirements and notify complainants of any action taken, and if action was not taken, why that was appropriate.

We agree with this recommendation.

Recommendation 9 – Wealth Industry Reporting

The committee recommends that the Australian Securities and Investments Commission (ASIC) establish an annual public reporting regime for the wealth management industry, by end-2017, to provide detail on:

- *the overall quality of the financial advice industry;*
- *misconduct in the provision of financial advice by Australian Financial Services Licence (AFSL) holders, their representatives, or employees (including their names and the names of their employer); and*
- *consequences for AFSL holders' representatives guilty of misconduct in the provision of financial advice and, where relevant, the consequences for the AFSL holder that they represent.*

The committee further recommends that ASIC report this information on an industry and individual service provider basis.

We agree with this recommendation. We support measures like this which help consumers regain trust in the wealth management industry.

Recommendation 10 – Contact Clients of Advisors

The committee recommends that, whenever an Australian Financial Services Licence (AFSL) holder becomes aware that a financial advisor (either employed by, or acting as a representative for that licence holder) has breached their legal obligations, that AFSL holder be required to contact each of that financial advisor's clients to advise them of the breach.

We agree with this recommendation. We have already put in place a process to write to an advisor's former clients if they are banned by ASIC.

Our only concern with the recommendation is that some legal breaches are minor and/or inadvertent. These wouldn't need to be reported to ASIC as they are not 'significant'. We think there should be a sensible threshold before licence holders need to contact clients. This is primarily to avoid unnecessary alarm.

ANZ RESPONSE TO RECOMMENDATIONS OF THE AUSTRALIAN SMALL BUSINESS AND FAMILY ENTERPRISE OMBUDSMAN INQUIRY INTO SMALL BUSINESS LENDING

ANZ understands these recommendations relate to business lending and not to other banking products which businesses may request from their bank, for example, hedges, derivatives, and payment products such as merchant facilities and other transactional banking products.

Nine of the recommendations are being addressed through the review and redrafting of the Code of Banking Practice. ANZ supports implementing reforms as part of that process.

Recommendation 1 – Bank implementation of ABA six point plan

Strengthen ABA six point plan by publishing individual bank implementation plans, including key milestones and deliverables. Outcomes against these plans must be published. Implementation by 1 July 2017

ANZ supports transparency of bank progress in implementing the industry reform program and ensuring banks are held to account. Ian McPhee AO was appointed in April 2016 to provide independent governance oversight to the reform program. He issues public reports each quarter on the industry's progress against its implementation plans, including a detailed project plan. ANZ understands that his reporting will increasingly focus on individual bank progress.

Recommendation 2 – ASIC approval of Code of Banking Practice

Revised Code of Banking Practice 2017 be approved and administered by the Australian Securities and Investments Commission under Regulatory Guide 183. The Code must be written in plain English and include a dedicated section on small business clarifying how breaches will be enforced. Implementation by December 2017

ANZ supports a Code of Banking Practice that is approved by ASIC, written in plain English with a dedicated section on small business. We are working with the industry to implement this and the industry will work with ASIC on how the Code can be approved by ASIC. We believe bank compliance with the Code should be overseen by a reformed independent monitoring committee.

Recommendation 3 – Small business contracts

For all loans below $5 million, where a small business has complied with loan payment requirements and has acted lawfully, the bank must not default a loan for any reason. Any conditions must be removed where banks can unilaterally:

- value existing security assets during the life of the loan

- invoke financial covenants or catch-all 'material adverse change' clauses

Implementation by 1 July 2017

ANZ supports parts of this recommendation and the intent of the recommendation to increase the transparency of loan terms for small business customers. We support being more specific about the changes in a small business customer's business or business operating environment that would trigger a review of their loan facilities.

ANZ will remove catch-all 'material adverse change' clauses from our main lending contract for small businesses.

Defaults or covenants can be considered under three headings:

1. **Monetary/non-payment defaults** such as the failure to pay interest due
2. **Specific event covenants** (see below)
3. **Financial indicator covenants** such as a breach of a loan to value ratio, interest cover ratio, or debt/EBITDA ratio.

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 agree that these should be set out in clear language and included in a summary of covenants. These covenants may include unlawful actions on the part of the customer, and we think they should also include serious breaches or defaults which are in the control of the borrower. Examples of such covenants which would allow a bank to enforce a lending contract 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.

Regarding financial indicator covenants, ANZ does not generally use these covenants where a customer's business lending is less than $1 million. During the inquiry ANZ explained that where they are included for small business lending, we very rarely use financial indicator covenants to take enforcement action, but they do serve as an early warning sign about the health of the business.

Financial indicator covenants encourage a business to talk to the bank and, where necessary, develop a plan to avoid problems or turn the business around. Early identification of deteriorating financial performance is prudent and responsible for the customer and any guarantor. This ensures the bank and customer discuss corrective action and support can be provided to give the business the best chance of being restored to health.

Recommendation 3 also calls for the removal of clauses allowing a bank to re-value existing security assets during the life of the loan. Consultation is required with APRA and the RBA about the effect on bank compliance with relevant APRA Prudential Standards (APS 220 and APS 113), of removing contractual rights to revalue securities. Subject to these consultations, we are reviewing 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.

ANZ is concerned to ensure that any action taken now, in a long period of asset appreciation, does not expose the individual customer (through reduction in equity), the banking industry and the wider economy to major losses at some point in the future.

We do not agree that all businesses with an individual loan below $5 million would be small businesses. We are of the view that these reforms should apply to business groups with total business lending (sometimes referred to as total credit exposure) of up to $3 million, not based on the size of an individual lending facility. This ensures large companies are excluded.

Recommendation 4 – Customer notice for contract changes

A minimum of 30-business day notice period to all changes to general restriction clauses and covenants (except for fraud and criminal actions) be added to give borrowers more time to respond and react to a potential breach of conditions. Implemented by 1 July 2017

We support providing 30 calendar days' notice where a bank exercises the power to unilaterally vary a particular small business's credit contract in a way that is materially adverse. This is consistent with recommendation 8 of the Khoury review of the Code of Banking Practice.

We support applying this to small businesses with total business lending across the business group of up to $3 million.

Banks operate nationally as do many of our customers. This makes calculating business days complicated because different states have different public holidays. The use of calendar days aligns with common practice across the industry for periods longer than 10 business days.

Recommendation 5 – Customer notice for decisions on roll over

For loans below $5 million, banks must provide borrowers with decisions on roll over at least 90 business days before loans mature, so borrowers can organise alternative financing. A longer period of time should be given for rural properties and complex businesses that would take longer to sell or refinance. Implementation by 1 July 2017

We support including a requirement in the Code of Banking Practice for banks to provide a notice period of 90 calendar days from when a customer is notified that the bank intends not to roll over a loan on maturity. We support the principle that the customer should be given sufficient time in which to find alternative financing.

We support applying this to small businesses with total business lending across the business group of up to $3 million.

ANZ also supports providing a longer period for rural properties, though a clear definition of rural properties is required. The industry will address this through the redrafting of the Code of Banking Practice. We note that 'complex businesses' is a difficult term to define and the focus of other recommendations has been on small businesses with more straight forward financing needs and limited resources to seek external advice.

Recommendation 6 – Providing customers with a summary of covenants

For loans below $5 million, banks must provide a one-page summary of the clauses and covenants that may trigger default or other detrimental outcomes for borrowers. Implementation by 1 July 2017

We support this recommendation, and are working to implement this noting that detrimental outcomes will need to be defined. The summary may need to be longer than one page, as acknowledged by Ms Carnell in her report.

Recommendation 7 of Mr Khoury's report proposes a similar requirement be added to the Code of Banking Practice.

We have initiated a review of our main small business lending contract, including the letter of offer and conditions, with a view to simplifying this contract. A summary of key information, including things referred to by Mr Khoury in recommendation 7, to accompany the letter of offer will be developed as part of this project.

As with other recommendations, we support this applying where total business lending to the business group is up to $3 million.

Recommendation 7 – Short and easy to understand small business contract

For loans below $5 million, banks must put in place a new small business standard form contract that is short and written in plain English. Implementation by December 2017.

We agree to put in place a new simplified small business contract (including letter of offer, and conditions) for new customers and existing customers who take out a new loan. This work is underway.

As with other recommendations, we support this applying where total business lending to the business group is up to $3 million.

Further simplifying the format, language and content of this contract builds on changes made to our small business contracts as part of the Unfair Contract Terms legislative reform.

Recommendation 8 – Valuation practices

All banks must provide borrowers with a choice of valuer, a full copy of the instructions given to the valuer and a full copy of the valuation report. Implementation by 1 March 2017.

We agree with the Ombudsman that small business customers should be provided with a full copy of the instructions to a valuer and a full copy of the valuation report where they pay for the valuation. This is ANZ's usual practice. An exception to this is where an enforcement process is underway and information about a valuation could potentially be passed to a prospective bidder impacting the sale price. In this case the valuation would be provided to the borrower at a later stage.

We also agree with the need to better define a process for working with small business customers who do not believe a valuation provided by a bank panel valuer is fair and reasonable. It is in the bank's and the customer's interest to ensure that the most accurate valuation of a property is obtained.

The first step is for ANZ to facilitate a discussion between the customer and the valuer. If there are still issues with the valuation, then the option is available to seek another valuation from an alternative bank panel valuer where the customer is prepared to pay for a second valuation.

ANZ is open to putting in place a process that would see a borrower provided with two or three names from our valuer panel for them to choose from. Valuers are registered professionals operating under full transparency, and bank practice is to discuss a valuation with the customer. However, we acknowledge that a customer paying for a valuation may feel greater control where they select the valuer.

The ABA with ANZ representatives is currently developing an industry guideline to give effect to this recommendation. The working group is reviewing a draft guideline.

Mr Khoury has recommended the industry develop a guideline setting out in detail how to ensure fair and transparent processes for valuing property, and that the Code include a requirement for banks to have fair and transparent processes in place for valuations for small business lending up to $5 million (recommendation 29). We support the Code including this requirement for small businesses covered by the Code.

Recommendation 9 – investigative accountant instructions and report

Every borrower must receive an identical copy of the instructions given to the investigating accountant by the bank and the final report provided by the investigative accountant to the bank. Implementation by 1 July 2017.

We support providing a small business customer with a copy of the full instructions and the final report provided by an investigative accountant to a bank. This is also reflected in Recommendation 29 of Mr Khoury's report.

Recommendation 10 – Investigative accountant conflict of interest

Banks must implement procedures to reduce the perceived conflict of interest of investigating accountants subsequently appointed as receivers. This can be achieved through a competitive process to source potential receivers and by instigating a policy of not appointing a receiver who has been the investigating accountant to the business.

We agree with the need for a bank to examine any perceived conflict of interest raised with it relating to the appointment of an investigating accountant as a receiver. The ABA is working on guidelines to implement this.

We are of the view that a conflict can best be addressed by working with the customer to understand where there is a perceived conflict. Where a conflict is established, we agree that it would not be appropriate for the investigative accountant to be appointed as receiver.

We note that ANZ only engages an investigative accountant in a small number of cases and the number of these that result in receivership is smaller. Customers in the commercial space typically find an investigative accountant can provide helpful advice to address business issues and turn around the business.

The best interests of the customer would not be served by ruling out the appointment of an investigative accountant as receiver.

In regional and remote areas, there may be very few investigative accountants or receivers from whom to choose. In many cases (including certain specialised industries), the most cost effective choice for the customer may be to appoint as receiver an investigative accountant who already understands the business or understands the industry.

Recommendation 11 – External dispute resolution

The banking industry must fund an external dispute resolution one-stop-shop with a dedicated small business unit that has appropriate expertise to resolve disputes relating to a credit facility limit of up to $5 million.

We have made submissions to the Ramsay review indicating we support an outcome that is simple, accessible and transparent. This may end up being a one-stop-shop with in particular better access for small business. We favour EDR resolving disputes relating to a credit facility of up to $3 million.

Recommendation 12 – Customer Advocate

Banks must establish a customer advocate to consider small business complaints and disputes that may or may not have been subject to internal dispute resolution.

We have had a Customer Advocate in place since 2003 whose mandate covers consumer and business customers.

Recommendation 13 – Disputes with third parties

External dispute resolution schemes must be expanded to include disputes with third parties that have been appointed by the bank, such as valuers, investigating accountants and receivers, and to borrowers who have previously undertaken farm debt mediation

This recommendation requires consultation with third party industry bodies and would be for those professions to fund. We understand this will be considered by the Ramsay review.

Recommendation 14 – Farm debt mediation

A nationally consistent approach to farm debt mediation must be introduced.

We strongly support a national approach to farm debt mediation and understands this is being considered by the Government.

Recommendation 15 – ASIC Small Business Commissioner

The Australian Securities and Investments Commission must establish a Small Business Commissioner.

This is a matter for Government.