ANZ

News Release

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Transcript of bluenotes video interview with ANZ Chief Risk Officer Kevin Corbally

ANDREW CORNELL: Morning Kevin and thanks for joining us on bluenotes. The crisis presents enormous uncertainty. So how are you framing risk assessment at this time and how does that actually play out in practice?

KEVIN CORBALLY: Thank you Andrew and good morning to you as well. Look, many of the risk policies and procedures that we have at ANZ are designed to ensure that we give our staff the right boundaries and guidelines in which they can operate in. In a time of crisis however, you need to be able to adjust. You need to be able to adapt. Otherwise you create unnecessary bureaucracy. And you also need to reflect the fact that normal operating environment sometimes may not actually be able to exist.

So some of the practical examples that we've undertaken at ANZ starts with some changes we've made to our property valuations. So, in the current environment it's very difficult for a property valuer to actually enter a house due to the restrictions that are in place. So we sat down with the Australian Property Institute and agreed a way forward with them. And what we've agreed is that we will have the ability for the valuers to use a range of other methods, such as satellite imagery and also teleconference and video conferencing facilities. For our business customers, we made a series of different temporary changes to a whole range of matters, such as the testing of financial covenants, how frequently we undertake annual reviews and how you actually would risk-rate a customer in a time of crisis. In addition what we also did, was we undertook a review of 18 customer segments that we felt would be most impacted by this crisis. And then have adjusted our risk appetite settings in response to those findings.

ANDREW CORNELL: What are the key principles behind the collective and individual provision numbers here? How much is driven by those new accounting standards, for example, which came in a year or so ago?

KEVIN CORBALLY: Look Andrew, you mentioned the new accounting standard, it's referred to as AASB9. That applies to all banks and it came into effect for us on the first of October 2018. Under the old standard, the way you recognised a loss was when that loss actually … the way you recognised a provision, was when the loss actually occurred. Under the new standard, you need to take a more forward-looking view and it's referred to as expected credit loss. What that actually means in reality is that you need to look, not just based on factors that you know today, but also what you think the future economic environment might be, in determining what that provision should be. So I kind of think about it a bit like setting aside money for a rainy day: you may or you may not need that money, but it's good to set it aside.

What the shareholders would have seen today, is they would have seen a significant increase in our expected credit loss provision charge. It's about $1.7 billion dollars. There's a lot of jargon involved in how you calculate a credit provision, but essentially there's two key components. One is the individual provision, which is the provision you set aside for customers whom you've already determined have defaulted or you've assessed that their loan has been impaired. And the second is the collective provision. And the collective provision charge is the one that really increased significantly as a result of COVID-19. How we've determined that collective provision charge is using, as the standard suggested, more

of a forward-looking approach. So we ran four different scenarios. First of all we ran a base-case scenario that looked at the current economic circumstances and our view of what the future might look like, based on where we were at the 31st of March. Then we had an upside and a downside, which reflected more optimistic or more pessimistic view of the future. And finally we ran what is called a severe scenario. And that, whilst it's less likely, was an extremely severe outcome in the future. Now, in thinking about those scenarios, one way to look at it is that we have to come up with a range of different assumptions. One is around things such gross domestic product, unemployment, property prices. We feed them into the model and in our case, I think we've taken a really prudent approach this year to our assumptions.

For example, with GDP we've assumed that that will actually reduce or contract in the June quarter by 13 per cent. And to put that in context, that's the largest contraction we've seen in Australia since the Great Depression. We then forecast some rebound in the September quarter, but it's actually not until 2022 that we get back to the levels that we saw pre-COVID-19. Then, in the severe and the downside scenarios, we actually run similar scenarios but for a longer duration in terms of the downturn. We then take all of those scenarios, we feed them into an expected credit loss model for every single customer that we've got and apply the probability weights that we come out of those scenarios. That's how we've driven the provisions this year.

ANDREW CORNELL: What are the extent of the repayment pauses for customers and how do they actually impact your outlook for provisioning?

KEVIN CORBALLY: So look Andrew, what we've done is we've, together with other banks in the industry, we've provided our customers with repayment deferrals. Not all of the banks have provided those deferrals for the same period. But in our case we've offered our customers, both home loan and also business customers the option of having a repayment deferral for up to six months. And what that means for those customers is that they don't actually need to make any payments to us during that period. Now at the moment, what we've seen is roughly about 10 per cent of our home loan customers and roughly about 15 per cent of our business banking customers take up that option. What APRA, and what the International Accounting Standards Board has said, is that we as a bank should not view that period of deferral as a period in which the customer is in arrears. So therefore we shouldn't treat the loan as an impaired loan. So that's one of the important considerations we needed to take in determining our provision this year. One of the things obviously we will also look to do going forward, is make sure we keep in contact with those customers and talk to them regularly, and connect with them over that six-month period, to ensure that their situation doesn't actually change.

ANDREW CORNELL: So now when you're thinking through the risk environment, both credit and operational risk in this year ahead, what's uppermost in your mind?

KEVIN CORBALLY: Andrew, it's very easy to be completely consumed by the credit risk aspects of COVID-19 at the moment. But if I reflect pre-COVID-19, one of the key risks we faced as an industry, and I think we were looking at as an organisation, was the threat of cyber-crime. The threat of protecting the data that we have from our customers and also fraud. I would argue that in the current environment, they're probably even higher risks now as criminal activities, criminals, look at how they can actually utilise the COVID-19 situation to impact our customers and our bank as well. So that's clearly an area that we need to continue to focus on. At the same time I would say that the current environment is placing enormous stress on people, whether that be our staff, whether that be our customers' staff.

Lots of people are now working from home, that places enormous stress on them. It also potentially increases the risk of fatigue and also potentially the risk of operational errors. So that's another thing we need to watch out for. Also with everyone working from home, there's a huge impact on the telecommunications infrastructure that we're using. So the risk of one of those telecommunication infrastructures falling over is another one we need to

focus on. And clearly leading into this situation, regulatory matters including anti-money laundering were top of mind and will continue to be top of mind as we go forward.

For media enquiries contact:

Stephen Ries, +61 409 655 551
Nick Higginbottom, +61 403 936 262

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