

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

**SUBMISSIONS BY ANZ IN RESPECT OF GENERAL QUESTIONS - ROUND 3 HEARINGS**

1. This submission responds on behalf of Australia and New Zealand Banking Group Limited (**ANZ**) to the general questions and issues raised in Counsel Assisting's closing address.
2. Some aspects of these questions and issues have already been addressed at a high level in ANZ's submission to the Commission concerning small to medium-sized lending dated 17 April 2018 (**April Submission**). This document should be read together with the April Submission.

**Question 1: 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? (T3034.18-20)**

**Question 2: What is the content of a banker's duty to act as a prudent and diligent banker in assessing a business loan application? What are the outer limits of this duty and should this outer limit be codified? (T3034.21-23)**

3. ANZ addresses questions 1 and 2 together: *first*, by reference to the content of the prudent and diligent banker duty in cl 27 of the Code of Banking Practice (**CBP**) as interpreted by the courts, and *second*, by reference to ANZ's practices with respect to assessing cash flow forecasts submitted to it in support of loan applications.

*Content of the duty*

4. Clause 27 of the CBP is focused on the exercise of care and skill *in the formation of a bank's opinion* as to whether a borrower will be able to repay the loan. Clause 27 is thus concerned with the process of arriving at an opinion, not the content of the opinion, or other aspects of the loan assessment process, such as the adequacy of the available security.<sup>1</sup> An example of conduct that might breach cl 27 is where a bank has formed the relevant opinion based on a misunderstanding of the borrower's business case, such that it failed to appreciate that the borrower could not repay the loan from business income.<sup>2</sup>
5. Courts have interpreted cl 27 as neither presupposing nor requiring that a bank must form an opinion that a borrower *will* be able to repay the loan before granting or extending credit.<sup>3</sup> The outer limits of the obligation were described by McLeish JA in *Doggett*:<sup>4</sup>

*[Clause 25.1] does not prescribe a precondition to the advancing of a loan, or the content of the opinion which must be formed before that is done, only the level of care and skill with which the exercise must be undertaken.*

6. Interpreted in this way, all that cl 27 requires is that a bank's opinion as to capacity to repay be arrived at through appropriate credit assessment methods and a sound

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<sup>1</sup> *Doggett v Commonwealth Bank of Australia* (2015) 47 VR 302 at 306 [8] (Whelan JA) and 342 [163]-[164] (McLeish JA); *Westpac Banking Corporation v Haynes* [2017] SASC 23 at [63] (Nicholson J). These cases concerned cl 25.1 of the 2004 version of the CBP, which was expressed in substantially the same terms as cl 27 of the current (2013) version of the CBP.

<sup>2</sup> See *Doggett* (2015) 47 VR 302 at 320 [68] (Whelan JA), 341 [161]-[162] (McLeish JA), 353-354 [218]-[219] (Garde AJA). See also [1.32] of ANZ's submission on findings arising from the case study involving ANZ dated 8 June 2018.

<sup>3</sup> *Doggett* (2015) 47 VR 302 at 306 [8] (Whelan JA) and 342 [163] (McLeish JA); see also *Haynes* [2017] SASC 23 at [63] (Nicholson J).

<sup>4</sup> (2015) 47 VR 302 at 342 [164] (Whelan JA and Garde AJA agreeing).

understanding of the borrower's financial situation. Having formed an opinion for the purposes of cl 27, it is then a matter for the bank whether it is willing to take on the risk that the borrower might not in fact repay the loan. This decision depends on the exercise of judgment, having regard to matters such as the available security or guarantee arrangements and the bank's risk appetite.<sup>5</sup>

7. In practice, and despite the judicial interpretation of cl 27 set out above, satisfaction of a customer's capacity to repay a loan is generally central to ANZ's assessment of credit applications (as discussed further below).
8. ANZ supports the changes to cl 27 that are proposed in the revised (and renamed) "Banking Code of Practice" (**New BCP**), which is due to be adopted in early 2019 and is discussed further at [19] below.
9. ANZ does not consider it desirable to codify the outer limits of the duty. The interests of ANZ's business customers, whose needs and circumstances are many and varied, are best served by a general duty that is applied on a case-by-case basis having regard to the judicial interpretation referred to above.

#### *The assessment of cash flow forecasts*

10. ANZ considers that borrowers and lenders have a shared responsibility in assessing cash flow forecasts and other inputs into the lending decision. Primary responsibility for the preparation of the cash flow forecast, and the provision of accurate information, rests always with the customer. Based on the information obtained, the customer makes, and takes responsibility for, the inherently risky decision to invest in a new or existing business, including by applying for credit from a bank.
11. ANZ's Credit Principles (October 2017) state that ANZ will "[o]nly lend what the customer has the capacity and ability to repay", by reference to the customer's true debt servicing capacity. In a business lending context, the Credit Principles contemplate that ANZ will draw conclusions as to the customer's capacity to repay based on the overall strength of underlying cash flows and the customer's ability to repay debt over the term of the loan.<sup>6</sup>
12. ANZ's long form Business Credit Application Form requires applicants to provide documents relevant to ANZ's "capacity and ability to repay" assessment. While established businesses may provide documents such as balance sheets and profit and loss statements, start-ups and businesses that have only been operating for a short period will generally provide a business plan and cash flow forecast for the next 12 months in support of credit applications.<sup>7</sup>
13. ANZ expects its frontline bankers and credit assessment staff to be satisfied as to the reasonableness of the figures contained in cash flow forecasts submitted in support of credit applications.<sup>8</sup> Relevant considerations include how revenue figures have been arrived at, and whether adjustments have been made to account for the time it will take for revenue to build after opening or to allow for seasonal factors. In certain circumstances, questions should be asked; for example, if figures have been calculated on the basis of unstated assumptions.<sup>9</sup>

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<sup>5</sup> *Doggett* (2015) 47 VR 302 at 342 [163] (McLeish JA); *Haynes* [2017] SASC 23 at [63] and [182]-[184] (Nicholson J).

<sup>6</sup> Exhibit KGG-11 to the witness statement of Kate Gibson dated 17 May 2018 (exhibit 3.15) (the **First Gibson Statement**): ANZ.800.399.9794 at .9794 to .9796.

<sup>7</sup> Exhibit KGG-3 to the First Gibson Statement: ANZ.800.532.0008. See also ANZ's Small Business Credit Requirements dated 17 April 2018 at exhibit KGG-13 to the First Gibson Statement: ANZ.800.515.0458 at .0504.

<sup>8</sup> T2171.06 and T2194.43-47.

<sup>9</sup> T2171.06-11; T2172.21-24; T2197.46-7.

14. While ANZ's assessment of credit applications includes a "suitability" assessment, this concerns the suitability of the product(s) sought, not the suitability of the business opportunity more generally. In assessing the reasonableness of a cash flow forecast, ANZ may identify matters that are relevant to business risk (eg risks arising from the nature of the relevant market or competitive forces within it, or the management experience of the business owners). These matters are relevant to ANZ's credit assessment judgment, however ANZ is not (and should not be) required to step into the role of financial advisor and communicate these risks to borrowers. Borrowers can, and where appropriate should, seek independent advice about their business plans and the risks involved in proposed ventures, including repayment obligations in respect of any loan obtained. At all times, the decision whether or not to invest in a business is the decision of the borrower.<sup>10</sup>
15. The balance of responsibilities described above is appropriate. ANZ supports the amendments incorporated into the New BCP (see [19] below), however it believes that no additional or more onerous regulations should be placed on banks in relation to their assessment of loan applications or the decision to offer, grant or extend business loans. Introducing further restrictions on the criteria that must be satisfied before a small business loan can be offered or extended has the potential to restrict access to capital in a way that is not productive for small business or for the Australian economy generally. It would be important to understand the implications of additional restrictions for the availability of credit and the broader economy of introducing any additional restrictions. The evidence presently before the Commission does not enable any such assessment to be undertaken.

**Question 3: Should any of the provisions in the National Credit Act which apply to consumer credit contracts also apply to credit contracts with small and medium sized business customers? If so, why and to which small and medium business customers? If not, why not? (T3035.10-13)**

16. ANZ refers to [13] of the April Submission and submits that no additional statutory obligations should be imposed with respect to the making of loans to small to medium business customers.<sup>11</sup> The response that follows focuses on small business lending, but ANZ submits that similar challenges would arise if the National Credit Act responsible lending obligations were applied to medium sized businesses.
17. The existing protections imposed under the CBP (including in particular cl 27), in combination with statutory causes of action available under the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**), strike an appropriate balance between the need to provide protection to small business borrowers, while at the same time recognising that, by its nature, lending in this sector requires a greater level of flexibility and risk than consumer lending.
18. ANZ's position in this regard is consistent with the Independent Review of the Code of Banking Practice Final Report, which recommended against incorporating the National Credit Act's responsible lending obligations into the CBP so that they apply to small business customers.<sup>12</sup>
19. Chapter 17 of the New BCP will require banks (among other things) to review an applicant's financial information, situation and account conduct carefully and prudently when providing a new loan or increasing a loan limit.

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<sup>10</sup> T2172.31-32.

<sup>11</sup> T3028.40-43 and T3034.05-09.

<sup>12</sup> P Khoury, *Independent Review Code of Banking Practice Final Report*, 31 January 2017 (**Independent Review**), page 50: <http://cobpreview.crkhoury.com.au/wp-content/uploads/sites/2/2017/02/Report-of-the-Independent-Review-of-the-Code-of-Banking-Practice-2017.pdf>.

20. These amendments clarify the responsible lending promise made by banks to their small business customers,<sup>13</sup> but avoid the adverse impact that National Credit Act responsible lending obligations would potentially have on the ability of small business to access credit.
21. ANZ notes the following:
- (a) the types of enquiries and verification steps involved in small business lending vary according to the type of business and borrower involved and the source of the income that is expected to service the borrowing;
  - (b) in contrast to consumer lending, where applicants may reasonably be expected to provide documentary evidence of past income, small business lending often requires consideration of projected income (which, by definition cannot be verified), in addition to or in the absence of relevant evidence of past income. This is particularly so in the case of start-up businesses and established businesses when they rely on projected income in support of applications to fund growth plans;
  - (c) in some circumstances there are likely to be limitations on the steps a bank can take to verify supporting documents; for example, where a cash flow forecast is provided by the purchaser of an existing business, a bank could not require the vendor to provide past tax returns and bank statements to verify historical income and expenses;
  - (d) even where accounts showing past performance are available, these are often unaudited where the business operates on a small scale; and
  - (e) small business lending requires, by its nature, the exercise of a higher degree of discretionary judgment than consumer lending, taking into account a wide range of considerations, including the borrower's industry and its economic outlook, the organisation and projected growth of the borrower's business, and the quality and experience of its management.
22. These features of the small business lending environment would create challenges in terms of compliance with "reasonable inquiries" and "reasonable steps to verify" obligations of the kind imposed under Chapter 3 of the National Credit Act. This is particularly so having regard to the way this obligation has been interpreted by ASIC in Regulatory Guide 209, which focuses on collection of information and documentation in relation to the borrower's existing financial situation as an indicator of future ability to repay. If legislation were to require banks to satisfy reasonable inquiries and verification obligations by reference to existing financials, and to the exclusion of forecasts and judgmental factors, this would restrict the availability of credit to small businesses, particularly in the start-up and growth phases.

**Question 4: The likely consequences of owner manager branches of Bank of Queensland being recipients of trailing or other commissions particularly having regard to the findings of the Sedgwick report into retail banking remuneration. (T3032.43-46)**

23. ANZ is not aware of all the relevant facts in the Bank of Queensland case study, including in relation to the full remuneration structure of its owner manager branches, how branch remuneration is passed on to employees, and the governance and cultural framework in place. For these reasons, ANZ is unable to assist the Commission by responding to this question.

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<sup>13</sup> See cl 1 of the New BCP for the definition of "small business" (version dated 23 April 2018): [https://www.ausbanking.org.au/images/uploads/New\\_Draft\\_Code.pdf](https://www.ausbanking.org.au/images/uploads/New_Draft_Code.pdf).

**Question 5: Is there any inadequacy or gap in the following established legal protections: (a) the equitable principles in relation to unconscionability as outlined in cases including *Amadio* and *Garcia*; (b) the national statutory prohibition on unconscionable conduct in relation to financial services; and (c) the statutory remedies for contracts made in New South Wales under the *Contracts Review Act*? If so, what is it? If not, would the protections apply in the case of Ms Flanagan? (T3040.23-25)**

24. Protections for persons who find themselves in a position of special disadvantage vis-à-vis a bank already exist under equitable principles, the statutory prohibition on unconscionable conduct under ss 12CA and 12CB of the ASIC Act, and the remedies available under the *Contracts Review Act 1980* (NSW).
25. ANZ believes that these protections provide flexibility, both in their application and in terms of available remedies. Concepts of special disadvantage have been formulated with care over many years by courts and legislatures to identify the various reasons why a person may be deserving of protection above that available to ordinary members of the public.<sup>14</sup> These concepts are ultimately concerned with identifying circumstances that may mean a person is unable to make an appropriately informed decision about his or her interests or act with free will, or which otherwise require legal intervention.
26. Equitable doctrines and statutory protections are reflected in ANZ's small business lending policies.<sup>15</sup> ANZ's Small Business Credit Requirements, for example, include a list of persons who are "unacceptable guarantors", from whom guarantees should not be accepted.<sup>16</sup> Relevant circumstances include where there is reason to suspect that the proposed guarantor:
- (a) has intellectual disabilities that would make it difficult to understand a guarantor's obligation;
  - (b) is incapacitated at the time of executing the guarantee (ie under the influence of alcohol or drugs);
  - (c) does not understand the effect of the guarantee;
  - (d) is under duress or influence from the customer or another guarantor; or
  - (e) is independent of the customer group and does not have the financial resources to repay or service the guarantee obligations and/or would encounter undue hardship (such as the loss of their home) if required to pay under the guarantee.
27. ANZ's Small Business Credit Requirements also provide guidance to bankers when assessing whether a proposed guarantor requires independent advice.<sup>17</sup> This subjective assessment should consider (at a minimum) the nature of the relationship between borrower and guarantor and the ability of the guarantor to understand the implications of, and to exercise judgment and free will in providing, the guarantee.<sup>18</sup> ANZ requires a proposed guarantor to obtain independent advice where he or she is in a special relationship with the borrower (whether financial, emotional or contractual) or has a special disability, and that special relationship or disability may impair his or her ability to

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<sup>14</sup> See eg *Blomley v Ryan* (1956) 99 CLR 362 at 405 (Fullagar J) with respect to the concept of special disability in equity. See also s 12CC of the ASIC Act, which contains a (non-exhaustive) list of factors that courts may take into account when considering statutory unconscionability under s 12CB of that Act. Similar factors are relevant to the assessment of whether a contract term is unfair under s 9(2) of the *Contracts Review Act 1980* (NSW).

<sup>15</sup> ANZ has limited its response to its small business lending policies on the basis that the Westpac case study involved a loan for \$160,000.

<sup>16</sup> Exhibit KGG-13 of the First Gibson Statement: ANZ.999.009.0065 at .0551.

<sup>17</sup> Exhibit KGG-13 of the First Gibson Statement: ANZ.999.009.0065 at .0551-.0552.

<sup>18</sup> Exhibit KGG-13 of the First Gibson Statement: ANZ.999.009.0065 at .0551-.0554.

understand the legal and financial risks involved in becoming a guarantor. Persons whom ANZ may require to obtain independent advice include parents guaranteeing a child's business facilities where they have no financial interest in the business and there is some reason to believe that they may, without that advice, be unable to understand the risks involved in giving a guarantee.

28. Further detail concerning ANZ's Small Business Credit Requirements as they apply to guarantors (including, in particular, notice provisions) is provided in answer to Question 6 below.
29. ANZ considers that existing legal protections, coupled with the policies it has in place, appropriately respond to the difficult circumstances which may arise in the case of third party guarantors and which involve competing policy considerations, as reflected in the Westpac case study concerning Ms Flanagan. ANZ is not aware of all the relevant facts in that case, but considers that, had Ms Flanagan approached ANZ, its Small Business Credit Requirements would have mandated an assessment as to whether to accept a guarantee from her that appropriately balanced the interests of parental care, affection and support with the need to identify circumstances where a potential guarantor may be unable to act with free will and an understanding of his or her interests.
30. ANZ agrees that the fact that a proposed guarantor has a \$1 shareholding in the borrower company, without more, is not sufficient to warrant the guarantor being treated as anything other than a third party guarantor.<sup>19</sup> In the absence of documentary evidence that Ms Flanagan was eligible to receive a genuine financial benefit from the business, she would have been treated as being "independent of the customer group" under ANZ's Small Business Credit Requirements as they apply to unacceptable guarantors (see [26(e)] above), notwithstanding her shareholding in the borrower company.

**Question 6: 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? If so, what might those steps be? (T3041.13-16)**

**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? (T3041.16-19)**

31. ANZ responds to this question by reference to small business lending.<sup>20</sup>
32. ANZ believes that the provision of information to guarantors as set out in the CBP, coupled with ANZ's processes for guarantors to obtain independent advice (discussed in [27] above), are sufficient to ensure that third party guarantors of small business borrowings are properly advised and able to make informed decisions before entering into guarantees.
33. ANZ expects a guarantor who, due to a special relationship of dependence with the borrower or a special disability, may have an impaired ability to understand the legal and financial risks involved in giving the guarantee, to obtain independent advice and provide evidence of that advice having been received (see [27] above).<sup>21</sup>

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<sup>19</sup> T3038.34-44.

<sup>20</sup> Unlike other policy questions, question 6 is not expressly limited to small business. ANZ nonetheless interprets this question as being so limited (as defined in [11] of the First Gibson Statement: ANZ.999.009.0065 at .0071), again having regard to the fact that the Westpac case study concerned a loan of \$160,000.

<sup>21</sup> T2203.10-24, T2204.16-40; exhibit KGG-13 to the First Gibson Statement: ANZ.800.515.0458 at .0551-.0554 and .0557-.0558. ANZ notes that it can sometimes be difficult for guarantors to obtain legal and/or financial advice – for example, some law societies have advised members that such advice should not be provided.

34. All guarantors, including third party guarantors, are provided with a prominent notice of various matters prior to signing a guarantee in accordance with cl 31.4 of the CBP. Clause 31.4 of the CBP also provides for information relevant to the proposed credit facility and borrower to be provided to the guarantor prior to execution of the guarantee.
35. The difficulties a bank or a guarantor may face if further information were required to be provided would depend on the type of information. For example, Counsel Assisting raised the possibility that a bank's serviceability assessment of a borrower, such as a bank's uncommitted monthly income (**UMI**) calculation, might be further information that could potentially be provided to a prospective guarantor.<sup>22</sup> One difficulty that could arise with the provision of this category of information is that it will often be apt to confuse, rather than assist, prospective guarantors.<sup>23</sup> The UMI calculation involves an exercise of judgmental discretion which varies depending on a borrower's circumstances, and may incorporate internally prescribed buffers in relation to interest rates or other inputs. Additionally, to the extent the further information is a statement of opinion (such as a UMI calculation), it could mistakenly be taken as financial advice, and might disclose a bank's credit policies which are competitively sensitive.

**Question 7: If a business loan is determined to have been affected by maladministration, should the financial services provider be permitted to require the loan to be repaid within a timeframe shorter than the remaining term of the loan in circumstances where the borrower is willing and able to meet the repayment schedule under the loan? (T3043.11-15)**

36. ANZ believes that where, following a determination by FOS of maladministration, a business borrower can demonstrate an ability to service the loan, it is appropriate for the borrower to repay the loan (as adjusted by FOS) over the remaining term of the loan contract. This is consistent with ANZ's practice.

**Question 8: Could FOS improve its processes for dealing with loans that are determined to have been affected by maladministration and, if so, how? Should the incoming body, AFCA, adopt a different process? (T3043.15-18)**

37. ANZ addresses question 8 by reference to the process that follows a determination by FOS of maladministration involving a loan for business purposes (as distinct from the process leading to such a determination).
38. The general approach adopted by FOS in cases involving business loans affected by maladministration<sup>24</sup> is to require a lender to refund the interest and fees paid. The borrower usually remains liable for the amount of the loan (but not interest) which represents the investment risk of their borrowing. ANZ supports this approach in cases involving established maladministration.
39. The repayment arrangement for any residual debt is generally left to the borrower and lender, without FOS involvement. AFCA may wish to consider taking an active role in assisting the parties to reach a mutually acceptable repayment arrangement.

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<sup>22</sup> T2205.01-.06.

<sup>23</sup> T2205.08-23.

<sup>24</sup> Financial Ombudsman Service, The FOS Approach to Responsible lending series: How we work out a consumer's loss: <http://fos.org.au/custom/files/docs/fos-approach-to-responsible-lending-assessing-consumer-loss.pdf>.

**Question 9: How, if at all, are banks to deal with circumstances in which, for reasons extraneous to the conduct of the borrower, the bank no longer wishes to fund a particular business or industry? That is, what is the bank to do if, for example, the market has changed such that its security is no longer adequate? What are the obligations on the bank in those circumstances? (T3052.40-45)**

40. ANZ considers that the answer to this question depends on the facts of the case. Speaking at a high level, a bank may decide to reduce its exposure or risk to a particular industry as a result of changes in the market, risks associated with the industry in question or reaching portfolio concentration limits. In those circumstances, there is no impact to existing facilities during the contractual term, but the bank may decline to provide additional finance or roll-over existing loans. If the borrower's loan is at maturity or close to maturity, ANZ agrees with the recommendation of the Carnell Report<sup>25</sup> that a minimum of three months' notice should be given to a small business borrower if a decision is made not to roll-over a loan.<sup>26</sup> This recommendation was adopted in cl 86 of the New BCP. ANZ is currently putting in place systems and processes for adoption of the New BCP in 2019.

**Question 10: Is there any reason why valuations or investigative accountants' 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? (T3053.1-5)**

41. The policy of ANZ is to provide customers with full copies of valuation reports and investigative accountants' reports where the customer pays for them, except in some limited circumstances.
42. ANZ endorses the requirements set out in the Australian Banking Association (ABA) Industry Guidelines and the changes in the New BCP (Chapter 24) which state that:
- (a) the bank's processes in relation to external expert valuations will be fair and transparent (cl 88);
  - (b) the bank's communication will be clear and it will explain the purpose of the valuation to the customer (cl 89);
  - (c) the bank will provide copies of property valuations and valuer instructions (except when enforcement proceedings have already commenced) (cl 90);
  - (d) the bank will only appoint appropriately qualified and experienced valuers who are members of professional organisations which abide by a similar code of conduct (cl 91);
  - (e) the bank will act fairly when using investigative accountants and insolvency practitioners, and will ethically manage potential conflicts of interest when appointing receivers who have been investigating accountants for a small business. For example: (a) the bank will only appoint qualified practitioners who are members of relevant professional organisations with appropriate codes of conduct; and (b) the bank will require additional internal oversight of the appointment of investigating accountants as receivers, to ensure that the decision is necessary and so as to review the circumstances leading to the appointment (cl 92); and

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<sup>25</sup> Australian Small Business and Family Enterprise Ombudsman, Inquiry into small business loans, 12 December 2016: [http://asbfeo.gov.au/sites/default/files/030217-ASBFEO\\_Report.pdf](http://asbfeo.gov.au/sites/default/files/030217-ASBFEO_Report.pdf) (**Carnell Report**).

<sup>26</sup> This is the minimum notice period. The notice period may be longer for particular industries.



- (f) if the relationship between the bank customer and the investigating accountant has deteriorated (for example, it has become unworkable) the bank will consider the appointment of an alternative qualified practitioner (cl 92).

43. Consistent with the New BCP, ANZ does not as a matter of course provide copies of valuations to customers when a sale process is underway. This is to ensure that the sale process is not undermined by disclosure of the valuation to a potential buyer. In this case, the valuation is provided to the customer at a later stage.

**Question 11: Is it appropriate for a bank to take enforcement action when no monetary defaults have occurred, and the bank can only rely 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? (T3053.5-9)**

44. In most cases, ANZ will only take enforcement action when the customer is in monetary default. However, there are some circumstances (outlined below) where ANZ believes that it is appropriate for the bank to take enforcement action where there is a non-monetary default.

45. The circumstances in which ANZ may take enforcement action for non-monetary defaults are set out in ANZ's Business Banking Finance Conditions of Use and are generally reflected in the changes in the New BCP (cl 80). The circumstances include:

- (a) where the customer is insolvent, or goes into bankruptcy, voluntary administration, or some other insolvency process or arrangement, or no longer has legal capacity;
- (b) where enforcement action is taken against the customer by another creditor;
- (c) where the bank believes on reasonable grounds that the customer has not complied with the law or any requirement of a statutory authority, or it becomes unlawful for the customer or the bank to continue with the loan;
- (d) where the customer gives the bank false, materially incorrect or misleading information or makes a representation or warranty to the bank which is false, materially incorrect or misleading;
- (e) where the customer does not provide financial information required by the customer's agreement with the bank; and
- (f) where the customer does not maintain a licence or permit necessary to conduct the customer's business.

46. While ANZ continues to include non-monetary defaults in its credit agreements, the provisions of ANZ's new Finance Conditions of Use for small business lending have been significantly confined. For example, they no longer include non-monetary defaults for material adverse change and now include materiality thresholds which must be satisfied before ANZ is entitled to act on a non-monetary default. Similar changes have been made to other contracts used by ANZ for business lending.

47. ANZ supports the further requirements in the New BCP which provide additional protections for customers that:

- (a) the bank will allow a reasonable time for the customer to remedy the non-monetary default, where it is able to be remedied, and notify the customer of this time period, except where, based on the bank's reasonable opinion, it is necessary for the bank to act to manage an immediate risk (cli 81 and 82); and

- (b) the bank will only act on a specific event of non-monetary default if the event, by its nature, is material, or the bank reasonably considers the event has had, or is likely to have, a material impact on:
    - (i) the customer's ability to meet its financial obligations to the bank;
    - (ii) the bank's credit or security risk (or ability to assess these); or
    - (iii) the bank's legal or reputation risk where specified circumstances arise (cl 83).
48. ANZ believes that the taking of recovery action based on non-monetary defaults where appropriate is an integral part of appropriate risk management processes for banks. For example, if the bank discovers that the customer has made a fraudulent representation to the bank, a non-monetary default clause triggered by such conduct enables the bank to act quickly in order to reduce the increased risk of not recovering its debt.
49. ANZ endeavours to give customers who are in default of their obligations a fair and reasonable period of notice before any legal recovery or enforcement action is taken against them. If a non-monetary default cannot be remedied and ANZ decides to take enforcement action, ANZ's practice is to clearly communicate this decision to the customer.

**Question 12: Is there a disconnect between what the banks are saying in their advertising, their annual reports, their other public documents and their conduct? If there is a disconnect, what, if anything, follows from that? Are customers to place any significance upon statements of the kind to which the Commissioner referred to in the course of BOQ's (Mr Snell's) evidence? (T3053.12-22)**

50. The Commissioner referred to statements by banks directed to "securing and enhancing the financial wellbeing of the customer" such as "focus on the customer", "putting our customers first" and "acting in the best interests of the customer".<sup>27</sup> Such statements may be made by banks in their advertising and/or as part of a statement of their corporate values.
51. Value statements are generally intended to communicate to staff why an organisation exists and to underpin an organisation's expectations as to how its staff will behave. They may also be communicated publicly to explain an organisation's purpose and activities to people outside the organisation.
52. In its January Submissions, ANZ observed that a central community expectation is that ANZ will act in accordance with its espoused values and will do what it has said publicly that it will do.<sup>28</sup> ANZ believes that customers understand that at times ANZ may fall short of these aspirational statements. It is reasonable to expect that customers also understand that while ANZ commits to a customer focus, it also has obligations to the law, shareholders, staff and the community.
53. Aspirational statements must also be understood in the context of the contractual relationships that exists between a bank and its customer. Broad aspirational statements cannot reasonably be understood as meaning that a bank is precluded from enforcing its contractual rights in appropriate circumstances.

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<sup>27</sup> T2354.21-34.

<sup>28</sup> ANZ submission in response to the Commission's letters of 15 December 2017 dated 29 January 2018 (**January Submissions**) [4.8].

54. It should also be noted that existing law protects customers who suffer loss in reliance on false, misleading or deceptive representations.<sup>29</sup>

**Question 13: 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? (T3055.13-15)**

55. ANZ acknowledges that problems can arise where banker remuneration and incentive plans place disproportionate emphasis on financial performance over more customer-centric measures.
56. For this reason, since late 2014 ANZ has introduced changes to its approach to remuneration and incentives, including with respect to small business bankers, in the form of enhancements to its "balanced scorecard" measures.<sup>30</sup> The measures have continued to evolve to place greater emphasis on customer experience and compliance with relevant policies and procedures, rather than financial objectives.
57. ANZ's current small business banker key result areas (**KRAs**) also emphasise non-financial objectives in a number of ways.<sup>31</sup>
58. *First*, eligibility for incentive payments are subject to compliance and behavioural "knock-outs".
59. *Second*, there are no sales related hurdle requirements, and the awarding of incentives is wholly discretionary, thereby giving managers the discretion to award incentives by reference to customer satisfaction and outcomes.<sup>32</sup>
60. *Third*, financial objectives comprise 30% of a small business banker's KRAs,<sup>33</sup> with the remaining 70% comprised of the following non-financial objectives:<sup>34</sup>
- (a) "customer", which is assessed through the Net Promoter Score, a common industry standard measure of customer advocacy where the customer completes a survey that asks whether the customer would recommend the banker and the experience to others, and demonstration of a customer service mindset;
  - (b) "process", which is assessed through the Quality Assessment Framework, an objective measure of a banker's technical competence; the Well Managed Dashboard, which monitors key internal compliance measures; and the pre-assessment loan re-work rate, an indicator of the quality of the loan submissions made by the banker; and
  - (c) "people", which is assessed through the banker's demonstration of ANZ's values, and for leadership roles, their coaching effectiveness.

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<sup>29</sup> See ss12DA and 12DB of the ASIC Act.

<sup>30</sup> January submissions [4.20]; First Gibson Statement: ANZ.999.009.0065 at .0094-.0095 [95]-[99].

<sup>31</sup> Exhibit KGG-26 to the First Gibson Statement: ANZ.800.528.0309.

<sup>32</sup> First Gibson Statement: ANZ.800.999.009.0065 at .0094-0095 [96].

<sup>33</sup> T2215.42-45.

<sup>34</sup> First Gibson Statement: ANZ.800.999.009.0065 at .0094 [95]; exhibit KGG-26 to the First Gibson Statement: ANZ.800.528.0309 at .0315-.0323.

**Question 14: Specifically in relation to the Wallis case study, should lenders be required to clearly draw the cross-collateralisation clauses and its effects to the attention of borrowers? If so, how should this be done? (T3055.16-18)**

61. ANZ has made changes to its main standard form small business contract which simplify and streamline the documentation, as well as the rights and obligations under the contract.<sup>35</sup> ANZ's letter of offer sets out the key terms of the loan contract including, among other things, any security provided, with reference to the cross-collateralisation of security, which is signed by the borrower as part of the security acknowledgement.<sup>36</sup>
62. ANZ also provides small business borrowers with a key information sheet setting out the key terms of the business lending arrangement which is designed to assist a borrower to understand the key terms of their contract as a whole.
63. ANZ considers this approach, combined with its simplified contract, provides adequate information to small business borrowers to understand the terms of their contract.

**Question 15: When and how much disclosure should a bank provide to a director of a business in respect of a decision of the bank's workout division (such as the SBS division of NAB), where that decision will affect a customer's use of a personal asset which indirectly secures the obligations of their business to the bank? (T3056.45-3057.2)**

64. Where a director advises the bank that he or she is proposing to sell a personal asset that has been provided as security for a business loan, the practice of ANZ's Lending Services team is to discuss and seek to reach agreement with the director as to the application of the net proceeds of sale. In doing so, ANZ's objective is to clearly communicate with the director the bank's views and the agreed sales process. The extent of disclosure and discussion between the bank and the director depends on the facts of the particular case.
65. Where a director has provided a guarantee secured by a mortgage over their home, and the bank takes enforcement action, the practice of ANZ's Lending Services team is to realise the primary security before realising the home.

**Question 16: Is ASIC's approach to the unfair contract terms provisions, and the consumer protection provisions under the ASIC Act more generally, appropriate and moulded to the risks of the contraventions and practical resources and constraints on ASIC? (T3059.4-7)**

**Question 17: Has ASIC's approach been effective in ensuring compliance with the unfair contract terms provisions that came into effect in November 2016, and the consumer protection provisions of the ASIC Act generally? (T3059.9-19)**

66. ANZ addresses questions 16 and 17 together.
67. Shortly after the announcement that the unfair contracts terms provisions in the ASIC Act would apply to "small business contracts" from 12 November 2016 (**UCT law**), ANZ established a steering committee and project team to oversee and implement its response to this legislative change and obtained independent advice in relation to the UCT law. ANZ introduced the first round of changes to its standard form small business contracts

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<sup>35</sup> These changes were made to respond to recommendations in the report by the Office of the Australian Small Business and Family Ombudsman Enterprise Ombudsman regarding lending to small business: see witness statement of Kate Gibson dated 17 May 2018 (exhibit 3.148) (the **Second Gibson Statement**): ANZ.999.010.0001 at .0010 [19].

<sup>36</sup> Exhibit KG-1 to the Second Gibson Statement: ANZ.800.405.6204 at .6209 and .6211.

when the UCT law came into effect.<sup>37</sup> ANZ considers that these changes were sufficient to ensure that the terms of its standard form small business contracts were not unfair within the meaning of the UCT law.

68. Despite that view, between April and December 2017, ANZ participated in various industry-wide and bilateral discussions with ASIC about ANZ's response to, and ASIC's interpretation of, the UCT law. On 18 December 2017 ANZ introduced a second round of changes to its small business loan contracts. These changes were made for a range of reasons, including concerns expressed by ASIC during the industry-wide discussions, the recommendations of the Carnell Report, and changing community standards and expectations.<sup>38</sup> The outcome of ANZ's consultation with ASIC are summarised at [77] of the Second Gibson Statement.<sup>39</sup>
69. ANZ regards ASIC's approach towards the implementation of the UCT law to have been appropriate and generally effective. Alternative approaches, such as the commencement of proceedings against individual banks, would have taken up significant time and resources. Even where such proceedings were successful, the outcome may have had limited application beyond the particular term(s) of the subject contract(s). In any event, it is unlikely that proceedings would have achieved changes across the industry in a shorter timeframe than the consultation process did (that is, before December 2017). Further, the industry-wide reforms in response to the Carnell Report and review of the CBP mean that in practice the major banks have agreed to apply changes to standard form contracts where the total business lending by the business group was up to \$3 million<sup>40</sup> (not \$1 million, as required by the ASIC Act). The changes introduced by the major banks have formed a benchmark for lenders more generally.
70. As to ASIC's activities generally, infringement notices and enforceable undertakings offer a range of benefits, including ASIC obtaining an efficient outcome in relation to technical or less egregious breaches without the significant investment of resources required by civil proceedings or prosecutions.
71. Questions as to the appropriateness and effectiveness of ASIC's activities must be answered having regard to a range of matters, including ASIC's strategic objectives, resources, tactics and outcomes. ANZ considers that it is desirable for ASIC to have a graduated set of measures that it can appropriately deploy having regard to these matters and the particular issues at stake.
72. Resources that may assist the Commission in considering these questions and ASIC's role, resources and powers, include the following:
- (a) Senate Economics References Committee's Final Report on the Performance of the Australian Securities and Investment Commission (26 June 2014);
  - (b) Financial System Inquiry Final Report (7 December 2014) (particularly Chapter 5);
  - (c) Capability Review of the Australian Securities and Investments Commission Final Report (20 April 2016);
  - (d) ASIC Enforcement Review Taskforce Report (18 December 2017); and

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<sup>37</sup> Second Gibson Statement: ANZ.999.010.0001 at .0011 [21]-[22] and [24].

<sup>38</sup> Second Gibson Statement: ANZ.999.010.0001 at .0011-.0012 [30]-[31] and [33(a)].

<sup>39</sup> Second Gibson Statement: ANZ.999.010.0001 at .0018 [77].

<sup>40</sup> Second Gibson Statement: ANZ.999.010.0001 at .0018 [73].

- (e) the Commonwealth Government's response to these reports, including in relation to changes to ASIC's funding,<sup>41</sup> ability to hire staff outside the *Public Service Act 1999* (Cth),<sup>42</sup> and enforcement powers.<sup>43</sup>

**Question 18: Is the proposed Code of Banking Practice, 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? (T3059.11-15)**

73. The New BCP represents a consensus position of ABA members. ANZ considers that the final document responds to identified and emerging consumer issues, is easier to understand than its predecessor, and introduces higher standards for how banks treat individual and small business customers and guarantors. It is, in ANZ's view, a comprehensive and appropriate response to the Independent Review.
74. ANZ supports the New BCP's definition of a small business, which imposes a threshold (among others) of total business lending (or total credit exposure) across the customer group of up to \$3 million.<sup>44</sup> In ANZ's view, this monetary threshold, which captures 98% of ANZ's business customer groups, provides a sound new industry standard for the protection of small business customers, while at the same time balancing the interests and capabilities of all ABA members (including banks with smaller balance sheets and risk appetites). ANZ would support a review of the appropriateness of the definition after several years.
75. ANZ believes that ASIC approval of the New BCP would provide community reassurance that its terms strike an appropriate balance between the rights and obligations of banks and the customers they serve. Conversely, a refusal by ASIC to approve the document could negatively impact community perceptions of the New BCP. ANZ would not expect most customers to understand the technical requirements of Regulatory Guide 183, against which ASIC considers applications for approval of financial sector codes of conduct.
76. If ASIC does not ultimately approve the New BCP, however, this should not unduly undermine its application or effectiveness in practice. The banking industry has for many years operated under a voluntary code of practice that has not been approved by ASIC. The CBP has conferred (and the New BCP will continue to confer) important rights on consumer and small business customers and guarantors, through incorporation by reference of bank obligations into lending contracts. Compliance with the New BCP will be monitored by the Banking Code Compliance Committee (currently the Code Compliance Monitoring Committee), which will have enhanced powers to impose appropriate sanctions on non-complying banks. ANZ is committed to implementing the New BCP requirements, including through initiatives that are already underway.

**12 June 2018**

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<sup>41</sup> Media Release, The Hon Kelly O'Dwyer MP Minister for Revenue and Financial Services, "Second and final phase of industry funding model ASIC fees-for-services", 24 May 2018: <http://kmo.ministers.treasury.gov.au/media-release/057-2018/>.

<sup>42</sup> Media Release, The Hon Kelly O'Dwyer MP Minister for Revenue and Financial Services, "Government takes action to enhance ASIC's capabilities", 28 March 2018: <http://kmo.ministers.treasury.gov.au/media-release/030-2018/>.

<sup>43</sup> Media Release, The Hon Kelly O'Dwyer MP Minister for Revenue and Financial Services, "Boosting Penalties to protect Australian consumers from corporate and financial misconduct", 20 April 2018: <http://kmo.ministers.treasury.gov.au/media-release/039-2018/>.

<sup>44</sup> Two further thresholds exist under the definition of a "small business", which must have (1) an annual turnover of less than \$10 million in the previous financial year; and (2) fewer than 100 full-time equivalent employees: see New BCP cl 1.