



12 March 2020

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cc: [REDACTED]

By email: [ADIpolicy@apra.gov.au](mailto:ADIpolicy@apra.gov.au)

Dear [REDACTED]

## **APRA Prudential Practice Guide: APG 220 Credit Risk Management – ANZ Response**

ANZ welcomes the opportunity to comment on APRA's Draft Prudential Practice Guide ("APG 220"). We also appreciate that APRA has already incorporated much of the feedback provided in finalising the Prudential Standard APS 220.

### **ANZ would like to respond on five key points:**

#### **1. Role of the Board and senior management**

APG 220 paragraph 16 says that it is expected that the Board "sufficiently, actively and rigorously" engage on credit risk issues. We request that the word "rigorously" be removed as the requirement to engage rigorously is difficult to define/measure and be applied on a consistent basis, as each credit risk issue presented to the Board will be unique.

The language creates a highly subjective standard that may be impossible to meet, and goes beyond the Standard's requirement for the Board to "regularly challenge, seek assurance and evidence" on similar topics contained in APS 220 paragraph 25.

#### **2. Credit origination and assessment and approval**

One of the most important principles in the new APS 220 is paragraph 40 which allows ADIs to adopt a "scalable and flexible approach to credit risk assessment", considering the "nature, type and size of the exposure". This approach is sound, enabling ADIs to focus more resources where they are needed, and is also included in paragraphs 42 to 44 of APG 220.

With this understanding, ANZ interprets many of the paragraphs in APG 220 that describe more traditional techniques to assessing credit risk in non-retail asset class customers will not always be relevant, particularly in the retail context. For example:

- Paragraph 53 assumes the use of financial analysis to derive financial ratios to monitor the customer's ongoing health
- Paragraph 64 assumes the credit decision will be judgemental and not automated
- Paragraph 66 assumes that each credit proposal will be reviewed by a "qualified credit analyst". If this was to apply to all non-retail asset class customers (particularly SMEs), this would have a major adverse effect on costs to ADIs and their customers, and give a competitive advantage to non-ADIs which would be free to automate assessments.

- Paragraph 73 assumes that each customer will have an individual credit file. The requirement for a file needs to be understood broadly, to allow for fully digital records as technologies change.

However, paragraph 68 allows ADIs to use “an automatic decision engine”, but implies this will be “from time to time” rather than regular practice. Automated approaches are the norm for most retail customers, and increasingly ADIs (using experienced credit judgement as required in paragraph 40 of APS 220) are seeking to adopt these techniques to small-medium enterprises lending rules as they are relatively simple. We also believe that automated credit decisioning does use “experienced credit judgement” in the development and review of scorecards and policy rules, particularly for retail and SME portfolios.

ANZ recommends that the first sentence in paragraph 68 be replaced with:

*ADIs may utilise an automatic decision engine to decision credit applications for retail and small-medium enterprise customers where this is commensurate with the nature and complexity of the exposures.*

### **3. Credit administration, measurement and monitoring**

APG 220 paragraph 72 says that the “loan review function” must determine that credit files are complete and that all approvals and other necessary documents have been obtained. However, APS 220 paragraph 62 allocates this responsibility to the “credit review function”.

Within ANZ, we use the first term to describe a first line, credit QA function and the second term to cover our Group Credit Assurance team, which is part of our third line. Both functions will typically check files to ensure all required approvals and documents are held, but have different sampling methodology. We are comfortable that ANZ is meeting the substance of both these requirements, but wish to draw APRA’s attention to the different wording to check that APRA does not in fact have a preference for where these activities would be undertaken.

### **4. Collateral and guarantees**

APS 220 Attachment A, paragraph 8 (c), requires ADIs to have ‘appropriate policies and processes which address...asset values including adequate haircuts for conservatism when using automated valuation methods’. APG220 is silent on haircuts. APS220 does not define ‘haircuts’.

It would be beneficial if APG220 included guidance on what ADIs are required to include in their policies and processes with respect to measures for conservatism when using AVMs. For example, ANZ adopts the following measures:

- Creating and using a ‘blended’ AVM value, which is based on a combination of estimates provided by approved external expert valuation data providers, rather than any one of them. This value is inherently conservative as the process for creating it adopts strict cut offs (based on Forecast Standard Deviations) for when any one external estimate informs it;
- Restricting the use of AVMs based on a cascade of various criteria which trigger the use of standard valuations.

ANZ takes the view that the above satisfies the requirements of paragraph 8(c).

## 5. Non-performing exposures

APS 220 and APS 113 treatment of days past due are inconsistent and need to be aligned to the APS 113 position.

The new APS 220 concept of non-performing essentially maps to the APS 113 concept of default, but does not incorporate the allowance for a small materiality threshold under APS 113 Attachment A para 79 (for example, this is currently \$150 for ANZ's wholesale businesses). This allowance is important as it avoids overestimating probability of default estimates and distorting loss given default estimates. An exposure below this materiality threshold is not treated internally as a default, so the exposure would not be downgraded and reported as a default.

However, there is no corresponding materiality allowance in the new APS 220 definition of non-performing in para 12 (a), so there will be a disconnect between what would be reported as default under APS 113 and a default under APS 220.

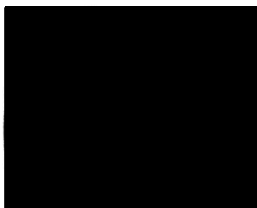
We believe this may be an oversight as para 117 of APG 220 refers to a materiality threshold but does not explain it.

We recommend that the Non-Performing Exposures section in APG 220 be amended to include the same allowance for materiality as in the current APS 113. We understand that this should not refer to APS 113 as this would not cover ADIs not operating under APS 113.

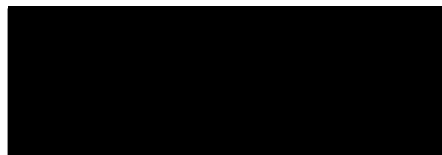
We wish to reiterate that we support APRA's proposal to modernise the APS 220 prudential standard to take into account changes to credit practices and to better align the standard with the relevant accounting standards. We believe these final amendments to the practice guide will provide additional clarity to ADIs.

Should you have any questions or require any clarification on any aspect of our responses, please contact [REDACTED] (for institutional and wholesale banking) on [REDACTED] or via email at [REDACTED] or [REDACTED] (for retail banking) on [REDACTED] or via email at [REDACTED].

Yours faithfully,



Chief Risk Officer, Institutional and Chief  
Wholesale Credit Officer



Acting Chief Risk Officer, Australia Division

cc. [REDACTED], Group Chief Risk Officer – ANZ  
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